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Private Equity 2023

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Luxembourg: Trends & Developments

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Trends and Developments

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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 the AIFMD II and ELTIF 2.0 could lead to the opening of investments in private equity funds for 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 March 2023, 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 EUR5,148 billion. Around a quarter of Luxembourg AIF's market is made up of private equity funds. A 10% growth in the Luxembourg private equity market per year is expected until 2025. Private equity should even be the primary driver of 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 of Luxembourg compared to other jurisdictions.

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 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 since its introduction in 2016.

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, it is expected that since the introduction of the ELTIF regulation (ELTIF 2.0) more European long-term investment funds (ELTIF) will be set up in Luxembourg, as they create opportunities for retail investors to invest in alternative investment products like private equity.

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

International and experienced staff

The Grand Duchy of Luxembourg has a population of around 660,000 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. 18 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.

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. The laws and the applicable tax regime can also 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.

Universal Investment Group (Universal), a leading asset manager in Europe and the largest third-party AIFM in Luxembourg, acquired Luxembourg-based financial services provider European Fund Administration S.A. in November 2022. This allowed Universal to increase its fund services business and its asset under management to more than 900 trillion euro.

The Bermuda-based global financial services provider Apex Group (Apex) announced to acquire the Luxembourg-based third-party marketing specialist Alfi Partners in January 2023 and various business operations such as the management company services of MJ Hudson Plc in April 2023. This broadened the list of asset managers and fund distributors acquired by Apex during the last years e.g. LRI, FundRock, Sanne Group.

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 private 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.

The EIF and SNCI, both based in Luxembourg, set up the Luxembourg Future Fund (LFF), a EUR150 million fund that aimed 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 LFF invested 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). In March 2023, the

Ministry of Finance, the Ministry of the Economy, SNCI and EIF launched the LFF 2 as successor of LFF 1.

Besides those projects, Luxembourg-based BGL BNP Paribas invests regularly in minority shareholdings in commercial, industrial or technological companies based in the Grand Duchy.

Influence of COVID-19

Despite the hit to private equity businesses when faced with liquidity issues as their targets were no longer performing due to the COVID-19 pandemic, the private equity activity has mostly recovered after COVID-19. COVID-19 was an interesting investment opportunity for some private equity firms (eg, in the healthcare and digital sectors).

Influence of the war in Ukraine

The war in Ukraine and the resulting inflation have influence on the international economic situation. The private equity market remained quite stable so far. The exposure of Luxembourg private equity asset managers to Russian assets has been very limited for a number of years.

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 to 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. Since 1 January 2023, the level 2 technical and formal guidelines (RTS) apply which provide for additional disclosure and reporting obligations for financial market participants.

A growing number of 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, artificial intelligence, machine learning and fintech. Luxembourg established the Luxembourg House of Financial Technology (LHoFT) five years ago. LHoFT is the Luxembourg fintech centre, which connects financial institutions, investors, the IT industry and authorities. According to a survey by S&P's 2021 Global Private Equity Outlook, firms expect that around 50% of their future investments will be made in information technology.

Forecast

The Luxembourg private equity business 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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