LUXEMBOURG FOR FINANCE

PRIVATE EQUITY

THE FINANCIAL CENTRE DEVELOPMENT AGENCY

CONTENT

LUXEMBOURG, A EUROPEAN PRIVATE EQUITY CAPITAL

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LUXEMBOURG, A EUROPEAN PRIVATE EQUITY CAPITAL

THE RISE OF ALTERNATIVE INVESTMENTS

In the aftermath of the global financial crisis of 2008, and the ensuing long-term low interest environment, alternative forms of financing have flourished as investors have looked for new ways to generate returns. Against a backdrop of rising regulatory pressure, bank lending has retreated, creating the opportunity for alternative assets to fill the gaps. Private equity (PE) has grown significantly as a result, seizing this opportunity in a way that has created momentum in the sector that has not waned since.

PE plays a central role in the European economy; PE-backed companies employ an estimated 10.2 million people across the continent[1]. Following the emergence of the pandemic in 2020, the industry saw a decline in dealmaking and a rise in dry powder as finding appropriate deals became more challenging. However, it has since bounced back, so much so that 2021 saw the global PE industry posting the strongest results since 1980; striking deals worth over €740 billion by the end of Q3 2021 and propelling global M&A activity to an all-time high[2].

A SAFE HARBOUR

Luxembourg has not been stranger to these trends. Building on its unique ecosystem and positioning, the Grand Duchy has become a European hub for the PE industry over the past decade, with its local market expected to grow at least 10% per year up to 2025[3]. Currently, 18 of the 20 largest global PE houses already have operations in Luxembourg[4], with several of them increasingly moving dealmaking and other decision-making roles to the Grand Duchy.

Brexit acted as a catalyst for many investment firms that already had offices in Luxembourg, seeing them shift further operations to the Grand Duchy to maintain access to European markets in the post-Brexit era and consolidate their fund oversight structure in a single jurisdiction. Subsequently, other UK PE firms joined the local ecosystem, partially explaining the increase of AIFM licenses recently observed in Luxembourg.

[1] Invest Europe
[2] Refinitiv
[3] PwC Luxembourg
[4] LPEA

EXPERTISE AND INNOVATION

PE players established in the Grand Duchy benefit from the country's multijurisdictional expertise, its multilingual talent pool, and its multiculturalism which provides significant benefits as they operate across Europe and beyond. This is underpinned by Luxembourg's service provider ecosystem and its unique range of regulated and unregulated vehicles that facilitate investment structuring and create operational efficiencies, all in the context of a well-conceived regulatory framework.

Luxembourg's early implementation of the Alternative Investment Fund Managers Directive (AIFMD) prompted the development of a sizable industry in the field. This has been further bolstered by the introduction of the Limited Partnerships regime - close to the Anglo-Saxon common law investment partnerships - and the Reserved Alternative Investment Fund (RAIF), providing flexibility as supervision takes place at the AIFM level rather than at fund level. Today, the net asset value of all PE & VC funds in Luxembourg is estimated at Euro 690 billion.[6]

PE AND THE POST-COVID WORLD

PE will be pivotal to foster innovation, create new jobs, promote economic growth, and to support the transition towards a greener and more equitable economy. As the largest European fund centre and a leading European PE hub, Luxembourg is ready to take on the challenge and support the funding of a future economy that is both more resilient and sustainable.

[5] LPEA based on Preqin data.
[6] LPEA

DELVING INTO LUXEMBOURG'S PE MARKET

02

DELVING INTO LUXEMBOURG'S PE MARKET

A SNAPSHOT OF PE IN EUROPE

The European PE industry was not immune to the pervasive shock caused by COVID-19 during 2020. While the year started strong, annual fundraising fell by €13 billion compared to the year before, reaching €101 billion. This decline, however, was in line with the deterioration saw in PE fundraising at a global level and across regions. Likewise, PE investments in European companies decreased 12% year-on-year to reach €88 billion across just over 8,000 companies[7]. However, the industry rebounded during 2021, with the year seeing record highs in terms of acquisitions.

The pandemic has also influenced the sectors chosen when searching for deals. Biotech and Healthcare, including Life Science, Information and Communication Technology (ICT), and Renewable Energy were the preferred ones during 2020 and their attractiveness did not vanish in 2021[8].

Prolonged holding periods for portfolio companies was another consequence of COVID-19 as PE houses saw a relative lack of appetite for new investments - which impacted exit multiples. Some market experts state, however, that the effects of the pandemic on the PE industry have receded completely by now.

At the time of writing this report, inflated valuations are an ongoing concern among industry players - even more so given the remarkable year seen for IPOs in 2021. While 2021 started modestly, by the end of Q2 the number of fund launches, and the amount of capital raised had reached the average of the last five years. Despite the acquisition boom in 2021, 2022 starts the year with relatively high levels of dry powder.

[7] Invest Europe.

[8] Invest Europe, in collaboration with Arthur D. Little.

OVERVIEW OF PE FUNDS IN LUXEMBOURG

Luxembourg is the natural choice for PE houses looking to establish operations in Europe. The Grand Duchy has a long-standing expertise in cross-border financial services and the necessary skill set to set up Private Equity and Venture Capital (PE & VC) funds looking to scale up their European and global operations.

Luxembourg's political, economic, and fiscal stability is combined with a business-oriented and predictable regulator, providing a reassuring financial services environment. Its high quality of life is also a draw for the Grand Duchy, gaining importance for all professionals and their families in a world profoundly changed by COVID-19. The combination of all these factors play a significant role in the decision to set up an AIFM in Luxembourg, with the country seeing a significant increase. Indeed, in 2018, 47% of PE firms in the Grand Duchy held such a license while 63% did so in 2021.[9]

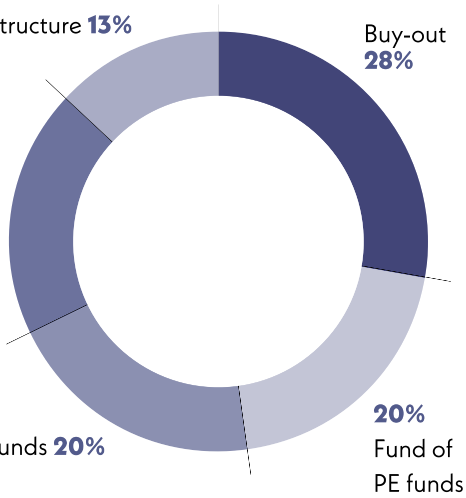
In terms of investment vehicles, there exist a large variety of structuring offerings suitable for all PE & VC projects within the country's ecosystem. Indeed, the toolbox can accommodate a variety of investment strategies, sizes and types of assets, investor profiles and locations, time to market, as well as regulatory, cost and tax considerations.

Alternative asset managers and investors setting up PE & VC funds in Luxembourg also benefit from the country's advanced and competitive tax system, which is aligned with both European and international regulations and best practices. They can also leverage the country's extensive double-tax treaty (DTT) network which encompasses over 99 DTTs in force and over 5 in negotiation.[10]

Given the favourable environment found in Luxembourg, the local PE industry is getting more traction with an increasing number of players from around the globe adding operations into the country. GPs activity undertaken from Luxembourg is well-diversified and split fairly evenly between buy-out, fund of PE funds, debt funds, venture capital, and infrastructure with no clear leading investment strategy. However, the two fastest growing strategies since 2018 have been venture capital and debt with buy-out funds holding the predominant share (30%) of all the current activities undertaken.[11]

[9] LPEA
[10] Administration des Contributions Directes
[11] LPEA

Luxembourg-based GPs investment strategies



Source: LPEA GP Survey 2021

PE firms make extensive use of different vehicles to structure their funds and investments thanks to the toolbox within the country. Unregulated funds continue to see strong growth, with a significant number of new PE funds launched structured as a RAIF or SCSp. Notably, following its introduction in 2016, RAIFs have grown threefold and have become the most frequently used vehicle to structure both PE and other alternative investments funds in Luxembourg[12]. As of January 2022, there were 1,686 accumulated RAIFs and 6,454 active SCSp in Luxembourg[13].

In terms of sector of investment, Luxembourg-based PE houses favour technology-related companies, mirroring what is observed at a European and global level. This is not surprising given the growing focus on technology as a result of the pandemic. Luxembourg PE houses also show significant interest in specialist sectors, such as FinTech; which given the country's role as a launchpad for these companies as well as the continued digitalisation of finance, is understandable.

Linked to the country's role as a leading sustainable finance hub, sustainable-linked investments have grown in popularity in recent years. This growth is likely to continue unabated given the transformation of finance services globally.

[12] LPEA

[13] PwC Luxembourg. Accumulated RAIFs refers to the number of them created over time until a given date. Active SCSp refers to the balance between SCSp registrations and SCSp deletions at a given date.

THE ECOSYSTEM: MAIN ACTORS

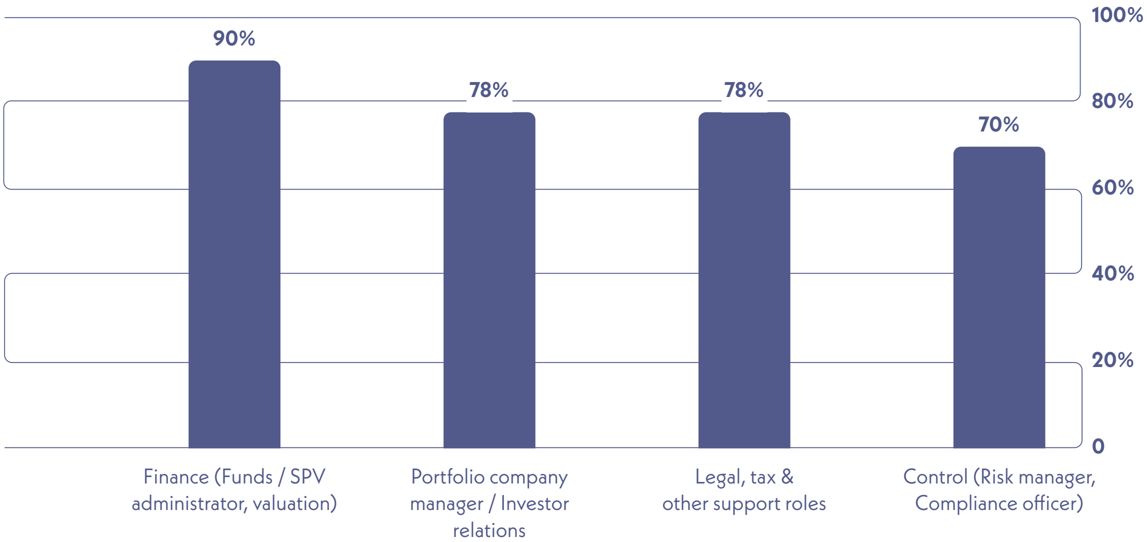
PE HOUSES (GENERAL PARTNERS - GPs)

PE houses set up shop in Luxembourg for a number of reasons, including the stability of the business environment and its comprehensive investment toolbox. Its geographic location is also a major pull. PE requires an active management of investments, meaning oftentimes travelling, for instance, to attend board meetings or to check assets in-situ. Given Luxembourg's strategic location in the heart of Europe, connections are made easier. The multilingual workforce is another significant draw as it allows for easy communication between project sponsors, investors, and other stakeholders in the language of their preference.

As the PE landscape has developed, a notable shift in the type of activities undertaken in Luxembourg has also occurred. The offering includes solutions related to investment structuring, acquisitions, portfolio company management, risk management and compliance, as well as fund administration, valuation, and distribution[14].

As a result, the roles within the country have evolved. While previously considered primarily a centre for back-office activities, recent survey data shows that the majority of GPs base their finance-related roles such as Fund/ SPV administration and valuation in Luxembourg. A large number have also shifted core middle office activities such as risk management, compliance reporting, and due diligence to the Grand Duchy and are also looking at investor relations, fundraising and, for specific practitioners, more deal specialists.[15] A trend relating to greater substance within GP operations has also been observed, with headcount and the use of individual premises, commensurate to business volume, increasing.

Type of roles in Luxembourg-based GPs, 2021



Source: LPEA GP Survey 2021

[14] KPMG Luxembourg
[15] LPEA

"EQT chose Luxembourg as its fund domicile in 2017 and has launched every new private equity fund from here since then. Luxembourg is an integral part of the EU and a well-established jurisdiction for financial services. The country offers a stable and predictable regulatory, tax and political framework for companies with global investors, such as EQT. Given Luxembourg's long history in this field, it is also here you will find the best possible talent and expertise. The Luxembourg AIFM provides EQT's funds with local portfolio management and risk management as well as numerous support functions, such as delegate oversight, accounting and reporting oversight and project management, to name a few."

Peter Veldman,
Deputy Head of Fund Operations & Head of Fund Management,
EQT Fund Management Sàrl

INVESTORS (LIMITED PARTNERS - LPS)

Luxembourg features a vast universe of LPs actively investing in PE, ranging from asset managers and insurers to pension funds and family offices. Given the current low-interest rate environment, asset owners and asset managers have been confronted with the challenge of obtaining higher yields, while continuing to monitor their long-term interests and liabilities. In this context, private equity has emerged as an attractive alternative to traditional investment options.

As of December 2021, Luxembourg alternative managers managed over €170 billion, as of October 2023, in PE & VC strategies in regulated vehicles alone[16]. Likewise, with €5.5 billion invested in PE funds[17], the 80+ life and non-life insurance companies present in the country represent a significant pool of potential PE investors, particularly given their growing appetite for this asset class. Private bankers and Wealth Managers are also proposing to their clients (HNWI and UHNWI[18]) access and exposure to PE via internal vehicles, external partnerships, or digital platforms.

Family offices have, for many years, been extensively investing in alternative assets as well, either through PE funds or by direct investments into private companies. A significant number of family offices have a presence in Luxembourg and their growing exposure to PE serves to strengthen the local LP community.

Given that the global PE AuM is forecast to reach slightly over €9.7 trillion by 2026, from an estimated €4.7 trillion at the end of 2021[19], Luxembourg's LP ecosystem is expected to continue to grow at a rapid rate as investors look to seize the opportunities presented by this asset class.

[16] CSSF

[17] EIOPA

[18] HNWI stands for High-Net-Worth Individual and refers to individuals with at least USD 1 million in liquid financial assets.
UHNWI stands for Ultra High-Net-Worth individual and refers to those with at least USD 30 million in liquid financial assets.

[19] Preqin

Th EIF and European Venture Capital

The Grand Duchy's alternative investment ecosystem is also bolstered by the presence of the European Investment Fund (EIF) - part of the European Investment Bank (EIB) group. The EIF helps Europe's small and medium-sized enterprises (SME) access financing, with the ultimate goal of stimulating the venture capital sector. It also acts as a counter-cyclical investor during market downturns, supporting first-time teams - where uncertainty for other investors is significantly elevated due to the lack of track records.

Even though it manages resources on behalf of European public institutions, the EIF pursues public policy with a market-oriented strategy, co-investing with venture capital firms on the same terms and conditions and seeking a positive return.

Over the last 20 years EIF has built an extensive network, accumulating significant market expertise, and establishing itself as the key public-private European VC investor in Europe. Venture capital firms based in Europe can partner with the EIF and co-invest in highly innovative global and European projects. While the EIF's equity instruments aim to improve the availability of risk capital for high-growth and innovative European SMEs, its debt products support a wide range of financial intermediaries, such as banks, mutual guarantee funds, leasing companies and special purpose vehicles providing funding to start-ups. Therefore, the EIF also provides guarantees and credit enhancement through securitisation to improve the lending capacity of financial intermediaries and thus the availability and terms of debt for beneficiary SMEs.

SERVICE PROVIDERS

Fund administration and distribution

The administration of a fund includes all operational functions such as legal matters, fund accounting, portfolio valuation, regulatory compliance, partnership interests redemptions, among others. These functions become notably more complex when there are cross-border investors and investments – a specialty of the Grand Duchy. Luxembourg law requires some tasks related to fund administration to be undertaken by the fund manager, however others can be outsourced to the wide range of service providers present in the country, which includes both specialist providers for the PE & VC space and international players servicing the overall fund industry. In general, the majority of PE administrators offer an all-encompassing central administration service, including administration, domiciliation, registration, regulatory checks, tax, reporting, and accounting.

Distribution is as central to funds as it is complex. In general, it is an intermediated business with many asset managers delegating their fund sales to a global distributor, who in turn has several sub-distribution networks and platforms for each region and sales channel. In Luxembourg, there are banks specialising in fund services and the provision of their local and international network of relationships, facilitating funds distribution both at intra-group level and to other third-party investors. Large GPs usually draw upon them for pan-European capital raising. Smaller players, however, may only use the National Private Placement Regimes (NPPR) to market their funds, also leveraging on Placement Agents to connect with investors.

"Thanks to its diversified investment toolbox, strong and professional ecosystem, sound and robust regulatory and compliance framework and entrepreneurial mind-set, Luxembourg remains one of the most attractive and secure options for private equity managers and investors.

With over fifty years in Luxembourg and over twenty years administering Private Equity funds and investor portfolios, Luxembourg remains a core part of IQ-EQ's strategy. We take care of all administrative and regulatory aspects of a fund, allowing our clients to focus on their core competencies, while ensuring cost efficiency.

During the recent period of economic turbulence, Private Equity has once again demonstrated its resilience, thanks to its long-term commitment to the real economy. We believe that with its r eputation for service excellence, industry talent and leading technology, Luxembourg is here to stay as a jurisdiction of choice for private equity fund managers."

Riccardo Zorzetto,
Client Relationship Director, Head of Private Equity
IQ-EQ Luxembourg

Depositary banks

In terms of alternative investment funds, a depositary bank has a dual mission: safeguarding the assets and monitoring the lawfulness of activities. However, it may also perform the role of registrar, paying agent, transfer agent and domiciliation agent. Selected closed-ended alternative funds are allowed to nominate non-banking institutions such as a Specialised Professional of the Financial Sector (Specialised PFS) as depositary so long certain conditions are met, however these services are largely provided by banks.

For the PE space, the monitoring element gains relevancy as the depositary does not safekeep the non-financial assets in a physical form. In this regard, the focus will shift to the supervision of compliance and day-to-day administration, including, among others, the oversight of cash flows, subscriptions and redemptions, the monitoring of legal documentation related to deals and acquisitions, and valuations checks.

Banks in Luxembourg are particularly well-suited to provide tailor-made services for PE funds, being reliable in terms of solvency and liquidity. This is further supported by the country's AAA sovereign rating, making Luxembourg a stable location to set up and domicile PE funds.

"The positioning of Luxembourg as a financial centre and the increased demand for alternative asset classes will continue to create significant opportunities. Alternative assets and in particular Private Equity have been one of the major investment themes and a significant growth driver for our Asset Servicing business at UBS.

With the rise of alternatives, UBS as a depositary bank has become even more relevant in implementing safeguards for the protection of investor's interests. As the largest global Wealth Manager and a world-wide Asset Manager, we give access to UBS' resources, while providing the services of a global custodian and fund depositary.

Our unique capabilities in Luxembourg allow us to cater for the needs of institutional, corporate and wealth management clients alike."

Christian Borner,
Head of Asset Servicing
UBS Europe SE, Luxembourg Branch

Audit, tax, and legal firms

Luxembourg hosts a multitude of Luxembourg-born and international audit, law, and tax firms, as well as expert consultants offering world-class services catering for all PE & VC funds needs throughout their lifecycle. Many of them have set up dedicated PE practices, which is underpinned by Luxembourg's multi-jurisdictional expertise as the second largest fund centre in the world and a PE hub within Europe.

ALTERNATIVE INVESTMENT FUNDS MANAGEMENT MODELS

Alternative funds like those used for private equity can be 'self-managed' when the fund product is directly subject to regulation. However, the most common approach in Luxembourg is to appoint an 'external' manager (AIFM) to reduce costs. An AIFM must be authorised to manage regulated AIFs (e.g., UCI part II, SIF, SICAR) and also unregulated AIFs (e.g., SCS, SCSp). Should the AIFM wish to provide investment advisory services, an additional MiFID license is required.

THE THIRD-PARTY MANCO OR AIFM

Alternative asset managers looking to domicile funds in Luxembourg for fundraising across the EU, however that are not yet ready or willing to create their own local oversight structure and incur in set-up costs, can also opt for the 'third-party management' model. In this scenario, the fund distribution and oversight activities are performed by a third-party Management Company or AIFM whereas investment management remains the responsibility of the investment manager.

Asset managers looking to launch only a few alternative funds in Luxembourg can, depending on their legal form, also opt for setting up a sub-fund in an existing umbrella fund structure managed by a third-party management company. This can be a cost-effective solution for smaller or non-European players looking to domicile and distribute funds via Luxembourg with the support of a well-known brand.

"Over the last decade, Luxembourg has emerged as one of the most important hubs for private equity fund domiciliation, capital raising and transaction activity. Many managers who have previously launched funds in offshore jurisdictions, are now looking to come onshore to Luxembourg, often at the behest of their investors. This is not a trend limited to the private equity space, although the structures available and range of service providers in Luxembourg mean that the jurisdiction offers a particularly attractive option to managers.

ManCos and Authorised AIFMs continue to draw the spotlight in Luxembourg, with regulation driving demand, competition, and consolidation. Over the last year, the pandemic has created unforeseen challenges for asset managers and their providers alike. Adding the complexity of Brexit, and many private equity funds need to guarantee that they have access to the European market to be able to raise capital, which Luxembourg facilitates. For this reason and others, we see the Grand Duchy as well positioned as a global financial services centre and the growth our business in Luxembourg is a key strategic priority for us in 2022 and beyond."

Xavier Parain,
Head of FundRock

AUTHORISED AND REGISTERED AIFM

In order for unregulated AIFs to be marketed across the EU, the AIFM must be authorised. In order to be authorised and thus benefit from the EU 'manager' passport, the AIFM must obtain a license from the regulator of the hosting European member state.

Smaller AIFMs can also choose, however, a simple registration – also referred to as a 'Light AIFM'. AIFMs which are 'below-threshold', in terms of assets managed, can thus opt for registration as they are exempt from many requirements, for example, the need to appoint a depositary. However, they do not benefit from the EU passport. The threshold for registration is €500 million or €100 million if leveraged. If these thresholds are exceeded, or if the registered 'Light AIFM' wishes to obtain the EU passport under the AIFMD, it is required to opt in and obtain an authorisation from the regulator.

The set-up of an unregulated AIF with a 'registered' AIFM is significantly more cost effective and quicker than setting up an authorised AIFM or adopting the third-party management company model. Additionally, it does not preclude the asset manager from upgrading the AIFM at a later stage by obtaining the necessary authorisations from the regulator.

Source: PwC ManCo Barometer 2021

Top 10 Luxembourg Authorised AIFMs (Dec 2023)

RANKING	ManCo	Country of the Group	Overall AuM in € million (Dec-23)*
1	EQT Fund Management S.à r.l.	Sweden	124,320
2	Universal-Investment-Luxembourg S.A.	Luxembourg	102,205
3	Hauck & Aufhäuser Fund Services S.A.	Germany	93,108
4	Carne Global Fund Managers (Luxembourg) S.A.	Luxembourg	69,822
5	Blackstone Europe Fund Management S.à r.l.	UK	59,733
6	M&G Luxembourg S.A.	UK	43,668
7	Alter Domus Management Company S.A.	Luxembourg	36,258
8	Sanne LIS S.A.	Luxembourg	35,318
9	Flossbach von Storch Invest S.A.	Germany	24,395
10	UBS Fund Management (Luxembourg) S.A.	Luxembourg	22,325

*this figure includes PE and other alternative investments strategies

Source: PwC ManCo Barometer 2023

DRIVERS FOR FUTURE DEVELOPMENT IN PE

03

DRIVERS FOR FUTURE DEVELOPMENT IN PE

THE DEMOCRATISATION OF PE

Providing retail investors with greater access to PE-related investments is an ongoing topic of discussion across geographies and on various levels of the industry. While the asset class has historically been reserved for qualified investors (e.g., institutional and professional investors), regulators, associations, and fund managers are examining how best to accommodate a greater retail investor participation.

Drivers for this push include the strong performance seen within the private markets compared to public markets in recent years. Alongside this, retail investors are searching for additional ways in order to diversify their portfolios to combat persistently low interest rates, uncertainty, and inflated stock valuations.

A number of options exist for retail investors, with varying degrees of suitability depending on the investors' needs.

- Feeder funds investing in larger private equity funds can be particularly useful, notably as they could allow subscriptions in amounts commensurate to retail investors - depending on the legal form they take.
- The European Long-Term Investment Fund (ELTIF), which is currently under revision to remove certain entry barriers for retail investors, will be another way of channelling private capital into long-term projects - including investing in private companies.
- Special Purpose Acquisition Companies (SPACs) would be a third option. Providing private companies a fast-track and cheaper route to public listing, PE houses have been increasingly leveraging on SPACs as an additional mean of fundraising. This gives retail investors the opportunity to gain greater exposure to this asset class as SPACs are generally accessible to a broad range of potential investors.

This move, however, does not come without risks. A high level of financial literacy would be required to understand PE's various technical complexities, including the illiquidity attached to PE investments and the fund's fee structure. At the time of writing this report, the perception of a possible correction in a market marked by unprecedented central banks aid and highly leveraged transactions adds to the challenge of protecting retail investors.

ESG & PE

The integration of Environmental, Social and Governance (ESG) factors into the investment and decision-making processes in the private equity sector has increased exponentially in recent years. In Luxembourg, more than 80% of PE houses consider ESG a key topic for their future investment and marketing strategy. The same proportion claim to have already set up an ESG policy and has committed to incorporate non-financial reporting linked to ESG in the short run.[20]

As the appetite for ESG products grows among investors, many PE firms are adapting their investment strategy to remain competitive. In line with the overall trend when assessing the three pillars of ESG, environmental factors are a clear issue being addressed given the pressing nature of the crisis faced around the globe, with PE houses being no exception.

In fact, initiatives related to climate change or eco-efficiency are already popular within PE firms' responsible investing strategy, and we see new factors related to the ″S″ pillar coming to the fore, such as diversity and gender balance, where the PE industry lags behind. Likewise, the "G" pillar is slowly but surely coming under the spotlight, for example considering the relatively small number of women holding management and board positions. With the Sustainable Finance Disclosure Regulation (SFDR) requiring companies to disclose how ESG forms a part of their investment process, many PE houses have made diversity issues their priority and have started taking concrete actions including recruiting women and building diverse teams.

[20] LPEA

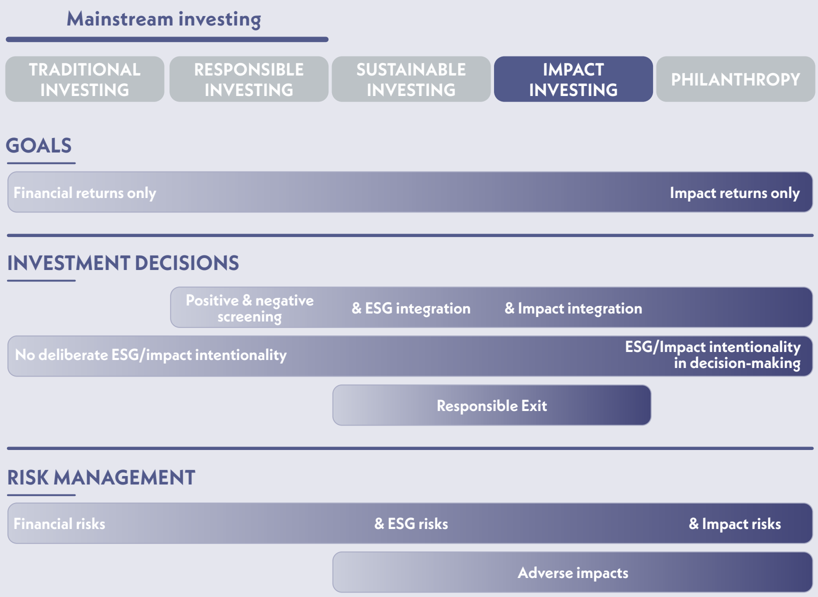
CASE STUDY: INNPACT S.A.

ESG & IMPACT INTEGRATION IN THE INVESTMENT PROCESS OF A PE FUND

Luxembourg-based **Innpact** supports Private Equity (PE) fund managers, among others, to strengthen their fund's Environmental and Social (E&S) practices. It does so by (i) ensuring consistency between the fund's mission and sustainability objectives in alignment with the UN SDGs, (ii) integrating impact criteria into the due diligence and investment decision process, (iii) designing a robust ESG & Impact risk framework, and (iv) by integrating sustainability and impact indicators within portfolio management as well as in monitoring and reporting practices.

PE funds are thus recommended to fully integrate positive impact generation into their structure on a progressive level – from the fund's governance to investment strategy, financial model and reporting indicators. This requires full active participation from top management and a strong alignment with investee companies. **Innpact** can provide support during the pre- & post-closing phase to ensure alignment with regulatory and reporting requirements with various levels of involvement ranging from compliance and internal trainings to acting as Impact & Sustainability Advisor.

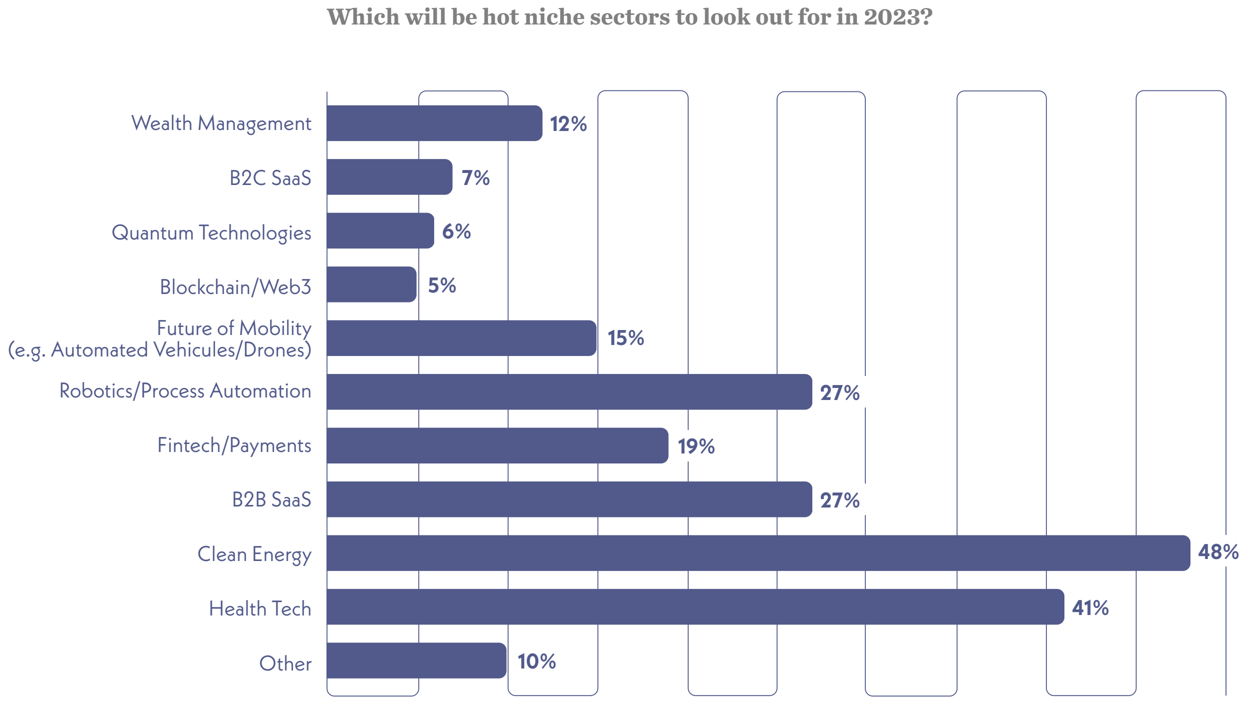
Similar to Sustainable Funds, Impact Funds integrate sustainability risks within their investment process while also considering impact risks and presenting a clear intent of generating positive impact (see table below). Impact investments currently represent only 1% of total European assets' allocation, but demand is rising: investors are increasingly targeting more ambitious impact strategies, which also bring lower volatility, risk reduction, and increased accountability. By embracing impact investments, PE firms can deliver value to investors and the society at large, while sourcing new investment opportunities.



INNOVATION & PE

PE plays an important role in directing capital into innovative projects, as well as a mentorship function to help increase the odds of start-ups succeeding. Moreover, particularly in the post COVID-19 context, the anticipated continued growth of the tech sector will likely prove to be a key draw for PE firms. According to S&P's 2021 Global Private Equity Outlook, 51% of surveyed firms expect to primarily focus on opportunities in Information Technology in the coming 12 months.

Sector Focus



Technology is not only a key focus for PE investments, but also within the operations and decision-making processes of GPs, playing an integral role in modernising internal functions and identifying value in terms of investments.

CASE STUDY: APOLLONIAN S.A.

Founded in 2017, **Apollonian** is a Luxembourg-based software-as-a-service company harnessing technology and data to provide comprehensive company analysis and multidimensional valuation solutions. **Apollonian**'s flagship platform, *Insight*, integrates organisations internal and external value-generating factors and revenue-driving assets, including intangibles, to produce a transparent and realistic third-party assessment of the present and future company value. Most recently, **Apollonian** has expanded its product offer by partnering with Modefinance, an Italian fintech company, to deliver ESMA certified credit rating and credit scoring services. By leveraging artificial intelligence and predictive analytics Apollonian is now capable of evaluating more than 250 million companies worldwide.

Striving to close information gaps existing in the private equity market and facilitate investment decision-making, **Apollonian** solutions cater for private portfolio managers helping them to identify relevant transaction leads, improve their deal flow management, due diligence processes and portfolio management. It also helps companies seeking to raise capital, mitigate risks and boost growth.

Apollonian expertise in intellectual assets valuation considers key elements such as intellectual properties & rights, trademarks, R&D capabilities, knowledge carriers and human capital skillsets – assets that show if a company will be able to survive and prosper in a competitive environment over the long haul.

The Digital Tech Fund was created in 2016 as part of Luxembourg's commitment to strengthening the Grand Duchy's digital innovation ecosystem in areas such as Cybersecurity, Big Data, Fintech, Internet of Things, Digital Health, and Satellite-based information & Communication Technologies. Managed by Expon Capital and supported by contributions from the Luxembourg government, Société Nationale de Crédit et d'Investissement (SNCI), the University of Luxembourg, and others, the fund brings together public and private partners to provide seed financing to start-ups within Luxembourg and acts as a catalyst for the launch of innovative companies.

A joint initiative between the Luxembourg government through its SNCI and the European Investment Fund (EIF) also gave birth to The Luxembourg Future Fund. This €150 million fund invests directly or indirectly in Venture Capital funds and in innovative SMEs active in areas considered key for the diversification of the Luxembourgish economy such as ICT, Cleantech and other technology sectors - excluding health technologies and life science.

"Venture Capital is the lifeblood of the most ambitious start-ups and the catalyst of Europe's biggest high-tech successes. European VCs have contributed to the development of over 100 unicorns (start-ups worth over €1 billion) in the last 7 years from just a few until then, generating dozens of billion in profits to investors. It is therefore no surprise that, over the last decade, we've seen a 500% increase in funds raised by European VCs.

Most recently, cloud technologies have demonstrated their resilience and contribution to society through difficult times. Combine VC's proven capacity to solve big problems with a rising sense of climate urgency and you have a recipe for a further strengthening of the investment case for venture-backed innovation. The world needs solutions, rapidly. That's what we're working on at Expon Capital with our Growth and Seed funds. Our Seed fund, the Digital Tech Fund, has been supporting Luxembourg Seed stage startups by backing the cream of the local crop."

Jérôme Wittamer,
Managing Partner,
Expon Capital

REGULATION AND SUPERVISION

04

REGULATION AND SUPERVISION

AIFMD IMPLEMENTATION

Luxembourg was one of the first countries to transpose the Alternative Investment Fund Managers Directive (AIFMD) in July 2013. The regulation targets non-retail fund managers with operations across the EU and sets out a wide array of provisions regarding authorisation, operating conditions, reporting, supervision, and cross-border marketing of Alternative Investment Funds (AIFs).

Private equity funds are included within the scope of this regulation and its adoption was a significant growth factor for the PE industry, as Luxembourg-domiciled PE funds managed by a licensed Alternative Investment Funds Manager (AIFM) are able to be passported throughout the EU. A legislative proposal containing amendments to the AIFM Directive was recently published for further discussions at the European Parliament and the EU Council. As of December 2021, the number of authorised AIFMs in Luxembourg totalled 261 entities, many of which are active in the PE space.[21]

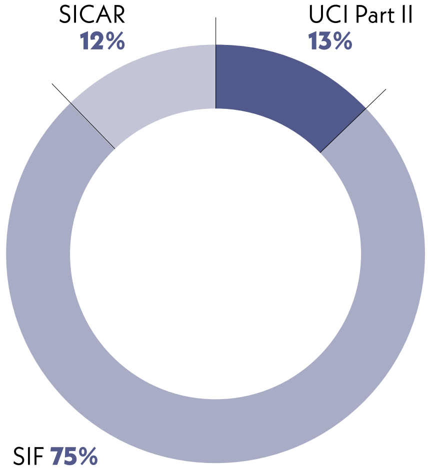
[21] CSSF

DIRECT REGULATION AND INDIRECT SUPERVISION

Luxembourg offers a range of AIF vehicles which are directly regulated and subject to the prior authorisation and ongoing supervision of the CSSF. These are:

- The *Société d'Investissement en Capital à Risque (SICAR)*, dedicated to investments into risk capital, such as private equity or venture capital.
- The *Specialised Investment Fund (SIF)* for investment into all asset classes.
- The "*UCI Part II*" fund, which stemmed from the UCITS implementation in Luxembourg and can be used as an investment vehicle for a wide range of asset classes.

Breakdown according to law and part applicable, December 2021



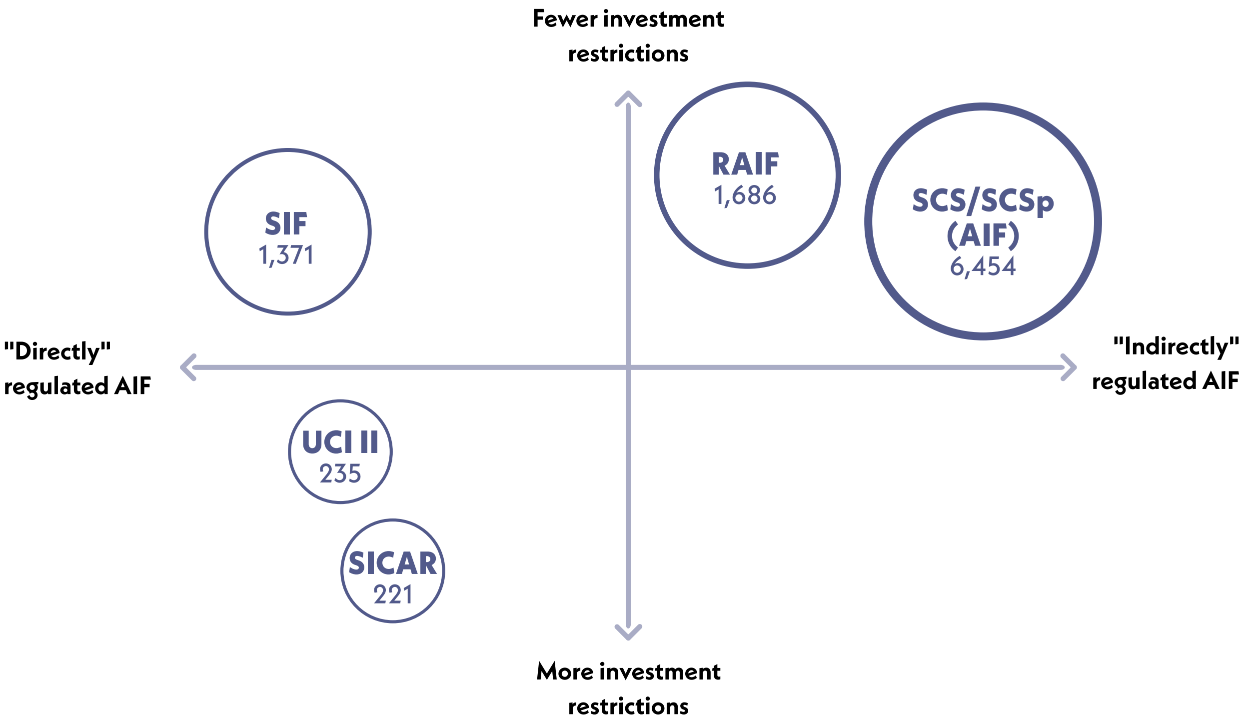
	FCP	SICAV	Other OPC / SIF	SICAR	Total
UCI Part II	110	123	2	0	235
SIF	292	1,039	40	0	1,371
SICAR	0	0	0	221	221
Total	**402**	**1,162**	**42**	**221**	**1,827**

Source: CSSF

In addition to these directly regulated approaches, the Luxembourg toolbox also includes a number of vehicles which are indirectly supervised, i.e., where supervision takes place at an AIFM level rather than at the fund level. Structures supporting this approach include:

- **The Reserved Alternative Investment Fund (RAIF)**: From an investment flexibility perspective the RAIF is identical to a SIF, however, has a quicker time to market as it is not subject to direct authorisation and supervision by the CSSF. RAIFs must appoint an 'authorised' external AIFM and is therefore 'indirectly' supervised via its regulated AIFM. The appointed AIFM or third-party manager can market RAIF shares, units, or partnership interests via the EU passport to well-informed investors across EU (both institutional and professional investors). The RAIF also allows for the creation of umbrella structures with ring-fenced sub-funds (compartments).
- **Limited Partnerships (LPs)**: Luxembourg revised its limited partnership regime in 2013, launching two limited partnerships based on the Anglo-Saxon regime: the Société en Commandite Simple, known as a common limited partnership or 'SCS'; and the Société en Commandite Spéciale, known as a special limited partnership, or 'SCSp'. Founded on the principle of contractual freedom, allowing parties to contract on whatever business terms suit them best, the core differentiating factor between the two is that the SCSp does not have legal personality (like an English limited partnership) while the SCS does (like a Scottish limited partnership). Luxembourg LPs can be used as a regulated AIF, and, if they qualify as such, can be marketed across Europe via financial services passporting and structured as an umbrella fund with segregated compartments, depending on their legal form.

Overview of Luxembourg's toolbox



Sources: ALFI, CSSF, PwC, RCS

AUTHORISATION PROCESS WITH THE REGULATOR (CSSF)

The CSSF is responsible for the authorisation and ongoing prudential supervision of directly regulated AIFs, as well as AIFMs established in Luxembourg and authorised under the AIFM legislation.

AUTHORISATION

The application file must be submitted digitally together with all required documentation through the CSSF ad-hoc eDesk portal. The regulator not only accepts the filing of applications with the related legal documentation in many languages - including English - but also welcomes any business communication in English.

The CSSF blends its long-standing cross-border funds expertise with responsiveness, as well as a long track record in financial innovation making it a reliable and solid partner for PE players with global ambitions.

For smaller AIFMs, a simple registration with the regulator is required. Accordingly, AIFM 'below-threshold' (managing no more than €500 million or €100 million if leveraged) can opt for a simple registration. A registered AIFM cannot, however, market its funds across the EU unless it opts in for authorisation under the AIFMD full regime or complies with the less burdensome European Venture Capital Funds (EuVECAs) or European Social Entrepreneurship Funds (EuSEFs) passport regimes.

UNREGULATED STRUCTURES

It is possible for Limited Partnerships (LPs) to be unregulated. Unregulated Luxembourg LPs are particularly interesting for smaller funds or first time funds which do not require an EU passport in the beginning.

In this case, the fund would need to appoint an external AIFM, either registered or authorised. Unregulated approaches include:

- **Limited partnerships (SCS or SCSp)**: The main feature of unregulated Luxembourg LPs is contractual freedom, making them particularly flexible and suitable for smaller or starting GPs to structure global acquisitions and use as a co-investment or carry vehicle. Luxembourg LPs are particularly efficient for structuring close-ended funds investing in illiquid assets. However, Luxembourg LPs are tax transparent and therefore cannot access DTT benefits. Accordingly, tax opaque holding vehicles may be more appropriate in certain circumstances.
- **Holding vehicles**: The most common structure in Luxembourg is the Société de Participations Financière (SOPARFI). SOPARFIs are used to invest and manage financial participations in Luxembourg or foreign companies and can also undertake commercial activities directly or indirectly connected to the management of their holdings – e.g., acquisition debt servicing. Should the SOPARFI take the form of a corporate entity, it benefits from Luxembourg's advantageous participation exemption regime in conformity with the EU Parent-Subsidiary Directive and Luxembourg's vast DTT network.

EU-WIDE ALTERNATIVE INVESTMENT REGULATIONS

There are also pan-European regulations directly applicable across all EU member states, including Luxembourg. These regimes are particularly interesting for 'registered' AIFM, providing them with an EU passport to market alternative funds across Europe without the need to meet the 'above-threshold' requirements for authorisation as set out in the AIFMD. However, in order to obtain a passport under these regimes, below-threshold AIFM are required to fulfil specific conditions regarding their investment policy, portfolio composition, diversification, and asset types.

EU Venture Capital Funds Regime (EuVECA)

EuVECA creates an optional regulatory framework tailored to the needs of venture capital companies focusing on early-stage investments and facilitating capital raising across Europe. The EuVECA label provides small VC companies with a "registered" AIFM the possibility to obtain the EU passport to market the fund across the EU. The EuVECA regime is less burdensome than having to comply with AIFMD requirements for the AIFM authorisation and no depositary is required.

EU Social Entrepreneurship Funds Regime (EuSEF)

This regime covers AIF that focus on social enterprises. The EuSEF label provides eligible AIF managers with EU passporting, so long their investments are focused on undertakings that have positive social impacts as their primary corporate objective.

A notable aspect is that "registered" AIFM focusing on social investments can apply for the EU passport under the EuSEF without the need to comply with AIFMD authorisation requirements. No depositary is required under this regime.

EU Long-Term Investment Funds Regime (ELTIF)

The ELTIF is a pan-European regime for AIF allowing investors to invest into private companies and projects in need of long-term capital, e.g., infrastructure projects. In case of ELTIFs, however, the fund must be managed by an authorised AIFM, which already benefits from the EU passport under the AIFMD. Amendments to the ELTIF Regime seeking to increase the uptake of this vehicle across the EU are under discussion at the time of publishing this report. Since its inception in 2015, only 57 ELTIFs (26 domiciled in Luxembourg) were launched managing just €2.4 billion.

ANNEX

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ANNEX

Luxembourg's PE vehicles: comparative table

	"Directly" regulated AIF			"Indirectly" supervised AIF & unregulated vehicles			
	UCI Part II	**SIF**	**SICAR**	**RAIF**	**Securitisation vehicle**	**Unregulated SCS/ SCSp**	**Standard Luxembourg corporates**
European passport	Yes	Yes	Yes	Yes	No, unless it falls under the scope of the AIFMD regime.	No, unless it falls under the scope of the AIFMD regime or the EuVECA or EuSEF regimes.	No, unless it falls under the scope of the AIFMD regime or the EuVECA or EuSEF regimes.
Authorisation and supervision by the CSSF	Yes	Yes	Yes	No authorisation required but the RAIF is indirectly supervised from the CSSF via its AIFM.	No (unless continuous issues of securities to the public).	No	No
AIFM registration regime	Possible.	Possible.	Possible.	No	Possible.	Possible.	Possible.
Capital requirements	› **FCP**: €1.250.000 to be reached no later than 6 months following the authorisation by the CSSF. › **Self-managed SICAV / SICAF**: €300.000 at the date of authorisation and €1.250.000 within 6 months following its authorisation.	€1.250.000 to be reached no later than 12 months following the authorisation by the CSSF	€1.000.000 to be reached no later than 12 months following the authorisation by the CSSF.	› **FCP**: €1.250.000 to be reached within 12 months from the entry into force of the management regulations. › **SICAV**: €1.250.000 to be reached within 12 months from the incorporation of the SICAV.	If the securitisation vehicle is set up as a company, it depends on the form: › **SA / SCA**: €30.000 › **Sàrl**: €12.000 › If the securitisation vehicle is set up as a fund, there is no minimum capital requirement.	No minimum capital requirement	Depends on the form: › **SA / SCA**: €30.000 › **Sàrl**: €12.000 No minimum capital requirement for other legal forms.
External authorised AIFM requirement	Required in case the entity is an AIF that is not self-managed and above the AIFMD threshold.	Required in case the entity is an AIF that is not self-managed and above the AIFMD threshold.	Required in case the entity is an AIF that is not self-managed and above the AIFMD threshold.	Always required.	Required in case the entity is an AIF that is not self-managed and above the AIFMD threshold.	Required in case the entity is an AIF that is not self-managed and above the AIFMD threshold.	Required in case the entity is an AIF that is not self-managed and above the AIFMD threshold.
Umbrella structure	Yes	Yes	Yes	Yes	Yes	No unless the entity is a regulated AIF (e.g., SIF, SICAR)	No unless the entity is a regulated AIF (e.g., SIF, SICAR)
Eligible investors	Unrestricted.	Well-informed investors.	Well-informed investors.	Well-informed investors.	Unrestricted.	Unrestricted.	Unrestricted.
Eligible assets	Unrestricted. The investment objective and strategy of the fund is subject to the prior approval of the CSSF.	Unrestricted.	Restricted to investments in securities representing risk capital.	Unrestricted, unless it invests in a portfolio of risk capital (such as a Sicar).	Unrestricted.	Unrestricted.	Unrestricted.

USEFUL CONTACTS

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USEFUL CONTACTS

PUBLIC SECTOR & INDUSTRY ASSOCIATIONS

Luxembourg Government
www.gouvernement.lu

Ministry of Finance
https://mfin.gouvernement.lu

Ministry of Economy (Invest in Luxembourg)
www.investinluxembourg.lu

Luxembourg for Finance (LFF)
www.luxembourgforfinance.com

Luxembourg Private Equity and Venture Capital Association (LPEA)
www.lpea.lu

Association of the Luxembourg Fund Industry (ALFI)
www.alfi.lu

The Luxembourg Bankers' Association (ABBL)
www.abbl.lu

Luxembourg House of Financial Technology (LHoFT)
www.lhoft.com

Luxembourg Association of Family Offices (LAFO)
www.lafo.lu

Luxembourg Insurance and Reinsurance Association (ACA)
www.aca.lu

Fondation de Luxembourg
www.fdlux.lu

Chamber of Commerce
www.cc.lu

Luxembourg Business Federation (FEDIL)
www.fedil.lu

Luxembourg Sustainable Finance Initiative (LSFI)
https://lsfi.lu

REGULATORS

Luxembourg Financial Services Regulator (CSSF)
www.cssf.lu

Luxembourg Insurance Regulator (CAA)
www.caa.lu

LEARNING AND DEVELOPMENT

House of Training
www.houseoftraining.lu

The University of Luxembourg
www.uni.lu

SOCIAL

Guichet
https://guichet.public.lu

Just Arrived
www.justarrived.lu

atHome (Property Search)
www.athome.lu

Caisse Nationale de Santé (CNS)
www.cns.lu

Meetup
https://www.meetup.com/cities/lu/luxembourg/social/

ABOUT LUXEMBOURG FOR FINANCE

Luxembourg for Finance (LFF) is the Agency for the Development of the Financial Centre. It is a public-private partnership between the Luxembourg Government and the Luxembourg Financial Industry Federation (PROFIL). Founded in 2008, its objective is to develop Luxembourg's financial services industry and identify new business opportunities.

LFF connects international investors to the range of financial services provided in Luxembourg, such as investment funds, wealth management, capital market operations or advisory services. In addition to being the first port of call for foreign journalists, LFF cooperates with the various professional associations and monitors global trends in finance, providing the necessary material on products and services available in Luxembourg. Furthermore, LFF manages multiple communication channels, organises seminars in international business locations, and takes part in selected world-class trade fairs and congresses.

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