CHAPTER 5

Luxembourg

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I. PRIVATE EQUITY FUNDS IN LUXEMBOURG

Introduction

The Grand Duchy of Luxembourg is one of the world's leading fund domiciles and is the leading private equity fund centre in Europe. With nine of the 10 largest private equity firms worldwide doing business from Luxembourg, it is an attractive jurisdiction in which to domicile private equity funds for many reasons, including its stable political environment where traditional political parties and policy makers, regardless of their position on the political spectrum, work together to ensure that Luxembourg remains a leading investment fund centre. **5-1**

Beyond this, Luxembourg's corporate laws and regulations are flexible and competitive, and Luxembourg offers a wide range of partnership and corporate vehicles, each adaptable in its own right, to allow partners and shareholders to tailor the management and general governance of such vehicles to their specific needs. In addition, the Luxembourg tax framework is regarded as one of the most stable in Europe, which provides many advantages for companies and partnerships as well as their shareholders, partners and employees.

In the alternative fund space, Luxembourg has developed an impressive range of regulated and unregulated investment fund vehicles, a variety of which may be utilised when establishing a private equity investment fund. The regulated fund regimes are opt-in regimes and, therefore, not obligatory and as such are typically used in relation to fund vehicles in corporate form or if an umbrella structure is required.

Unregulated funds, save for the potential need to comply with the AIFM Directive under certain circumstances, are the most commonly utilised vehicles for private equity funds. Luxembourg limited partnerships, in particular the special limited partnership (*société en commandite spéciale*, the *"SCSp"*), have become the preferred structures for private equity houses. Luxembourg benefits from significant depth and experience in relation to servicing private equity funds, and Luxembourg funds are familiar to private equity investors which typically regard them as the gold standard in terms of investment vehicles.

As a result of these various factors, Luxembourg is the most attractive jurisdic-

tion amongst the civil law jurisdictions and, indeed in Europe, in which to establish and operate a private equity fund.

II. WHAT IS A PRIVATE EQUITY FUND?

General concept

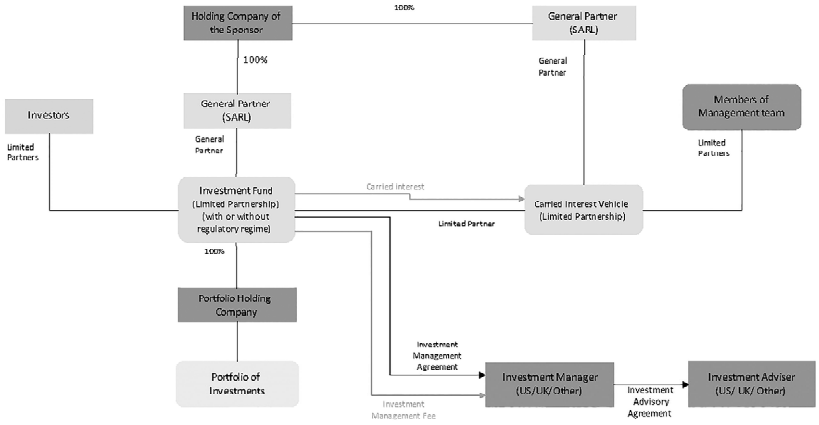
5-2 The general concept of a "private equity fund", as detailed in Ch.1, applies equally with respect to Luxembourg private equity funds.

Private equity fund structures

5-3 Private equity funds in Luxembourg may be established as unregulated or regulated structures. Within these two categories, various types of vehicles are available. Unregulated limited partnerships have, however, generally become the vehicle of choice for most managers who wish to establish private equity funds which are domiciled in the EU.

In circumstances where it is preferable to establish a fund which is subject to a regulatory regime, the reserved alternative investment fund (*fonds d'investissement alternatif réservé*, the "RAIF"), the specialised investment fund (*fonds d'investissement spécialisé*, the "SIF") and the investment company in risk capital (*société d'investissement en capital à risque*, the "SICAR") are most frequently selected. The application of one of these regulatory regimes can provide additional structuring flexibility and help to accommodate specific commercial and regulatory considerations.

A wide range of different factors, including the choice of available legal vehicles and their suitability for the relevant asset class, the likely preferences of target investors and the extent of local regulation, will influence and determine the fund structure which the manager of a private equity fund ultimately selects and implements.



Typical Luxembourg Private Equity Fund Structure[1]

Limited partnerships

The legal framework for limited partnerships has existed in Luxembourg for over a century and its origins can be traced back to the "commenda contract" which was an early form of limited partnership. In 2013, however, the legislature modernised the partnership regime by revamping the legal regime of the common limited partnership (*société en commandite simple*, the "SCS") and introducing a new type of partnership vehicle—the SCSp. **5-4**

Luxembourg's limited partnership regime now comprises three types of limited partnership:

(i) the SCSp;
(ii) the SCS (together with the SCSp, the "Luxembourg Limited Partnerships"); and
(iii) the corporate partnership limited by shares (*société en commandite par actions*, the "SCA").

This set the scene for limited partnerships, in particular the SCSp, and to a lesser extent the SCS, to become the legal vehicle of choice for private equity funds established in Luxembourg, independent of their regulatory status (see "Regulatory Regimes", below at para.5-6, et seq.). Luxembourg Limited Partnerships are modelled on the successful Anglo-Saxon limited partnership regimes and offer features similar to foreign partnership regimes applicable in England, Scotland, the State of Delaware, USA and other common law jurisdictions.

By contrast, the SCA is a hybrid entity, which is incorporated under Luxembourg law, and exhibits a number of corporate and partnership characteristics.

Each Luxembourg Limited Partnership is formed under the law of 10 August 1915 on commercial companies, as amended (the "Companies Law"), which contains a number of provisions that are particular to each type of Luxembourg Limited Partnership. The provisions in respect of Luxembourg Limited Partnerships in the Companies Law are not extensive and therefore afford great structur-

[1] The graph omits any service provider which the AIFM Directive and/or any of the Luxembourg regulatory regimes may require.

ing flexibility as well as contractual freedom, provided that fundamental civil law principles are respected.

In addition, Luxembourg Limited Partnerships: (i) can accommodate specific requirements for both investors and fund managers, (ii) can be established as, for example, master-feeder structures, fund-of-funds structures, alternative investment vehicles, co-investment vehicles or carry vehicles, (iii) may fall outside or within the scope of the AIFM Directive (examples of the former are certain joint ventures and single investor vehicles), and (iv) may be governed by a specific regulatory regime and may be supervised by Luxembourg's financial regulator, the *Commission de Surveillance du Secteur Financier* (the "CSSF").

These desirable features have contributed to the success of the Luxembourg Limited Partnerships and ensured that they have become the preferred vehicles for a wide variety of investment strategies. In particular, managers who focus on private equity (and other closed-ended investment strategies) which are familiar with Anglo-Saxon limited partnerships often prefer Luxembourg Limited Partnerships to other available options.

Considerations under the AIFM Directive

5-5 Each unregulated Luxembourg Limited Partnership may qualify as an alternative investment fund (an "AIF")[2] if its activities fall within the scope of the law of 12 July 2013 on alternative investment fund managers, as amended (the "AIFM Law"). In these circumstances, the Luxembourg Limited Partnership will be subject to the AIFM Law (although the extent to which the AIFM Law will apply must be determined on a case-by-case basis) and will be required to appoint an AIFM which complies fully with the AIFM Directive (a "Full-Scope AIFM"), a non-EU AIFM or an AIFM which is subject to the de minimis rules under the AIFM Directive (a "Sub-Threshold AIFM"). Unregulated AIFs are often favoured since they afford a shorter time-to-market and remove any risk of regulatory or supervisory delay. In cases where those AIFs are subject to the AIFM Law, the investor protection provisions under the AIFM Directive will apply.

Regulatory regimes

5-6 The limited partnership regime can be combined with the non-public fund regimes which are available in Luxembourg, namely (i) the RAIF, (ii) the SIF, and (iii) the SICAR. These regimes have been developed over a number of years in order to meet a changing market, investor demands and to ensure that Luxembourg remains an attractive jurisdiction for alternative investment funds.

Private equity funds which are directly or indirectly regulated in Luxembourg may be established under and/or will be subject to one of the following regimes:

(i) the law of 23 July 2016 on reserved alternative investment funds, as amended (the "RAIF Law");
(ii) the law of 13 February 2007 on specialised investment funds, as amended (the "SIF Law"); and/or
(iii) the law of 15 June 2004 relating to the investment company in risk capital, as amended (the "SICAR Law").

As mentioned above, the application of one of these regulatory regimes can provide additional structuring flexibility and help to accommodate specific com-

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[2] See art.1(39) of the AIFM Law for the definition of an "AIF".

mercial and regulatory considerations. For example, a Luxembourg Limited Partnership which opts in to one of these regulatory regimes may be structured as an umbrella fund with multiple sub-funds (and the legal segregation of assets and liabilities between the relevant sub-funds will be respected as a matter of Luxembourg law), may market its interests to "well-informed investors" or professional investors and may furthermore be subject to a specific tax regime. Where a Luxembourg regulatory regime applies, both the relevant provisions of the Companies Law and that specific regulatory regime will apply.

Reserved Alternative Investment Fund

5-7 The introduction of the AIFM Directive and the adoption of the AIFM Law, which implemented the AIFM Directive in Luxembourg, resulted in certain (especially larger) AIFs being subject to a double level of regulation. That is regulation at the level of the manager and at the level of the fund. This was probably an unintended consequence of the AIFM Directive.

As a consequence, and in order to meet the needs of the fund industry whilst ensuring full compliance with the AIFM Directive, the RAIF Law was adopted to provide a solution to those seeking to avoid this double layer of regulation, and to ensure greater efficiency in terms of establishment and operating/corporate rules.

The RAIF Law came into effect on 1 August 2016 and governs the RAIF regime. It affords managers the well-established benefits of Luxembourg investment funds, as well as full compliance with the AIFM Directive, without, however, imposing direct regulation and supervision by the CSSF. As such, RAIFs offer tremendous "time-to-market" efficiencies as compared to SIFs and SICARs.

RAIFs may be established under two distinct options, since the RAIF Law allows RAIFs to adopt the legal and tax features of the SIF regime or the SICAR regime. These are existing, CSSF-regulated fund regimes which have been widely used since 2007 and 2004 respectively.

The majority of RAIFs follow the fall-back principles and features applicable to SIFs under the SIF Law. A RAIF which is established on this basis is subject to risk-spreading requirements.[3] Since the RAIF Law does not provide detailed rules about risk spreading, it is market practice to apply the diversification requirements which apply to SIFs as set out in CSSF Circular 07/309 ("Circular 07/309"), noting that deviations from the application of that circular are possible. In accordance with that circular, a RAIF should, in principle, not invest more than 30 per cent of its assets or of the commitments to that RAIF to subscribe for securities of the same type as those issued by the same issuer. This limit does not apply to:

(i) investments in securities issued or guaranteed by a Member State of the Organisation for Economic Co-operation and Development or its regional or local authorities or by EU, regional or global supranational institutions and bodies; or

(ii) investments in undertakings for collective investment (a "UCI") which are subject to risk diversification requirements comparable to those applicable to RAIFs.

Each sub-fund of an umbrella UCI is to be considered as a separate issuer for the purposes of this restriction. As a result of the difficulties which RAIFs that invest in illiquid assets frequently encounter in complying with the risk diversification rules immediately after their establishment, compliance with the risk diversifica-

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[3] See art.1(1)(b) of the RAIF Law.

tion requirement may be delayed and a "ramp up period" may be applied. This approach aligns with the CSSF regulatory practice which applies to SIFs.

The second option is based on the regime applicable to SICARs. RAIFs which invest exclusively in risk capital ("RAIF-SICARs") are not subject to requirements in relation to risk spreading and are not subject to the risk diversification rules which are described above. RAIF-SICARs may, however, only invest in risk capital. For these purposes, investment in risk capital means the direct or indirect contribution of assets to entities in expectation of their launch, development or listing on a stock exchange.

Each RAIF must appoint an alternative investment fund manager (an "AIFM") which is authorised in the EEA. As a result, each RAIF benefits from the marketing passport under the AIFM Directive and interests in a RAIF may be marketed to professional investors in the EEA under that passport. It is interesting to note that the appointment of an EEA-authorised AIFM is a requirement of the RAIF Law rather than the AIFM Directive itself, and as a result, each RAIF is indirectly subject to the requirements of the AIFM Directive.

A RAIF may be established as an investment company with variable capital (a *société d'investissement à capital variable*, "SICAV") or an investment company with fixed capital (a *société d'investissement à capital fixe*, "SICAF"), both of which encompass a wide range of corporate forms. Furthermore, a RAIF (other than a RAIF-SICAR) may be established as a common fund (*fonds commun de placement*, an "FCP"), which is a contractual arrangement (see " Legal and Organisational Forms" below at para.5-10, et seq.).

Since its introduction, the RAIF has proved an extremely popular investment vehicle and on 2 May 2022, 1,801[4] RAIFs had been registered in Luxembourg. The ability to establish a RAIF relatively quickly and to benefit from the marketing passport under the AIFM Directive has made it an attractive vehicle for fund sponsors and investors across all alternative investment strategies and asset classes, including private equity.

Specialised Investment Fund

5-8 Of all the types of investment vehicles that are available in Luxembourg, the SIF represents the most flexible option for fund managers who do not seek (public) distribution to retail investors and nevertheless seek a product which is regulated by the CSSF.

SIFs are governed by the SIF Law, which was amended by the AIFM Law following the introduction of the AIFM Directive. As a consequence, the SIF Law now comprises two distinct parts: Part I sets out the general provisions which apply to all SIFs and Part II sets out specific provisions which apply to SIFs that qualify as AIFs under the AIFM Directive, and therefore are required to appoint an AIFM. It will be necessary for a SIF to qualify as an AIF and be managed by an EEA-authorised AIFM in order to benefit from the marketing passport under the AIFM Directive.

SIFs are regulated by the CSSF and generally, but not always, qualify as AIFs. Prior CSSF approval is required for the establishment of a SIF as well as any subsequent changes to any documentation and information provided to the CSSF as part of the authorisation application.

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[4] RCS website: *https://www.lbr.lu/mjrcs/jsp/webapp/static/mjrcs/en/mjrcs/pdf/listeFIAR.pdf?FROM_MENU=true&time=1628175609115&pageTitle=menu.item.geninfoFIAR&currentMenuLabel=menu.item.geninfoFIAR*.

SIFs are operationally flexible and fiscally efficient multi-purpose investment vehicles for institutional and other qualified investors. Whilst there are no restrictions on the types of assets in which a SIF may invest, a SIF is subject to risk diversification requirements.[5] The CSSF has issued guidance in Circular 07/309 (see "Reserved Alternative Investment Fund" above at para.5-7) in relation to this risk-spreading requirement, which a SIF will satisfy if it does not invest more than 30 per cent of the assets of, or the commitments to, that SIF in securities of the same type issued by the same issuer. Duly justified derogations may be obtained from the CSSF. Compliance with the risk diversification requirement may be delayed and a SIF may apply a "ramp up period" if the asset type justifies such an arrangement. Circular 07/309 contains additional investment restrictions in respect of short sales, financial derivative instruments and borrowing.

Each SIF must ensure that appropriate risk management procedures and conflict of interest policies are in place.[6] In addition, SIFs must comply with a number of rules relating to persons who are responsible for portfolio management. These persons must be approved (in advance) by the CSSF and need to be of sufficiently good repute, as well as have the necessary experience.[7] With respect to the delegation of portfolio management, the relevant delegate must, in principle, be a regulated entity, although it is possible, in certain circumstances, to appoint individual persons or an entity without a licence.[8] The CSSF is, however, reluctant to approve individuals and has a clear preference for delegation to a regulated entity.

The SIF regime has been quite successful since its introduction and there are currently 1,359 SIFs authorised by the CSSF which manage over €712.988 billion of assets.[9]

As is the case for RAIFs, a SIF may be established as a SICAV, a SICAF or an FCP (see "Legal and Organisational Forms" below at para.5-10, et seq.).

Investment Company in Risk Capital (SICAR)

5-9 SICARs are governed by the SICAR Law, which was implemented specifically to facilitate investment in private equity, particularly in venture capital and other early-stage investments. SICARs are regulated by the CSSF.

The SICAR Law was amended by the AIFM Law following the introduction of the AIFM Directive and as a consequence, the SICAR Law now comprises two distinct parts: Part I sets out the general provisions which apply to all SICARs and Part II sets out specific provisions which apply to SICARs which qualify as AIFs under the AIFM Directive, and are therefore required to appoint an AIFM. It will be necessary for a SICAR to qualify as an AIF and be managed by an EEA-authorised AIFM in order to benefit from the marketing passport under the AIFM Directive.

In contrast to a SIF, a SICAR is not subject to any risk diversification requirements. A SICAR is, however, only permitted to invest in assets which represent "risk capital". In this context, risk capital means the direct and indirect contribution of assets to entities in anticipation of their launch, development or listing on a stock exchange. The CSSF issued further guidance about the concept of risk capital in CSSF Circular 06/241 and clarified that a SICAR's investments need

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5 See arts 4 and 25 of the SIF Law. This principle applies in respect of each sub-fund.
6 See art.42a of the SIF Law.
7 See art.42(4) of the SIF Law.
8 See art.42b of the SIF Law.
9 As of 31 March 2022 (source: CSSF *https://www.cssf.lu/en/2022/04/global-situation-of-undertakings-for-collective-investment-at-the-end-of-march-2022/*).

to exhibit an enhanced level of risk (beyond mere market risk) and contribute to the development of the portfolio companies which a SICAR holds.

The SICAR is an interesting product dedicated to private equity and venture capital investment and certainly offers tangible advantages. There are however, currently only 216 authorised SICARs which invest approximately €73.458 billion of net assets,[10] and SICARs should be considered as a niche product.

A SICAR may be established as a SICAV or a SICAF, although the abbreviations "SICAV" and "SICAF" are generally not used in the context of SICARs (see "Legal and Organisational Forms" below at para.5-10, et seq.).

III. LEGAL AND ORGANISATIONAL FORMS

Introduction

5-10 As mentioned above, a RAIF and a SIF may be established as a SICAV, a SICAF or an FCP, whilst a SICAR may be established as a SICAV or a SICAF.

SICAV

5-11 A SICAV is a company which possesses separate legal personality and whose capital is always equal to its net assets, i.e. the SICAV's capital increases and decreases automatically as a result of subscriptions or redemptions and variations in its net asset value. This feature facilitates the process of accepting new investor contributions, as well as the redemption of the SICAV's securities by eliminating formal procedures which would otherwise be necessary to increase or reduce the capital of a corporate vehicle, such as the approval of shareholders or the involvement of a Luxembourg notary.

A RAIF, SIF and SICAR in the form of a SICAV may be established as a public limited company (*société anonyme*), an SCA, a private limited company (a *société à responsabilité limitée*, "SARL"), a co-operative company organised as a public limited company (a *société coopérative organisée comme une société anonyme*), an SCS, or an SCSp,[11] all of which are governed by the Companies Law.

A number of differences exist between those legal forms. However, a detailed discussion on these differences is beyond the scope of this chapter.

SICAF

5-12 A SICAF is a company whose capital is fixed and which possesses separate legal personality. Variations in the capital of a SICAF are possible in accordance with certain provisions of the Companies Law. A RAIF, a SIF and a SICAR in the form of a SICAF may be established in any corporate form which the Companies Law permits.

FCP

5-13 An FCP is an undivided co-ownership of assets, established by a contract, known as management regulations (*règlement de gestion*), between the investors in that

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[10] As at 31 March 2022 (source: CSSF *https://www.cssf.lu/en/2022/04/global-situation-of-undertakings-for-collective-investment-at-the-end-of-march-2022/*).

[11] All corporate forms have legal personality except the SCSp.

FCP and a Luxembourg management company (*société de gestion*) which is authorised by the CSSF. An FCP has no legal personality, is not liable for the obligations of its management company and may have sub-funds. Each investor in an FCP receives units in that FCP in consideration for its contribution or subscription to that FCP, and the liability of each such investor is limited to the amount of its contribution or subscription. The rights and obligations of unitholders in an FCP are set out in the management regulations of that FCP and are not subject to any specific corporate law requirements.

IV. UMBRELLA FUNDS WITH MULTIPLE SUB-FUNDS

Unregulated AIFs

5-14 It is only possible to structure a Luxembourg Limited Partnership as an umbrella fund where it is subject to the one of the regulatory regimes described above. Where a Luxembourg Limited Partnership is only governed by the Companies Law and/or subject to the AIFM Directive, it may not be established as an umbrella fund, and it will be necessary to achieve the segregation of assets by forming one or more separate limited partnerships.

Funds subject to a regulatory regime

5-15 Each of the RAIF Law, the SIF Law and the SICAR Law permits the establishment of umbrella funds.[12] An umbrella fund is a single legal entity with one or more sub-funds or compartments where each sub-fund corresponds to a distinct portfolio of assets and liabilities and may have a different investment policy, a different base currency, different types of investors and different terms (for example, with respect to redemption rights and fee arrangements). Each investor selects the sub-fund in which it wishes to invest and, as a consequence, participates exclusively in the gains or losses of that sub-fund. Due to a range of practical advantages, an umbrella structure is frequently chosen and over 65 per cent of all Luxembourg regulated investment funds are established as an umbrella fund.[13]

An umbrella fund, as a whole, constitutes a single legal entity and can therefore only be governed by one specific Luxembourg regulatory regime. It is not therefore possible, for example, to establish an umbrella fund in which one sub-fund is subject to the provisions of the RAIF Law, whilst other sub-funds in that umbrella fund are subject to the provisions of the SIF Law and/ or the SICAR Law.

The various sub-funds of an umbrella fund do not have separate legal personality and, as a consequence, cannot enter into any agreements themselves. It is therefore the umbrella fund (or its management company in the case of an FCP or the general partner in the case of a Luxembourg Limited Partnership) which acts in respect of the sub-fund(s) and concludes any agreements on behalf of the relevant sub-fund(s).

Each sub-fund is only responsible for its own debts and other obligations, unless its constitutional documents provide otherwise. As a result of this ring-fencing, the creditors of a sub-fund will generally only have recourse against the assets of that sub-fund. They will not have recourse to the assets of the other sub-

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[12] See art.49 of the RAIF Law, art.71 of the SIF Law and art.3 of the SICAR Law.

[13] As at 31 March 2022 (source: CSSF *https://www.cssf.lu/en/2022/04/global-situation-of-undertakings-for-collective-investment-at-the-end-of-march-2022/*).

funds of the same umbrella fund and each sub-fund is therefore protected under Luxembourg law from the insolvency of the other sub-funds within the same umbrella fund.

Other advantages of an umbrella structure include the requirement to appoint a single depositary and central administration agent, and carry out a single audit for the umbrella fund (encompassing all sub-funds). This simplifies the operation of that umbrella fund and almost invariably results in lower fees for these service providers, due to economies of scale.

V. KEY PLAYERS

Introduction

5-16 The key players involved in the establishment and operation of a private equity fund in the form of a Luxembourg Limited Partnership are discussed below.

Fund principals and sponsors

5-17 The principles which are set out in Ch.1 apply equally to Luxembourg Limited Partnerships.

General partner

5-18 The general partner of a Luxembourg Limited Partnership has unlimited liability for the debts and obligations of that limited partnership and is ultimately responsible for the management of the limited partnership (although it will typically delegate substantially all of the responsibility for portfolio management to an investment manager for regulatory and practical reasons). Almost invariably, the general partner of a private equity fund will be a private limited liability company which is formed by the principals and/or sponsor of that private equity fund (and will typically be owned by a member of the group of which they form part).

There is no requirement under Luxembourg law for the general partner of a Luxembourg Limited Partnership to be established under Luxembourg law. Any such general partner will, however, typically be a Luxembourg SARL, a limited liability company which is required to have paid up share capital of €12,000 or more under the Companies Law.

Typically, the general partner of a Luxembourg Limited Partnership will hold less than 5 per cent of the interests in that limited partnership in order to avoid the risk of that general partner being regarded as engaging in commercial activity (which would lead to adverse tax consequences under Tax Circular L.I.R. n°14/4 dated 9 January 2015).

It is possible for a Luxembourg Limited Partnership to have more than one general partner.

Limited partner

5-19 The limited partners in a Luxembourg Limited Partnership are responsible for contributing most of the capital to that limited partnership (see generally, "Capital Contributions" in Ch.1). The liability of a limited partner in a Luxembourg Limited Partnership is generally limited to the amount of its commitment to that limited partnership under the limited partnership agreement which governs that limited partnership.

Limited partners may be institutional investors such as endowments, insurance companies, family offices and pension funds. They may also be high net worth individuals who will usually be sophisticated investors. Once committed, a limited partner will generally not be entitled to withdraw from a fund or to transfer its limited partnership interest, although the general partner will usually have the discretion to permit transfers. The emergence of secondary funds (see "Common Terminology for Funds" in Ch.1) has given more scope for limited partners to find buyers for their limited partnership interests.

Since the Companies Law does not contain provisions which govern the withdrawal or transfer of interests in a Luxembourg Limited Partnership, the limited partnership agreement of a Luxembourg Limited Partnership should contain appropriate provisions about those matters.

Limited partners are generally not permitted to control or participate in the management of a Luxembourg Limited Partnership and to do so may prejudice their limited liability (and have other undesirable consequences). Under the Companies Law, limited partners in a Luxembourg Limited Partnership are prohibited from carrying out acts of management vis-à-vis third parties. The Companies Law does, however, specify a number of internal acts of management which a limited partner may undertake in relation to a Luxembourg Limited Partnership without compromising its status and limited liability. Failure to adhere to these constraints may result in that limited partner being liable to persons who enter into contracts with that Luxembourg Limited Partnership.

Investment managers and advisers

The principles set out in Ch.1 apply equally to Luxembourg Limited Partnerships.[14] **5-20**

Advisory and investment committees

The principles set out in Ch.1 apply equally to Luxembourg Limited Partnerships. **5-21**

Key players under the AIFM Directive

These are as discussed below. **5-22**

Alternative Investment Fund Managers

To the extent that a Luxembourg Limited Partnership qualifies as an AIF, it will be required to appoint an AIFM. Depending on the assets under management and the features of the relevant Luxembourg Limited Partnership, the AIFM may be: (i) a Full-Scope AIFM, (ii) a Sub-Threshold AIFM, or (iii) a non-EU AIFM. **5-23**

Each RAIF must be managed by an external Full-Scope AIFM which is established in the EEA. The RAIF Law does not contemplate the internal management of a RAIF and an AIFM which is not a Full-Scope AIFM is not entitled to manage a RAIF. As soon as the marketing passport under the AIFM Directive is available to third country managers, AIFMs that are registered in those third countries would also be able to manage RAIFs.

A SIF may qualify as an AIF whose AIFM is a Sub-Threshold AIFM or a Full-Scope AIFM. A SIF which falls into the former category (other than an FCP) can

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[14] In the Luxembourg context, "managers and advisers" should be understood and read as "investment managers and investment advisers".

be structured as an internally managed sub-threshold AIF or as an externally managed sub-threshold AIF. An externally managed sub-threshold AIF is required under the AIFM Law to appoint an external Sub-Threshold AIFM in order to operate under the de minimis rules of the AIFM Directive. In the case of Luxembourg Limited Partnerships, the general partner often assumes the function of the Sub-Threshold AIFM. A SIF which falls into the latter category must appoint an external authorised AIFM or seek authorisation as an (internally managed) authorised AIFM.

A SICAR may qualify as an AIF whose AIFM is a Sub-Threshold AIFM or a Full-Scope AIFM. A SICAR which falls into the former category can be structured as an internally managed sub-threshold AIF or as an externally managed sub-threshold AIF. An externally managed sub-threshold AIF is required under the AIFM Law to appoint an external Sub-Threshold AIFM in order to operate under the de minimis rules of the AIFM Directive. In the case of Luxembourg Limited Partnerships, the general partner often assumes the function of the Sub-Threshold AIFM. A SICAR which falls into the latter category must appoint an external authorised AIFM or seek authorisation as an (internally managed) authorised AIFM.

Depositary

5-24 Each of the AIFM Directive, the RAIF Law, the SIF Law and the SICAR Law requires the appointment of a depositary.[15] The depositary must either be established in Luxembourg, or if established in another Member State of the EEA, must have a branch in Luxembourg. The depositary must be either a credit institution or an investment firm, which satisfies certain qualitative requirements. For closed-ended funds that do not permit redemptions during a period of five years from the date of the initial investment and generally do not invest in assets which must be held in custody in accordance with the provisions of the AIFM Law or which generally invest in issuers or non-listed companies in order to potentially acquire control over such companies in accordance with the AIFM Law, the depositary may also be a depositary with the status of a professional depositary of assets other than financial instruments (known as "depositary lite").

Central administration

5-25 The Companies Law provides that every Luxembourg Limited Partnership will be governed by Luxembourg law, provided that its central administration (broadly, its head office) is located in Luxembourg. Until evidence to the contrary is brought, the central administration of a Luxembourg Limited Partnership is deemed to be the same as that of its registered office.

In accordance with the applicable law, RAIFs, SIFs and SICARs are required to have their registered office and head office (central administration) in Luxembourg.

Auditor

5-26 Each unregulated AIF which is subject to the full application of the AIFM Law, each RAIF, each SIF and each SICAR is required to prepare and issue audited annual accounts, and as such will need to appoint a Luxembourg auditor.

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[15] See art.19 of the AIFM Law, art.5 of the RAIF Law, arts 16 and 33 of the SIF Law and arts 8 and 48 of the SICAR Law.

VI. FUND ECONOMICS

Overview

The key economic features of a Luxembourg private equity fund are discussed below. **5-27**

Capital contributions

The principles set out in Ch.1 apply equally to Luxembourg Limited Partnerships.[16] In addition, under the Companies Law, a limited partner in a Luxembourg Limited Partnership may make its contribution to that Luxembourg Limited Partnership in cash, in kind or in the form of services. **5-28**

Furthermore, in the case of a Luxembourg Limited Partnership, all distributions, clawbacks, givebacks and escrow or similar arrangements are simply dealt with in the limited partnership agreement which governs that Luxembourg Limited Partnership, and are therefore a matter of negotiation among the partners in that Luxembourg Limited Partnership.

Distributions

The principles set out in Ch.1 apply equally to Luxembourg Limited Partnerships. **5-29**

Waterfall

Luxembourg Partnerships are able to accommodate a wide variety of waterfall models and the description in Ch.1 applies equally in the context of Luxembourg Limited Partnerships. **5-30**

Timing

The timing of distributions by a Luxembourg Limited Partnership will be set out in the limited partnership agreement which governs that Luxembourg Limited Partnership and will often be at the discretion of the general partner, unless that limited partnership agreement provides otherwise (see Ch.1 for further detail). **5-31**

Tax efficient carried interest

In the case of a Luxembourg Limited Partnership, the carried interest will generally be payable to a carried interest vehicle which is an affiliate of the general partner of that Luxembourg Limited Partnership. **5-32**

Management fee

A Luxembourg Limited Partnership will usually pay a management fee to its investment manager, often quarterly in arrears, in accordance with the limited partnership agreement which governs that Luxembourg Limited Partnership. **5-33**

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[16] In the Luxembourg context, "manager" should be understood and read as "investment manager".

Establishment expenses

5-34 The principles set out in Ch.1 apply equally to Luxembourg Limited Partnerships.[17]

VII. FUND DOCUMENTATION

Offering memorandum

5-35 The principles set out in Ch.1 apply equally to Luxembourg Limited Partnerships.

In addition, the AIFM Directive prescribes certain information which must be included in the offering memorandum (or disclosure document prepared under art.23 of the AIFM Directive) for a private equity fund where the AIFM Directive applies to that private equity fund.

Any private equity fund which is subject to a Luxembourg regulatory regime is required to ensure under Luxembourg law that its offering memorandum includes the information necessary for limited partners to be able to make an informed judgment about the proposed investment, and in particular, the risks attached to that investment. In recent years, a range of international regulatory developments have led to a variety of requirements which are typically addressed in the offering documentation of investment funds. Whilst there is no legal requirement to review and update an offering memorandum annually, to comply with new developments, and as a matter of good governance, an offering memorandum should be kept materially clear and accurate (to the extent that the relevant private equity fund issues additional securities or partnership interests to new investors).

Limited partnership agreement

5-36 The principles set out in Ch.1 apply equally to Luxembourg Limited Partnerships.[18]

Any private equity fund which is subject to a Luxembourg regulatory regime is required to include certain information in its limited partnership agreement.

Side letters

5-37 The principles set out in Ch.1 apply equally to Luxembourg Limited Partnerships.

Investment management/advisory agreement

5-38 The principles set out in Ch.1 apply equally to Luxembourg Limited Partnerships.[19]

Subscription booklet

5-39 The principles set out in Ch.1 apply equally to Luxembourg Limited Partnerships.

In addition, a range of anti-money laundering and "know your customer informa-

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17 In the Luxembourg context, "manager" should be understood and read as "investment manager".
18 In the Luxembourg context, "manager" should be understood and read as "investment manager".
19 In the Luxembourg context, "manager" should be understood and read as "investment manager".

tion" must be provided by the prospective investor in order to comply with relevant Luxembourg and EU legislation.

Legal opinion

5-40 It is no longer common practice for the legal adviser to a private equity fund to address a legal opinion to all of the prospective limited partners in that private equity fund. Some large institutional investors may, however, still require such an opinion before investing in a Luxembourg Limited Partnership. Such an opinion would typically address the formation, good standing and capacity of the Luxembourg Limited Partnership and the general partner and the due admission of the limited partners to the Luxembourg Limited Partnership as a matter of Luxembourg law. Such an opinion may also address the limited liability of the limited partners and the tax status of the Luxembourg Limited Partnership under Luxembourg law.

Management team documents

5-41 The relationship between the principals of a private equity fund and the sponsor of that private equity fund will often be governed by the documentation about the ownership and structure of the special limited partner which is entitled to the carried interest from that private equity fund (which might, for example, be another limited partnership, a trust or an offshore entity) (see the "Typical Luxembourg Private Equity Fund Structure" figure above).

That relationship may be complex, in particular with respect to the allocation of that carried interest between the principals, which often include, among other items, vesting, good leaver and bad leaver provisions. These are private and sensitive matters which a private equity fund would rarely make available to its investors.

VIII. REGULATORY CONSIDERATIONS

Introduction

5-42 When establishing a Luxembourg fund, participants need to consider the effect of a wide range of regulatory issues.

The AIFM Directive

5-43 The AIFM Directive is addressed in detail in Ch.1.

Luxembourg

5-44 To the extent that a Luxembourg Limited Partnership opts in to a specific regulatory regime in Luxembourg (see "Regulatory Regimes" above at para.5-6, et seq.), it will need to comply with the requirements of that regime.

Unless a relevant exemption applies, the offering of interests in a Partnership may be subject to the Prospectus Regulation ((EU) 2017/1129) and therefore the law of 16 July 2019 on prospectuses for securities.

The provision of management, advisory and arranging services to a Luxembourg Limited Partnership, an overseas limited partnership or other investment fund and/or any investor in any such limited partnership or other fund in or from Luxembourg are regulated activities under the law of 5 April 1993 on the financial

sector, as amended and only persons which are authorised by the CSSF may carry out those activities, unless an exemption applies.

Marketing private equity funds

5-45 An unregulated Luxembourg Limited Partnership which complies fully with the AIFM Directive may take advantage of the marketing passport under the AIFM Directive for marketing to professional investors, resulting in significant improvements in relation to the ease and efficiency of the relevant marketing and distribution process in the EEA. A Luxembourg Limited Partnership which is managed by a Sub-Threshold AIFM or a non-EU AIFM will not be able to take advantage of the marketing passport under the AIFM Directive. Nevertheless, both types of management arrangements are widely used and familiar to the investor community.

A RAIF benefits from the marketing passport under the AIFM Directive by virtue of being a Luxembourg AIF which is managed by an authorised AIFM, and may be marketed in the EEA to professional investors in accordance with the AIFM Directive without being required to comply with the national private placement regime (if any) in the jurisdiction in which the relevant prospective investor is situated.

Where it is proposed to market interests in a RAIF to a well-informed investor outside the EEA or to a well-informed investor within the EEA who does not qualify as a professional investor, the requirements of the relevant national private placement regime must be observed.

Only a SIF and a SICAR which is managed by an authorised AIFM may benefit from the marketing passport under the AIFM Directive and market interests in that SIF or SICAR to professional investors within the EEA by virtue of the marketing passport under the AIFM Directive. They may also be privately placed, in accordance with relevant local rules, in countries within and outside the EEA.