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Private Equity 2024

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Luxembourg: Trends and 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 the Luxembourg-based Private Equity investment funds have become more and more attractive for institutional and professional investors worldwide. The asset class is still not yet easily accessible to retail investors, but the introduction of AIFMD II, ELTIF 2.0 and the EU Retail Investment Strategy, together with the modernisation of the Luxembourg fund toolbox (adoption of the bill of law no 8183 in July 2023), are set to enable retail investors to engage alternative asset classes, which are also deployed by private equity providers.

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 May 2024, 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 EUR5,472 billion. Assets under management of all Luxembourg funds (regulated and unregulated) grew to EUR5.485 trillion in March 2024 which reflects the highest amount which was reached since 2021.

Around a quarter of the Luxembourg AIF's market is made up of private equity funds. According to Preqin, Luxembourg is the domicile of 51.5% of all European Private Equity funds. Luxembourg's private equity and venture capital funds increased by 5.7% until end of 2023 compared to December 2022 according to the Luxembourg fund association ALFI and the financial supervisory authority CSSF. It is expected that private equity should even be the primary driver of growth with regard to alternative asset classes from the perspective of Luxembourg alternative investment fund managers (AIFMs) and management companies. One has to note that until around 15 years ago private equity meant the acquisition of participation in unlisted industry groups, their development and on-sale after a few years. However, in the last 15 years, such private equity providers also have established other business lines like credit funds, infrastructure funds, real estate funds or other alternative asset classes. Hence, the term private equity in a broader sense refers to all these business lines.

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 structures 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. It celebrates its 20th birthday in 2024. 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 and more cost-efficient launch, the RAIF is one of the preferred fund structure types for the set-up of AIFs since its introduction in 2016 and is also well-known by foreign fund promoters and investors.

The Luxembourg legislator regularly reviews the applicable provisions for fund structures and aims to adapt them to the current market situation. Therefore, in July 2023, the Luxembourg fund toolbox has been modernised by the law of 23 July 2023, eg, by lowering the minimum investment threshold for well-informed investors of RAIFs and SIFs to EUR100,000 (before EUR125,000) to allow an easier access to those fund products.

Limited partnerships and 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 also attracts UK and US investors as it is similar to the English limited partnership. These company types are tax transparent and can be interesting for tax-exempted investors.

AIFs should be set up only in the form of an SCS or SCSp if not relying on the structure of a RAIF or a SIF. In this form, they are easier and more cost-efficient to set up for private equity fund structures, which have been preferred by private equity investors of late. They benefit from the flexible Luxembourg corporate law and can be set-up under private seal. If an SCS or SCSp shall have multiple compartments, the SCS and SCSp can also be structured as SIF or RAIF.

The SOPARFI (financial participation company), which is non-regulated (and also not a SIF or RAIF), is also used for the holding and financing of private equity investments. Such SOPARFIs usually take the form of a public limited liability company (SA), private limited liability company (SARL) or partnership limited by shares (SCA). These entities are fully taxable in Luxembourg, which is not the case for a SCS, SCSp, SIF or RAIF.

As a specific fund label, European long-term investment funds (ELTIFs) have been implemented in 2015. The more flexible ELTIF 2.0 framework, applicable since January 2024 has led to the result that Luxembourg ELTIF structures reflect around 70% of Europe's market share in ELTIFs. They create opportunities for retail investors to invest in alternative investment products like private equity.

Besides ELTIFs, also the EuVECA framework is interesting for venture capital/ private equity investments. The European venture capital funds Regulation (EU) no 345/2013 (EuVECA Regulation) provides harmonised requirements for qualified venture capital funds that intend to invest at least 70% of their aggregate capital contributions and uncalled committed capital in assets that are "qualifying investments" (EuVECA Funds).

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 a strong 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. As mentioned in previous years, several large private equity firms have opened an office in Luxembourg, or even established their headquarters there. Their staff base has been increasing steadily over the last ten years. 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 around two thirds of Luxembourg private equity firms also hold an AIFM licence in Luxembourg.

Luxembourg boasts a stable political and economic situation and keeps its Triple-A rating. 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.

Despite the reduction in deal flow, major Luxembourg deals were noted

Apex Group, a global financial services provider, completed its acquisition of MJ Hudson's business outsourcing division in October 2023, enhancing its presence in Luxembourg. This acquisition integrated MJ Hudson's Luxembourg management company operations into Apex's existing FundRock brand, reinforcing FundRock's position as one of the largest management companies in Luxembourg.

In January 2024, it was announced that a global wealth management platform FNZ completed its acquisition of Luxembourg-based B2B fund platform Ifsam. The deal expands FNZ's capabilities in managing private equity and other alternative asset classes. FNZ further stated its plan to set up a centre of excellence for fund processing services in Luxembourg, supporting FNZ's significant investment in the European market.

Alter Domus, a leading global provider of end-to-end tech-enabled fund administration, private debt, and corporate services for the alternative investment industry, with headquarter in Luxembourg, announced in March 2024 that it has secured a new strategic investment from Cinven. Cinven is a leading international private equity firm focused on building world-class global and European companies. The transaction gives Alter Domus an enterprise value of EUR4.9 billion (USD5.3 billion).

Gen II Fund Services (Gen II), a New York-based private capital fund administrator, announced the acquisition of Crestbridge, a preeminent European provider of private capital fund administration solutions, in April 2024. The acquisition expands Gen II's presence in Luxembourg, increasing Gen II's assets under administration to over USD1 trillion.

Vistra Group has obtained regulatory approval to proceed with its acquisition of Kroll (Luxembourg) Management Company ("Kroll") in May 2024. Kroll will officially separate from its parent company in London by August 2024 and will then operate under the Vistra Luxembourg family of companies. A further merger with Vistra Fund Management is anticipated, pending subsequent regulatory approval.

The Luxembourg Future Fund 2 has announced an €8 million investment in the M80 Capital II CommV fund in June 2024, aimed at fostering digital transformation in small and medium-sized enterprises (SMEs). M80 Capital II CommV focuses on leveraging advanced digital technologies such as IT management, robotics, the Internet of Things (IoT), and artificial intelligence (AI) to optimize business processes and enhance value creation for traditional SMEs facing complex challenges. This initiative strengthens Luxembourg's position in digital transformation. The LFF2 is joint initiative by the Luxembourg public-sector banking institution "Société nationale de crédit et d'investissement (SNCI)" and the European Investment Fund (EIF).

GAM, an independent investment manager listed in Switzerland, has announced in July 2024 it has reached a definitive agreement to transfer its Management Company activities in Ireland, Luxembourg and the UK to Apex Group.

It is noteworthy that Luxembourg-headquartered private equity company CVC Capital Partners successfully listed on Euronext Amsterdam in April 2024, raising EUR250 million and achieving a market capitalisation of EUR14 billion. Being the largest IPO in Europe for 2024, the IPO supports CVC's long-term growth and increases its profile, with the company managing approximately EUR186 billion in assets across various investment strategies.

Influence of the war in Ukraine and global conflicts

The war in Ukraine, further global conflicts that have arisen and the resulting inflation have impacted 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. The European Supervisory Authorities published its proposed changes of the SFDR, amongst others, a new financial product classification system, in June 2024.

In addition, the EU's Corporate Sustainability Reporting Directive (CSRD) and European Sustainability Reporting Standards (ESRS) require the disclosure of sustainability information for large companies operating in the EU starting from the 2024 financial year, with the first reports due in 2025.

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, CSRD 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 but also a method used for private equity transactions. Private equity companies in Luxembourg now focus on technology-related companies, artificial intelligence (AI), machine learning, fintech, tokenisation and blockchain. According to a survey by S&P's 2024 Private Equity and Venture Capital Outlook, 54% of GP investment professionals expect AI to influence deal sourcing and target selection in the future. Luxembourg pioneered this trend with the establishment of the Luxembourg House of Financial Technology (LHoFT) early in 2017. LHoFT is the country's fintech centre, supporting the digital transformation of Luxembourg's financial sector by connecting financial institutions, investors, the IT industry and authorities.

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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