

Luxembourg parallel fund structures



Mr. Daniel Krauspenhaar

Director

daniel.krauspenhaar@wildgen.lu



Mr. Mark Shaw

Partner -Avocat aux Barreaux de Londres et de Luxe

mark.shaw@wildgen.lu

Luxembourg is the largest European and the second largest worldwide fund domicile, due to its efficiency, flexibility and its professional, well-established and experienced fund industry having an excellent reputation. Luxembourg is also one of the preferred jurisdictions for setting up parallel fund structures for European investors. Whereas the main fund may, for instance, be based in Delaware or the Cayman Islands, one or several parallel fund vehicles are often set up in Luxembourg (or the other way round).

What are parallel fund structures?

Parallel fund structures are those which invest directly or indirectly through one or more separate conduit, holding or similar entities alongside the main fund. The parallel fund and the main fund usually have the same or at least a very similar investment policy and strategy, i.e. they invest on similar terms at the same point in time, have common investment targets, similar risk profiles and durations. It is also common that commitments are called at the same time according to the same conditions and investments are made on a pro rata basis per the commitments of the parallel fund and the main fund. To the extent legally and operationally possible, the investors of the parallel fund and the main fund are pooled and share the same voting and other rights, i.e. the aim is to treat investors across the different vehicles equally.

What are the differences between the parallel fund and the main fund?

The differences are largely due to legal, regulatory, tax or operational reasons. This partly applies to the fund structure itself. For instance, whereas a Luxembourg fund may qualify as an alternative investment fund and therefore its manager may be subject to regulatory requirements around the Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers ("AIFMD"), different legal and regulatory requirements will apply to a Delaware or Cayman Islands domiciled investment fund and its manager. This also

partly applies to the investors to be targeted by the respective fund structures. For instance, an insurance company being based in Germany and thus being subject to the German and European regulatory requirements, such as the national laws transposing the Directive 2009/138/EC of the European Parliament and of the Council of 25 November 2009 on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II), has to comply with different rules than a family office being located in Singapore. The parallel fund and the main fund may also differ with respect to its size although assets under management are usually aggregated to determine the size of the entire fund structure.

What are the main advantages of parallel fund structures?

Parallel fund structures allow the initiator to target different types of investors in different jurisdictions. Whereas European investors will normally prefer or due to legal and regulatory requirements or some kind of internal rules even be restricted to invest through a Luxembourg or other European vehicle, U.S. investor will usually invest through a Delaware or Cayman vehicle. In addition, Luxembourg or other European vehicles may exclude U.S. investors to avoid being subject to any U.S. specific (tax) rules. On the other side Delaware or Cayman vehicles may avoid the regulatory burden and costs due to AIFMD. On the investment side, parallel fund structures allow the collection of larger sums of commitments and therefore larger or possibly more diversified investments. A parallel fund structure therefore allows the efficient management of a larger pool of investments. This may also increase the profitability of the initiator and the portfolio manager.

What are the main challenges of parallel fund structures?

A parallel fund structure consists of different vehicles in different jurisdictions which provide for different legal and regulatory requirements. It is therefore important to ensure compliance with such different requirements. From an operational point of view, it will be necessary to coordinate the services of the different service providers in the respective jurisdictions. Another main challenge is to ensure that investors are treated equally across the different vehicles while however taking into account the specific differences, for example, certain costs may be particular to a certain vehicle and other costs may incur independently through which vehicle investments are made. The same applies to distribution waterfalls and voting rights. All these aspects need to be taken into account in the structuring stage because adoptions at a later stage may be complicated. For all aforementioned reasons, a parallel fund structure will usually also be more expensive and complex at the structuring stage than the set up of a single investment vehicle.

From a legal and regulatory point of view, why is Luxembourg a preferred jurisdiction for parallel fund structures?

As already mentioned above, Luxembourg has a professional, well-established and experienced fund industry. But this is not the only reason why Luxembourg is a preferred jurisdiction for parallel fund structures. Luxembourg in particular offers a consistent, but flexible legal and

regulatory environment.

From a corporate law point of view, this in particular applies to the limited partnership regime which is very flexible and easily to manage, for instance with respect to formal and registration requirements. Furthermore, Luxembourg allows for a special limited partnership without legal personality (the SCSp), which should be familiar to the initiator, as it is similar to a Cayman or Delaware partnership.

There is also legal certainty around the Luxembourg limited partnership regime when it comes, for example, to the question what limited partners are permitted to do (and what not). Recent partnership reforms in other European jurisdiction have started only several years after that was done in Luxembourg and often still not provide as much flexibility as this is the case in Luxembourg. Due to its flexibility, Luxembourg especially offers the possibility to structure a fund vehicle in parallel to a main fund vehicle in Delaware or Cayman Islands.

From a regulatory point of view, in Luxembourg also different products are available and suited for a parallel fund structure. In this regard, in particular, the so-called reserved alternative investment fund ("RAIF"), was introduced in Luxembourg in 2016. RAIF is broadly similar an unregulated fund structure but requires a fully-authorised alternative investment fund manager ("AIFM") and depositary. Unlike a specialised investment fund (SIF), the RAIF does not need to be authorised by the Luxembourg supervisory authority for the financial sector (CSSF), merely registered. Under the RAIF regime several sub-funds may be set up. In addition, through the AIFM, a European passport is available. In the context of Brexit, this may also be a further argument to move to Luxembourg.

What other structuring options are available in Luxembourg?

Given the flexibility of the funds regime in Luxembourg, initiators may also want to consider the possibility of maintaining a single master fund in Luxembourg, with one or a combination of feeders in the Cayman Islands and/or Delaware, depending on investor type and currency. This has the benefit of simplified portfolio management and eliminating tracking error between the main fund and the parallel fund.

In considering the ultimate structure, initiators should consider the needs and preferences of investors to ensure an easier path to fund raising, as well as the tax implications for both the investors and the investment portfolio and also the overall cost impact of maintaining such a structure.