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Private Equity 2021

Luxembourg: Trends & Developments

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Trends and Developments

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Luxembourg Private Equity Market Status

Private equity (PE) has increased its importance within the Luxembourg finance and fund industry and has become more and more attractive for institutional and professional investors. Regarding retail investors, the asset class is not easily accessible but current developments at the EU Commission level seem to be propelling this topic. Luxembourg is a well-recognised financial centre and the number one domicile for investment funds within Europe. Sponsors, investment managers and investors from Europe, the USA and Asia use Luxembourg to structure their investments and respective vehicles.

As of 31 May 2021, the net assets of regulated Luxembourg Investment funds, including alternative investment funds (AIFs) and undertakings for collective investments in transferable securities (UCITS), amounted to over EUR5.3 billion. At the end of June 2020, this number was still just over EUR4.5 billion net assets. During the last few years, the number and assets under management of AIFs investing in PE has increased consistently. The Luxembourg Private Equity and Venture Capital Association (LPEA) estimates that of European PE and venture capital funds, around 90%, are domiciled in the Grand Duchy of Luxembourg with assets under management reaching EUR400 billion.

The Merits of Luxembourg

The growth of PE investments in Luxembourg is a consequence of several key advantages to be found in Luxembourg.

Flexible company law and fund structures

Luxembourg offers a wide range of fund and company structuring to the PE industry. The flexible company and investment fund laws in Luxembourg allow to structure the PE funds and PE investments in accordance with the investors' needs. The most important fund structures for PE funds are:

- the specialised investment fund (SIF);
- the investment company in risk capital (SICAR); and
- the reserved alternative investment fund (RAIF).

All three fund types enable to invest in different asset classes like private equity.

SIF

The SIF is the standard structure, authorised and supervised by the Luxembourg financial supervisory authority CSSF for PE investments under the consideration of diversification rules.

SICAR

The SICAR is the fund type which is especially intended to serve for PE investments as it requires the investment in risk capital. Its purpose is the collection of funds from well-informed investors being aware of the risks and the development of the acquired target company. Risk diversification rules do not apply for SICARs.

RAIF

The RAIF is similar to the SIF structure but it is not authorised and supervised by the CSSF. Due to that, it can be set-up in a simplified process and time to market launch can be ensured in comparison with the SIF and SICAR. A RAIF needs however to appoint a fully authorised AIFM for its supervision. Due to the swift launch, the RAIF became the preferred fund structure type for the set-up of AIFs in the last three years.

Additional forms

In addition to the different AIF fund types, the Luxembourg company law offers company forms which can organised in accordance with the specific needs of the involved parties (GPs, LPs, etc). Private equity investors and managers have a strong preference for unregulated partnerships, the limited partnership (SCS) and the specialised limited partnership (SCSp). Both company types refer to the organisation of partners with the general partner managing the company and besides that, limited partners. The SCSp has no legal personality, is very popular and attracts UK and US investors as it is similar to the English limited partnership. In addition, those company types are also tax transparent and can be interesting for tax-exempted investors.

AIFs can be set-up only in the form of a SCS or SCSp without the structure of a RAIF or a SIF. In this form they can be set up easier for PE fund structures which is lately preferred by PE investors. For PE acquisitions also the SOPARFI (financial participation company) which is non-regulated is used for the holding and financing of PE investments.

International and experienced staff

The Grand-Duchy of Luxembourg has a population around 600,000 residents and one can find an international environment where English has become the predominant working language in the financial industry. Investors and market players have a diverse choice of service providers which have an expertise in PE structuring, transaction advise, funds administration, depositary and audit services. Corporate documents and fund documentation can be prepared in English, German or French.

Other Luxembourg benefits

Another advantage is the European passport. Luxembourg AIFMs can manage Luxembourg funds but also other AIFs established in other EU countries. This was experienced by UK companies prior to Brexit and some fund managers, like M&G Investments, transferred their offices to Luxembourg in order to maintain the benefit of the European passporting regime. During the last few years, several large PE firms have opened an office in, or even established their headquarters in Luxembourg. This was mostly followed by the moving of PE funds to Luxembourg and/or launching new fund structures under Luxembourg fund types.

Luxembourg boasts a stable political and economic situation. In addition, a flexible and attractive tax regime in compliance with EU regulations and directives is offered to investors and firms.

PE/investment via Luxembourg Structures

PE target acquisitions are also carried out via Luxembourg structures. The advantage is that Luxembourg service providers are experienced in the structuring of PE investments and the laws and the applicable tax regime can be in favour of such transactions. Nowadays, market PE firms prefer to have the entire PE acquisition structure in Luxembourg to avoid the structures being distributed over several countries and to also avoid European supervisory mechanisms starting to take effect.

PE investments in Luxembourg firms

While many PE firms that have moved to Luxembourg appreciate its attractiveness, it is also noteworthy that PE investments into Luxembourg-based target groups take place from time to time.

Despite the reduction in deal flow, major Benelux-based deals have progressed. A recent notable transaction saw TMF Group acquire Selectra Management Company, a regulated management company from Luxembourg serving both alternative investment funds and undertakings for the collective investment in transferable securities, from Farad Group. The transaction was completed in mid-February 2021.

Moreover, in mid-2020, Netherlands-based Van Mossel Automotive Group acquired a Luxembourg car dealer called Autopolis, with around 320 people in Luxembourg who deal in 13 car brands, from a Belgian investment firm to form the largest car network in the Benelux region. The transaction was completed in January 2021.

PE firms also acquired management companies of investment funds in Luxembourg. Hauck & Aufhäuser, chapter 15 management company and AIFM was acquired the Chinese investment group Fosun in September 2016. In 2017, Universal-Investment group including Universal-Investment-Luxembourg S.A., recently recognised as top 1 AIFM and third-party Manco, based on assets under management, have been acquired by the UK PE firm Montagu Private Equity.

Influence of COVID-19

When COVID-19 appeared in March 2020, PE business took a certain hit. A few investment funds, including PE funds, faced liquidity issues as their targets were no longer performing due to the pandemic (eg, travel industry entities).

Further, COVID-19 lead to a pause in PE investments as PE firms had to adapt to the new situation. For example, buyouts or exits needed to be postponed or put on hold. Other and new asset classes became more relevant during the pandemic. Some PE firms switched focus and started to invest in the healthcare sector or in the digital sector.

However, since Q3 2020, PE activity has rebound and mostly recovered, showing a strong resilience. COVID-19 could even be a great opportunity for some businesses in a less than secure situation. Such companies could be interesting investment opportunities for PE firms. Investing funds and support into such firms can bolster economic recovery and indirectly bring growth to the market.

Reporting requirements

Investor reporting can be considered an upcoming trend which continues to be increasingly important in Luxembourg. As relevant data is requested by investors, transparency and daily reporting for investors becomes more important and needs to be considered by PE market players in Luxembourg.

Growth of ESG importance

Reporting and investment need to take greater account of economic social governmental (ESG) criteria. Since Regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 2019 on sustainability-related disclosures in the financial services sector (SFDR) became effective on 11 March 2021, investment fund managers and PE firms have to consider ESG criteria when making investments. If they do not intend to consider such criteria, they need to explain their reasons.

Ever more investors are requiring the consideration of ESG criteria. Companies have become more accountable to shareholders and customers and shareholders pay significantly attention on how their money is invested and whether their investment has any positive or negative impact on the environment. This is a new challenge for PE firms as there are more considerations to be taken into account when choosing an appropriate investment. They need to review the impact and also the value of investments.

Furthermore, banks are more frequently asking for ESG considerations when providing a loan facility. The attractiveness of investee companies could increasingly depend on the implementation of reliable and effective ESG policies and strategies by the target companies. SFDR and other EU regulations which are expected to follow will become more and more important and also influence PE investments and PE investment funds in Luxembourg and elsewhere in the future.

MATAP influence

Based on the "Made in America Tax Plan" (MATAP) and consequential measures still under discussion between the governments, it is expected that all internationally operating businesses need to pay a minimum level of tax. In relation to Luxembourg structures, it needs to be verified which entities or investment funds will be covered by the tax plan. It further needs to be ensured that the implementation of such tax regime does not hinder the PE industry in Luxembourg to still grow but also support the fight against tax avoidance.

Forecast

The Luxembourg PE business in relation to PE investment funds and also PE investments is expected to continuously grow and adapt to the upcoming regulatory and investors demands. Luxembourg as a well-known platform for PE business will develop with the market and support the growth of private investments in companies.

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