

Spotlight on Secondaries: Enhancing side letter management

Side letter management in secondaries is a complex task for private fund managers. These bespoke agreements, negotiated between fund managers and individual investors, often contain unique terms that can significantly impact the fund's operations and compliance. In the context of secondaries transactions, managing these side letters at scale requires meticulous attention to detail and robust administrative frameworks, write [Nadia Assaadi-Irtizaal](#), [James Duffield](#) and [Ore Adegbotolu](#).

The use of side letters and other tailored governance arrangements has become an increasingly prevalent feature in the private markets landscape, a trend which includes secondaries. As investors seek greater control over their commitments, governance rights, and reporting standards, side letters allow them to negotiate customised terms beyond the general limited partnership agreement (LPA). However, while these arrangements provide significant benefits, they also introduce operational complexity, compliance risks, and administrative burdens.

A specialist fund administrator can play an important role in managing these complexities. From ensuring compliance with investor-specific obligations to streamlining reporting and fee calculations. As the volume and complexity of side letters increases, the role of an administrator becomes ever more critical in ensuring smooth execution and ongoing compliance.

Why are side letters and tailored terms being adopted?

In venture capital and private equity funds, LPAs serve as the foundation for fund governance and economic arrangements, and are designed to be broadly applicable to all limited partners (LPs). Large or strategic investors often seek additional protections, preferential terms, or customized reporting, which cannot be easily embedded within a standard LPA without creating inconsistency among investors. Side letters address this issue by allowing investors to secure bespoke terms without disrupting the broader fund structure.

Standard practice: What do side letters typically cover?

While side letters are bespoke agreements, they tend to cover a common set of provisions that address investor-specific needs. Some of the most frequent categories of side letter provisions include:

Preferential fee arrangements

- Fee reductions (e.g. lower management fees or carried interest for anchor investors).
- Most favored nation (MFN) clauses, which allow investors to opt into the best terms granted to other LPs.
- Early bird discounts for LPs who are committing into a fund early, within a specified timeframe.
- Fee discounts for investors who are re-investing in next generation funds.

Reporting and transparency

- More frequent reporting on portfolio performance.
- Additional disclosure on underlying fund investments.
- ESG or impact investing reports in line with investor mandates.

Governance rights and investor protections

- Advisory committee participation or observer rights.
- Co-investment opportunities alongside the fund.
- Enhanced removal rights over the GP in cases of misconduct.

Tax structuring and regulatory compliance

- ERISA compliance provisions for US pension funds.
- AIFMD-related reporting for European investors.
- FATCA and CRS exemptions or structuring considerations.

Transfer and liquidity preferences

- Right of first refusal (ROFR) in secondary transactions.
- Ability to transfer LP interests under specific conditions.

- Customised redemption rights – though these are rare in closed-ended vehicles.

Excuse Rights (ESG and ethical investment criteria)

- Allows LPs to excuse their capital from being allocated to specific sectors or regions, as previously agreed with the GP.

While these terms vary from one fund to another, they must be carefully managed to ensure that they do not create inconsistencies, operational challenges, or conflicts with fund documents.

Most favoured nation (MFN) clauses

One of the most common side letter provisions is MFN clauses. MFNs allow investors to benefit from the terms granted to other investors in the same fund. Essentially, an MFN provision ensures that no investor receives preferential treatment without offering the same terms to others.

Here's how MFN provisions typically work:

Election of Terms: Investors can elect to adopt the terms from other investors' side letters. This means if one investor negotiates a favourable term, others can choose to apply that term to their own investment.

Transparency: MFN provisions often include the right to review other investors' side letters, promoting transparency and fairness.

Carve-outs: To manage the administrative burden, MFN provisions may include carve-outs or restrictions. For example, larger investors or those who invested early may have exclusive rights that are not available to smaller or later investors.

These provisions help maintain an even-handed approach to investor rights, ensuring that all investors are treated fairly while accommodating specific needs and circumstances.

Practical considerations as a result of side letters

and tailored terms

While side letters provide essential flexibility, considerations should be given to the following factors, to ensure a seamless onboarding process:

Increased operational complexity

- Each side letter introduces unique obligations that must be tracked and executed correctly.
- Differing fee arrangements require precise accounting and reconciliation.
- Customized reporting obligations must be integrated into the standard investor reporting process.

Risk of conflicts and compliance issues

- Side letters should be agreed at negotiation stage alongside other governing documents including the LPA, to avoid any contradiction between the two.
- MFN clauses can create a cascade effect where a new concession must be offered to multiple investors, complicating fund management.
- Certain side letter provisions (e.g. ESG exclusions) may impact investment flexibility.

Legal and regulatory scrutiny

- Regulators increasingly scrutinise preferential treatment of LPs, particularly if it disadvantages other investors.
- Failure to honour side letter terms could result in legal disputes or reputational damage.

Given these challenges, fund managers must implement robust governance and tracking mechanisms to ensure compliance with all investor-specific terms.

The role of a specialist fund administrator in managing side letters

A specialist fund administrator plays a vital role in ensuring that side letters are properly structured, executed, and managed throughout the life of the fund

and when LP or GP stakes in a fund are offered on the secondaries market. The complexity of tracking multiple bespoke agreements across investors makes a dedicated administration function essential for mitigating risks and ensuring compliance. Automation and the use of systems can ease centralized recordkeeping, reporting needs, complex calculations and monitoring, while AI can help enhance efficiency, reducing the administrative burden resulting from the increasing use of side letters.

A specialised fund administrator can help with the following processes related to side letter management:

Centralized side letter management and compliance

- Comprehensive tracking systems to ensure all side letter provisions are documented and monitored.
- Automated alerts and dashboards to prevent missed obligations.
- Proactive compliance oversight to flag conflicts or regulatory risks before they become an issue.

Accurate and efficient fee calculations

- Implementing and reconciling differentiated fee structures across multiple investors.
- Ensuring MFN provisions are correctly applied, avoiding unintentional violations.
- Managing complex carry and distribution waterfalls to reflect customised investor terms.

Enhanced investor reporting and transparency

- Tailored reporting solutions to meet investor-specific side letter requirements.
- Automation tools to streamline ESG, tax, and financial disclosures.
- Regular audits and reconciliations to ensure accuracy and consistency.

Governance and advisory support

- Assisting fund managers in structuring side letters to avoid operational pitfalls.
- Providing regulatory guidance on compliance with AIFMD, FATCA, CRS,

and other investor-specific regimes.

- Supporting advisory committee obligations and governance structures defined in side letters.

In essence, a fund administrator does far more than simply track side letter terms, they act as a strategic partner, ensuring that investor-specific arrangements enhance fund efficiency rather than create operational bottlenecks.

Side letters and tailored governance arrangements have become a fundamental aspect in venture capital and private equity funds. They allow LPs to negotiate customised terms that align with their regulatory, economic, and governance requirements. However, these arrangements introduce significant complexity, requiring fund managers to navigate intricate compliance, reporting, and operational challenges.

A specialist fund administrator provides the expertise and technology needed to streamline side letter management, reduce risk, ensuring terms are adhered to for each investor. By leveraging a strong administrator, fund managers making deals on secondaries markets can focus on investment strategy and investor relations, confident that their tailored agreements are being handled with precision and efficiency.

How Aztec can help

Whether it's managing large volumes of unstructured and unstandardized data from multiple sources or navigating highly nuanced and complex structuring, investor management and governance requirements specific to secondaries transactions – your fund operations deserve more than a standard administrative approach.

With specialist teams, purpose-built technology, and a proven track record in supporting your peers, we understand the unique demands and complexities you face – and can apply this rich insight and experience directly to your funds. What's more, our end-to-end data management solution, [Aztec Xtract](#), blends AI and automation with specialist human expertise to deliver reliable, structured and decision-ready data that empowers you to act with speed and confidence.



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