

Private equity in Luxembourg: the offer, challenges and opportunities

The private equity industry is currently facing one of its most challenging times. Fundraising activity is slow, reaching a final close continues to be a long road for many fund managers and the AIFMD (and other new legislation including FATCA and Dodd Frank) increase the regulatory burden. There is also continued uncertainty as to how the AIFMD will look, and whether it will be suitably adapted for private equity and what the additional costs to the industry will be. So, what are the implications for Luxembourg?

Competition between jurisdictions to attract those funds which are coming to the market is intense and this means Luxembourg needs to ensure it has a competitive offering. Luxembourg's EU member status has attracted fund managers with a European investor base, composed primarily of large institutional investors including pensions and insurance companies, in the light of the AIFMD and associated questions around third country provisions, passporting and equivalency. This has certainly been our experience. Ips is a specialist private equity fund services firm. We established an office in Luxembourg in 2009 and our rationale for coming here was very much client driven. Demand has been primarily for the holding structure (Soparfi) that sits below private equity funds at the asset level and are driven by fund managers looking to benefit from Luxembourg's double tax treaties. We have also seen a handful of clients wishing to establish a Luxembourg fund structure as requested by particular institutional EU investors.

The Luxembourg offering

Better known for its UCITS funds industry, Luxembourg has grown and diversified in recent years and in doing so is building a formidable reputation as a hub for asset level holding structures to private equity. The regime has not yet established itself as a leading centre for private equity funds despite efforts to attract this industry. The journey began in 1990 with the increasing use of the unregulated Soparfi structure, of which there are now in excess of



30,000. Since then, Luxembourg has aimed to attract the private equity industry with the introduction of the SICAR (Investment Company in Risk Capital) and the SIF (Specialized Investment Fund).

These regulated structures were well received by fund managers of all asset classes. According to statistics released in March, there are now 271 SICARs and 1,305 SIFs registered with the Commission de Surveillance du Secteur Financier ("Cssf"). This represents a 19% increase year-on-year in the number of SIFs and an 18% increase in net assets bringing the total to 226.8bn. The share of these funds that relate to private equity cannot yet be determined. Luxembourg also reached out globally and now has access to more than 60 double tax treaties. Additionally the parent-subsidiary directive eliminates double taxation of dividends paid by a subsidiary in one member state to a parent company in another member state.

The Advantages of SIF and SICAR Structures

Both structures benefit from consolidation exemptions, are reserved for "well-informed" investors and can have a variable capital base and a multi-compartment structure. Management services rendered to SIFs and SICARs are also VAT exempt. The Cssf supervises SIFs and SICARs with a lighter touch than other regulated vehicles. This satisfies investor demands for corporate governance whilst also giving fund managers flexibility. SIFs and SICARs require the services of a central administrator, an independent auditor and a custodian bank. SIFs and SICARs have required these services since their launch in 2007 and 2004 respectively.

With independent depositaries being a feature of the AIFMD, Luxembourg has the advantage of an established pool of experienced providers of custodian services for private equity. The AIFMD requires EU credit institutions to act as depositary, though also permits professional firms including law firms, accountants and administrators to act as depositaries where a fund is closed to investor redemptions for a

period of 5 years and where the fund trades non-custody assets such as shares or loans of privately held companies. This AIFMD requirement would reduce an advantage of non-EU funds that today do not require a custodian. By introducing this new requirement across the EU, Luxembourg stands to gain – although ultimately at the unfortunate and unnecessary additional cost to investors and pension stakeholders.

Challenges and opportunities

Luxembourg's regulatory environment, skilled workforce and legislative framework have attracted the likes of Carlyle, KKR, PAI, CVC, Partners Group and 3i. However, there cannot be any room for complacency or inertia in the increasingly competitive funds space. The Netherlands continue to grow a double-taxation treaty network of over 79 agreements signed, increasing competition with Luxembourg.

Malta continues to position itself as an EU funds destination of choice with a lower cost and well educated labour force along with its Anglo Saxon connections and shared cultural heritage with the United Kingdom. Private equity specific infrastructure has developed alongside this growth. Notably, recent years have seen an influx of specialist administrators and the establishment of the Luxembourg Private Equity Association, which now has over 70 members. The mission of the LPEA is to represent and promote the interests of Private Equity and Venture Capital players based in Luxembourg, to support government and private initiatives to enhance the attractiveness of Luxembourg and to represent the interests of its members and the industry as well as Luxembourg as a place of doing PE business towards relevant international PE industry bodies.

These developments will help to perpetuate the jurisdiction's success as the industry works together to address challenges and generate opportunities. One of the next challenges for Luxembourg will be the implementation of the AIFMD. While industry bodies consider Level II measures and in recent weeks have responded to the ESMA consultation, the Duchy stands to benefit from its funds industry experience and ability to adapt quickly to new requirements. For instance, the draft bill concerning amendment of the SIF law will bring it into line with AIFMD requirements through addressing subjects such as risk management, conflicts of interest and delegation.

However, these are just a few elements and the whole Directive will need to be translated into Luxembourg law appropriately. The depositary function is an

essential piece of the jigsaw and is unique in Luxembourg for private equity funds and might appear more restrictive for some type of assets. Luxembourg will therefore need to ensure that it stays abreast of developments on this front in order to avoid any unnecessary competitive disadvantage. Remaining competitive in monitoring regulation is going to be key. The additional regulatory burden will need to be digested by the regulator who will face additional work while having to keep acceptable licensing/approval periods. New SICAR applications with the regulator are not meeting the stated timeframe for approval, which strains fund manager relationships with local intermediaries and with investors. Delays mean that a fund cannot commence operations and investment opportunities can be lost. Luxembourg needs to be an easy place to do business.

Beyond the Directive, one critical legislative development will be the amendment of the commercial law to establish a vehicle with equivalent characteristics to the Limited Partnership ("LP") - the favoured structure for private equity in UK and the Channel Islands. As long as Luxembourg does not have this product (and it must be 100% right), many asset managers and advisers, will not consider Luxembourg for their fund raising structures. Although some consider that the SCS (Société en commandite simple) already allows a similar structure as the limited partnership, the debate is now ongoing on whether the development will be an adaptation of the SCS to closely mimic an LP or whether a brand new vehicle with a specific status will be required.

Finally, service providers in Luxembourg will need to continue to up their game. More consolidation is likely to happen in the coming years due to market conditions and providers will have to address such events in the right manner in order to ensure service quality is not diminished due to cultural clashes. But behind each challenge, there is a real opportunity for the Duchy. Luxembourg has a long history of providing custodian services and of passporting - both of which are important in the light of the AIFMD. The development of a Limited Partnership will broaden Luxembourg's potential investor base and specialized service providers will leverage their multi-jurisdictional experience to bring a high level of service delivery.

Last but not least, Luxembourg's proven track record in translating EU directives quickly and in a business-oriented style will serve it, and the private equity industry, well during this time of change.

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Administrateurs de fonds et technologie : un choix stratégique

Dans un contexte économique et financier encore très fragilisé par la crise récente, le secteur de l'administration des fonds doit s'adapter à des réglementations de plus en plus nombreuses et strictes. Afin de s'y conformer sans s'éloigner de leurs objectifs de croissance et offrir les services de qualité attendus par leurs clients, les administrateurs de fonds doivent pouvoir s'appuyer sur une technologie fiable, efficace et flexible.

Dealys Fund Operations GmbH, une joint venture détenue par Allianz Global Investors et DekaBank, gère actuellement quelque 2500 fonds en Allemagne et au Luxembourg. Ces fonds représentent un total de plus de 340 milliards d'euros. Dealys offre également ses services d'administration de fonds à d'autres compagnies de gestion d'actifs, à la fois en Allemagne et au Luxembourg, par le biais de sa filiale luxembourgeoise Dealys Fund Operations S.A.

Pourriez-vous présenter vos activités?

Roman G. Trageiser, Porte-parole du Board of Managing Directors, Dealys Fund Operations GmbH, et Président du conseil de surveillance, Dealys Fund Operations S.A.: Allianz Global Investors et DekaBank, deux compagnies allemandes de premier plan actives dans la gestion des investissements, ont décidé de fusionner leurs back-offices respectifs en 2009, pour optimiser leur fonctionnement et permettre leur croissance. Cette décision a vu naître une nouvelle entité: Dealys. Cette dernière poursuit deux objectifs principaux: d'une part se positionner en tant que partenaire stable et fiable pour ses clients et, d'autre part, leur permettre de se consacrer entièrement à leur core business grâce à l'externalisation de leurs activités de back-office auprès de Dealys.

En quoi la technologie est-elle un choix stratégique, particulièrement à l'heure actuelle?

R.G.T.: La réalisation des deux objectifs poursuivis par Dealys est étroitement liée à la performance de notre système informatique. Nous devons être capables d'offrir à nos clients des services complets d'administration de fonds, ainsi que des solutions

sur mesure, également mises à jour quant aux divers instruments financiers et exigences réglementaires. Opter pour un back-office commun, au sein de Dealys, permet également à Allianz Global Investors et DekaBank de tirer un avantage compétitif résultant d'économies d'échelle: des volumes de traitement plus élevés, des coûts informatiques partagés, une maximisation des synergies, sans augmenter le 'time-to-market' et ainsi répondre aux exigences propres de nos clients. Faire le bon choix en termes de technologie est donc crucial.

Quelle est la solution choisie par Dealys?

R.G.T.: Nous avons opté pour une plateforme complètement intégrée, modulaire et configurable: SimCorp Dimension. Cette solution nous est apparue comme la plus adéquate présente sur le marché, offrant des fonctionnalités complètes et à jour, ainsi que la capacité de répondre à nos exigences en matière de flexibilité, d'évolutivité, de personnalisation, de performance et de fiabilité.

Quels ont été les principaux défis à relever?

R.G.T.: Allianz Global Investors avait déjà opté pour SimCorp Dimension en 2005 et y avait migré l'ensemble de ses fonds. La migration des fonds de DekaBank, combinés à ceux de Allianz Global Investors, a constitué le principal défi. Quelque 50 fonds par semaine ont été automatiquement migrés vers la nouvelle plateforme commune. Au total, approximativement 2500 fonds mutuels et spéciaux en Allemagne et au Luxembourg ont été migrés. C'est un volume énorme, tant en termes de nombre de fonds traités qu'au niveau de leurs catégories. La migration s'est en outre effectuée sans impacter les activités journalières de Dealys, qui a ainsi pu fournir un service de qualité dès le 1er jour.

Quels bénéfices tirez-vous de ce choix technologique?

R.G.T.: Avoir opté pour un système configurable selon nos besoins, évolutif et flexible permet à Dealys de mettre en œuvre sa stratégie de croissance, présente et future. Le traitement de volumes importants et la possibilité d'être encore davantage orientés vers notre clientèle par le biais de solutions sur mesure, constituent également un bénéfice considérable. Dealys offre à ses clients des services compétitifs et complets, toujours à jour quant aux nouvelles réglementations grâce aux mises à jour bisannuelles de SimCorp Dimension.



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