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Private Equity 2022

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Luxembourg: Trends & Developments

Marcus Peter and Marie-Thérèse Wich
GSK Stockmann SA

Trends and Developments

Contributed by:

Marcus Peter and Marie-Thérèse Wich
GSK Stockmann SA see p.7

Luxembourg Private Equity Market Status

Private equity has increased in importance within the Luxembourg finance and fund industry during recent years, and has become more and more attractive for institutional and professional investors. The asset class is not easily accessible to retail investors, but the introduction of AIFMD II could lead to the opening of private equity funds to retail investors as well.

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 2022, the net assets of regulated Luxembourg investment funds, including alternative investment funds (AIFs) and undertakings for collective investments in transferable securities (UCITS), amounted to more than EUR5.368 billion. During the last few years, the number of assets under management of AIFs investing in private equity has increased consistently, rising in 2021 by 29.9% to a total of EUR137.2 billion. A 10% growth in the Luxembourg private equity market per year is expected until 2025. Private equity should even be the driver of the primary growth with regard to managed asset classes from the perspective of Luxembourg alternative investment fund managers (AIFMs) and management companies.

The Merits of Luxembourg

The growth of private equity investments in Luxembourg is a consequence of several key advantages in Luxembourg.

Flexible company law and fund structures

Luxembourg offers a wide range of fund and company structurings to the private equity industry. The flexible company and investment fund laws in Luxembourg allow private equity funds and investments to be structured in accordance with investors' needs. The most important fund structures (regulated and non-regulated) for private equity 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 investment in different asset classes like private equity.

- The SIF is the standard structure, authorised and supervised by the Luxembourg financial supervisory authority (*Commission de Surveillance du Secteur Financier* – CSSF) for private equity investments under the consideration of diversification rules.
- The SICAR is the fund type especially intended to serve for private equity investments as it requires an investment in risk capital. Its purpose is the collection of funds from well-informed investors who are aware of the risks and the development of the acquired target

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company. Risk diversification rules do not apply for SICARs.

- The RAIF is similar to the SIF structure but is not authorised or supervised by the CSSF. This enables a simplified process and a shorter time to market in comparison with the SIF and SICAR. However, a RAIF needs to appoint a fully authorised AIFM for its supervision. Due to the swift launch, the RAIF has become the preferred fund structure type for the set-up of AIFs over the last four years.

Additional forms

In addition to the different AIF fund types, Luxembourg company law offers company forms that can be organised in accordance with the specific needs of the parties involved (general partners, limited partners, 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. These company types are also tax transparent and can be interesting for tax-exempted investors.

AIFs can be set up only in the form of an SCS or SCSp without the structure of a RAIF or a SIF. In this form, they are easier to set up for private equity fund structures, which have been preferred by private equity investors of late. The SOPARFI (financial participation company), which is non-regulated, is also used for the holding and financing of private equity investments. Besides the regular fund structures, a few European long-term investment funds (ELTIF) have

been set up in Luxembourg, which could be investment opportunities for retail investors. Around 30% of the existing ELTIFs in Luxembourg have a private equity investment structure.

Special purpose vehicles that are created and owned by the AIF holding the target assets are also established in Luxembourg.

International and experienced staff

The Grand-Duchy of Luxembourg has a population of around 600,000 residents, and 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 with expertise in private equity structuring, transaction advice, funds administration, and 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 as well as other AIFs established in other EU countries. This was utilised by UK companies prior to Brexit, with some fund managers, like M&G Investments, transferring their offices to Luxembourg in order to maintain the benefit of the European passporting regime. During the last few years, several large private equity firms have opened an office in Luxembourg, or even established their headquarters there. This was mostly followed by the moving of private equity funds to Luxembourg and/or the launching of new fund structures under Luxembourg fund types. Eighteen of the 20 largest private equity houses have operations in Luxembourg, and 63% of Luxembourg private equity firms also hold an AIFM licence in Luxembourg.

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Luxembourg boasts a stable political and economic situation. Investors and firms also benefit from a flexible and attractive tax regime that complies with EU regulations and directives.

Private Equity/Investment via Luxembourg Structures

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

Private equity investments in Luxembourg firms and by Luxembourg private equity firms

While many private equity firms that have moved to Luxembourg appreciate its attractiveness, it is also noteworthy that private equity investments into Luxembourg-based target groups or by private equity Luxembourg companies into other companies take place from time to time.

Despite the reduction in deal flow, major Benelux-based deals have progressed of late. 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. In July 2022, it was announced that Luxembourg-based private equity company CVC Capital Partners had struck a deal to shift partial ownership of TMF Group from CVC's pri-

vate equity fund to CVC's strategic opportunities fund. Another stake in TMF Group shall be sold to the Abu Dhabi Investment Authority Sovereign Wealth Fund.

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.

The EIF and SNCI, both based in Luxembourg, set up the Luxembourg Future Fund, a EUR150 million fund that aims to stimulate the diversification and sustainable development of the Luxembourgish economy by attracting venture capital fund managers and early-to-later stage innovative businesses into Luxembourg. The Luxembourg Future Fund invests directly or indirectly in venture capital funds and SMEs to foster the sustainable development of Luxembourg strategic sectors (ie, companies active in the ICT, clean-tech and other technology sectors, excluding health technologies and life science).

Besides those projects, Luxembourg-based BGL BNP Paribas plans to invest EUR50 million in minority shareholdings in commercial, industrial or technological companies based in the Grand-Duchy.

Influence of COVID-19

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

However, private equity activity has rebound and mostly recovered since Q3 2020, showing strong resilience. COVID-19 could even be a great opportunity for some businesses in a less than secure situation, which might be interesting investment opportunities for private equity firms (eg, in the healthcare sector or digital sectors). Investing funds and support into such firms can bolster economic recovery and indirectly bring growth to the market.

Influence of the war in Ukraine

The war in Ukraine and the resulting inflation have not yet hit the private equity market. A few investors have mentioned concerns about investment risks, but the Luxembourg private equity market continues to grow.

Reporting requirements

Investor reporting can be considered an upcoming trend that is 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 private equity market players in Luxembourg.

Growth of ESG importance

Reporting and investment need to take greater account of 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 private equity firms have to consider ESG criteria when making investments. If they do not intend to consider such criteria, they need to explain their reasons and all related risks.

Ever more investors are requiring the consideration of ESG criteria. Companies have become

more accountable to shareholders and customers, and shareholders pay significantly more attention to how their money is invested and whether their investment has any positive or negative impact on the environment. For example, institutional investors like pension funds focus on funds that promote or target sustainable investments (Articles 8 and 9 under the SFDR). This is a new challenge for private equity firms as there are more considerations to be taken into account when choosing an appropriate investment. Such firms need to review the impact and also the value of investments. 80% of private equity houses consider ESG to be a main topic for future investment and their marketing strategy.

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. The SFDR and other EU regulations that are expected to follow will become more and more important, and will influence private equity investments and investment funds in Luxembourg and elsewhere in the future.

Digitalisation and technology

Digitalisation and technology play a significant role in Luxembourg, and represent potential investment opportunities. Private equity companies in Luxembourg now focus on technology-related companies and fintech. Luxembourg established the LHoFT (Luxembourg House of Financial Technology) five years ago, which is the Luxembourg fintech centre connecting financial institutions, investors, the IT industry and authorities. According to a survey by S&P's 2021 Global Private Equity Outlook, firms expect that

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their future investments will be made in information technology (around 50%).

Forecast

Luxembourg private equity business in relation to private equity investment funds and also private equity investments is expected to grow continuously over the coming years, and to adapt to the upcoming regulatory and investor demands. As a well-known platform for private equity business, Luxembourg will develop with the market and support the growth of private investments in companies.

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Authors



Marcus Peter heads the investment funds and private equity practice at GSK Stockmann in Luxembourg, where he has been a partner since 2016. He has worked as a

lawyer in Luxembourg since 2004 and is also admitted as a lawyer in Germany. Marcus is an expert in Luxembourg investment funds and private equity law, M&A and corporate law. He is a member of the Luxembourg Private Equity Association (LPEA), the Chinese-Luxembourgish Chamber of Commerce, DAV Luxembourg, EVER and CBBL (Cross Border Business Lawyers). He holds a PhD from the European Institute in Saarbruecken, Germany.



Marie-Thérèse Wich is a senior associate at GSK Stockmann in Luxembourg. She has experience in advising national and international clients on all legal and regulatory aspects in

the fields of investment funds (UCITS, AIFs, regulated and non-regulated structures) and private equity, as well as corporate and M&A matters. Marie-Thérèse is admitted as a lawyer in both Germany and Luxembourg. Prior to joining GSK Stockmann, she worked with a leading independent law firm in Luxembourg. She is a member of the German-French lawyers' association (DFJ).

GSK Stockmann SA

44, Avenue John F. Kennedy
L-1855
Luxembourg

Tel: +352 271802 00
Fax: +352 271802 11
Email: marie-therese.wich@gsk-lux.com
Web: www.gsk-lux.com



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