Luxembourg: New Growth Opportunities for an Expanding Global Funds Industry

Q What are the key trends currently driving development in private equity?

The evolution of the private equity sector during the last four decades has been exponential and is currently valued at approximately US$4 trillion globally. While the sector has faced many challenges and opportunities during this time, there are a number of trends shaping the private equity industry.

COVID-19

COVID-19 has presented much uncertainty and many challenges to the global private equity industry and market perspectives are mixed. However, this uncertainty has offered some private equity firms, who are fortunate enough to have plenty of dry powder, or may have recently completed large closings, a unique opportunity to invest in assets at interesting price points. It also affords private equity firms the opportunity to be closer to their portfolio companies, invest in businesses suffering from the pandemic and demonstrate added value by putting the sizeable amounts of capital they have to work. It would not be surprising, once the economic impact of COVID-19 filters through, to see private equity taking a more active role in the debt markets and continuing a trend, which has been prevalent since the global financial crisis.

Environmental, Social and Governance ("ESG")

ESG issues dominated the regulatory and public arena prior to the outbreak of COVID-19 and increasing numbers of private equity firms have signed up to the United Nation's Principles of Responsible Investing. However, investor appetite is gradually demanding further action on the ESG front in light of growing recognition that performance and value can be enhanced by the inclusion of ESG metrics. In the European Union, the European Securities and Markets Authority (ESMA) has engaged with a response to the European Commission's consultation on the renewed sustainable finance strategy and there is genuine regulatory momentum in relation to ESG across the investment management sphere. As such, private equity firms are coming under increased pressure to incorporate ESG factors into their investment strategies.

Brexit

With the Brexit transition period terminating at the end of this year, private equity firms are keeping a very close eye on the progress of the negotiations between the UK and the EU. Although the outcome of these negotiations remains unclear, many private equity firms are considering their options with respect to ensuring the European market remains accessible to them after 31 December 2020 with some having already taken action by relocating their activities.

Q

How is this playing out in the Luxembourg context?

Luxembourg remains a pre-eminent jurisdiction for private equity investment funds, with unregulated funds (the majority of managers, however, are regulated under the AIFMD). These funds typically invest via wholly owned investment vehicles or directly into the target. The structuring options available to private equity firms are vast and varied and Luxembourg company law allows shareholders or limited partners to tailor the management and general organisation of such vehicles to their specific needs. The fund vehicles most commonly used for private equity include special limited partnerships and common limited partnerships. Where partnerships are used as the fund vehicle, Luxembourg company law allows for significant contractual freedom, including in relation to fund terms, as long as fundamental civil law principles are respected.

Luxembourg partnerships offer the level of contractual flexibility usually associated with Anglo-Saxon partnerships. They have proven to be extremely popular as pooling vehicles for private equity fund firms. With respect to a portfolio company, limited liability companies are the preferred vehicle for private equity firms due to their unmatched flexibility and relatively low associated costs. With regard to unwinding an existing structure or exit strategies, private equity firms will find flexible, straightforward and time efficient options that can be implemented in a cost effective manner by service providers. The range and quality of specialised private equity service providers in Luxembourg has also increased markedly over the last decade or so.

The Grand Duchy of Luxembourg is an agile financial services centre that is cognisant of the trends affecting not only the private equity sector but also the broader financial services industry. It has continued to react expeditiously in order to enhance product offerings, address unexpected challenges, promote sustainable finance and ESG to ensure Luxembourg continues to be regarded as a leading private equity hub that is attractive to EU and non-EU private equity firms and asset managers, most of whom have established their EU hubs in Luxembourg

Q

How are these trends impacting your organisation's objectives?

Luxembourg is a leading European financial services centre and growth in the private equity sector and, more generally, in the alternative space continues to be on an upward trajectory. The Maples Group has a long track record of providing top quality legal, fiduciary and fund services to private equity firms across our various locations. We remain committed to ensuring that our Luxembourg office is a highly successful Luxembourg law practice offering first-class legal, regulatory and tax services.

Furthermore, our fiduciary team has provided corporate governance solutions to clients in this space for well over a decade and our fund services team has extensive experience providing tailored fund administration solutions to Luxembourg vehicles. As such, the continued growth and developments in the private equity sector lend themselves well to the attainment of our organisation's objectives and we play an active role in the industry in Luxembourg.

As private equity firms examine how best to: (i) maintain and enhance their European presence and access to European markets in light of continuing developments with Brexit and third country passporting; (ii) embrace ESG; and (iii) capitalise on opportunities and address challenges presented by the pandemic, many have committed to Luxembourg as a jurisdiction from which they operate and we will continue to support our clients in this regard.

Q What impact has the rise of covenant-light deals had on the private equity sector in Luxembourg?

The use and number of covenant-light deals in Europe has increased over the last number of years. In Luxembourg, parties may agree to a type of covenant-light arrangement, although this does not occur at the same frequency or to the same extent as seen in the US context and certain minimum covenants are typically required in order to ensure the arrangement is enforceable. Due to the relatively low 'take-up' rate, the impact of covenant-light deals has been negligible on the Luxembourg private equity sector.

Q Can you discuss the main factors which will lead to growth in private equity in Luxembourg? Is there anything that could thwart the path ahead?

Luxembourg has taken steps to position itself as Europe's leading location for both private equity fund vehicles and asset-holding vehicles. Luxembourg partnerships – in particular the special limited partnership, or SCSp, and in addition (although to a lesser extent) the simple limited partnership, or SCS – have become the go-to form of entity for private equity pooling vehicles, while private limited liability companies (or SARLs) remain the preferred asset-holding vehicles for private equity funds globally.

Furthermore, the introduction of the AIFMD-compliant Reserved Alternative Investment Fund (RAIF) regime in 2016 has added another available option, and this form is often used by private equity sponsors for pooling vehicles, especially in the context of pan-European (or global) marketing to professional investors and in instances where the pooling vehicle needs to be tax opaque.

Luxembourg also benefits from a strong economy and the best credit rating (it is one of only eleven countries who have earned a triple A rating from all of the recognised rating agencies), a global reputation for investor protection, good and predictable rule of law and a stable political regime where traditional political parties and policy makers, regardless of their position on the political spectrum, have worked together to ensure that Luxembourg remains a business-friendly political environment, conducive to welcoming decision-makers and entrepreneurs and have fostered a well-educated, multi-lingual and diverse workforce. The Luxembourg tax framework is also regarded as one of the most stable and rewarding in Europe for companies, their shareholders and their employees and corporate laws and regulations are modern, flexible and competitive.

Growth in the private equity sector in Luxembourg may to a certain extent, be impeded by the current environment as private equity deals move at a slower pace in light of the inherent uncertainties. However, the nature of COVID-19 means that all areas of the global economy have been affected and the private equity sector in Luxembourg and across the globe is no exception, however it is certainly more robust than most.

Q Given real estate can be expected to struggle due to the pandemic, what changes are you seeing in the market to account for this?

At the time of writing, there have been no new legal or regulatory changes in this context. While it is expected that certain segments of the real estate market (specifically retail and office) will continue to feel the effects of the pandemic, it has been a boon to others (like logistics).

Q Can you outline the primary challenges facing private equity clients in Luxembourg at the moment, and how your services are helping them overcome these difficulties?

COVID-19 was unprecedented and has clearly been the largest challenge the private equity sector has faced this year. While markets have been hit by downturns and recessions in the past, this rapidly changing situation is presenting challenges for private equity firms and private equity fund vehicles globally. The nature of the pandemic, the duration and the ongoing uncertainty means that a forecast on the outlook for the global economy is almost impossible and continued uncertainty around the long-term impact that it will have on the global markets will unfortunately continue for the foreseeable future.

Equally, responsible investing, widely understood as the integration of ESG factors into investment processes and decision-making, has fast become an integral part of the conversation between private equity firms and investors. With the focus on ESG issues growing, certain institutional investors actively pursuing the agenda on sustainable and responsible investing and the introduction of a package of legal and regulatory ESG initiatives and measures, private equity firms, if they haven't already done so, will have to make a concerted effort to integrate ESG criteria into their business and investment decisions.

The Maples Group works with leading private equity firms and institutional investors in Europe, the Americas and Asia and provides individual and tailored advice to all our clients on a range of issues including how to address COVID-19 related challenges impacting their business along with the implementation of ESG policies and frameworks into their operational infrastructure. In addition, we regularly draft articles and client updates and present on a range of topics, including ESG. We also have a dedicated microsite available at https://maples.com/esg, which is publicly available and where we compile all of our ESG related publications and resources.

Q What are the most significant developments you expect within Luxembourg's private equity industry over the coming year?

The challenges and the trends described above will continue to shape the private equity sector in 2021 and beyond. In addition, the private equity industry will be affected by changes in the tax legislation (e.g. the transposition of ATAD 2 and DAC 6 into Luxembourg law, regulatory developments around AIFMD and the resulting obligations for market participants).

Q What are the key objectives over the coming year to ensure Luxembourg remains a competitive global jurisdiction, particularly in terms of the private equity sector?

Despite a number of unknown variables that have the potential to upset the status quo, Luxembourg remains a prominent and stable location for doing business in the EU and beyond. It is Europe's leading private equity fund centre and the second largest onshore private equity fund centre worldwide after the US. Nine of the ten largest private equity firms worldwide are doing business out of Luxembourg. The government, the regulator and industry remain committed to ensure that Luxembourg remains the pre-eminent European location for private equity fund firms.

When it comes to setting up a structure, Luxembourg's efficiency and ease of use within the civil law world is exemplary. It is possible to incorporate companies within a few days and Anglo-Saxon style limited partnerships in very short order, office space is readily available and a wide range of quality and specialised service providers can provide all necessary services. Luxembourg company law offers a wide range of partnership and company options for pooling vehicles and asset holding vehicles alike, each flexible in their own way, to allow the managers, shareholders and limited partners to tailor the terms, management and general organisation of such vehicles to their specific needs.

In order to ensure that Luxembourg remains a competitive global jurisdiction, it will leverage upon its reputation as a pragmatic legal jurisdiction and its existing legal framework. The business-friendly and stable political and economic environment, coupled with the structuring options and workforce will also ensure that it can react expeditiously to changes in the market as and when needed and continue to serve clients from around the globe to the standards they have come to expect.

In Luxembourg, the Maples Group provides full service legal advice through our independent law firm, Maples and Calder (Luxembourg) SARL, which is registered with the Luxembourg Bar.

Funds & Investment Management

Johan Terblanche
+352 28 55 12 44
johan.terblanche@maples.com

Michelle Barry
+352 28 55 12 47
michelle.barry@maples.com