Resilience and innovation: why Luxembourg is a leading centre for private equity

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Background

Over the years, Luxembourg has successfully established itself as a leading global centre for private equity (**PE**). It remains the natural choice for PE firms, bolstered by a strong appetite from limited partners – such as asset managers, insurances, pension funds, family offices and high net worth (**HNW**) individuals – to invest into a wide range of PE strategies, from fund of funds or buyout to more venture capital-oriented strategies.

Despite a general decrease in assets under management in Luxembourg in the aftermath of COVID-19 and the war in Ukraine, the overall performance of PE as an asset class throughout recent years has indeed shown significant resilience. Luxembourg's political, economic and fiscal stability, in combination with a forward-looking strategy, has earned the trust of financial players and resulted in Luxembourg's reputation as a tested and mature financial centre – its recent triple "A" ratings confirm this assessment.

Against this background, we highlight some of the key points to consider when implementing PE strategies or transactions in and through Luxembourg.

Legal landscape

Luxembourg's pragmatic and adaptive nature has helped to foster a well-developed and business-friendly legal system, to which those who are notably familiar with the common law regime and are frequent users of Luxembourg structures can easily relate.

A great majority of PE funds are unregulated, and all the (unregulated) corporate vehicles that PE players establish are primarily governed by the Luxembourg law on commercial companies of 10 August 1915 (which offers attractive features like smooth company incorporation, immediate legal personality, etc). Luxembourg regulated funds, on their end, are authorised and supervised by the *Commission de Surveillance du Secteur Financier* (**CSSF**), which is widely viewed as a pragmatic and efficient regulator.

In terms of investment vehicles, unregulated special limited partnerships (**SCSp**), often qualifying as reserved alternative investment funds (**RAIFs**), have proven to be the structure of choice for PE fund initiators and their investors, particularly due to the fiscal transparency and substantial contractual flexibility they offer. When qualifying as a RAIF, these conceptual advantages are complemented by a light regulatory layer via the oversight by an authorised AIFM and, most importantly, the access to the AIFMD passport. Luxembourg now hosts more than 2,000 RAIFs, and more than 7,000 SCSp.

Another advantage Luxembourg offers is a very efficient and attractive financial collateral legal framework, which is of great relevance in the context of many PE actors relying on a certain level of bank financing for their acquisitions.

Combined with one of the EU's most flexible and attractive tax regimes (eg, with possible tax neutrality at fund level, tax-efficient means of repatriation of proceeds and a broad tax treaty network), Luxembourg is set to continue to thrive as a key PE hub.

PE management

Well-established delegation models offer a multitude of solutions for organising portfolio management or distribution activities with an entity outside of Luxembourg, either via the European passport or by relying on the relevant national rules or any bilateral agreement that Luxembourg has concluded to ensure the proper functioning of delegation models beyond the territory of the EEA.

This being said, the PE market has become more mature, with an increasing number of PE firms holding an AIFM licence, and a general shift from back office tasks towards middle and front office activities co-ordinated from Luxembourg, which today encompass services such as investment structuring, acquisitions, (local) portfolio management, risk management and compliance, as well as fund administration, valuation and distribution.

The right support on the ground

Luxembourg has indeed been consistently building up a dense and experienced service provider ecosystem (domiciliary agents, central administrators, auditors, depositaries, management companies, etc), often with dedicated PE practices able to take up all the mainstream PE administration and operational functions as well as more customised services.

Importantly, Luxembourg also plays host to fintech players, putting it at the forefront of digital transformation to address digitalisation, which is playing an increasingly critical role in the PE industry. Its geographic location and multilingual workforce are also often viewed as important drivers for setting up in Luxembourg.

What about strategies?

Within PE strategies, Luxembourg remains a centre for specialist sectors, such as digital assets/technologies (with investments in technology-related/fintech companies clearly a growing trend), but also continues to strengthen its reputation as a leading sustainable finance hub with a focus on ESG-linked investments.

Classic PE strategies, however, remain popular, underpinned by a growing appetite from managers historically launching offshore structures to complement their products with Luxembourg fund vehicles – a development which is showcased by a large number of Luxembourg parallel funds investing alongside Cayman or Jersey funds, for example. Due to investor demand, certain initiators even consider a complete re-domiciliation or merger of their existing structure.

Looking ahead

Even in the current market situation, if the inflation-recession cycle is relatively short, private markets can be expected to rebound rapidly, with PE in particular taking advantage of periods of market stress. With the continuing success of ESG-related strategies (SFDR and Taxonomy), the trend towards the retailisation of investment funds (ELTIF 2.0) and upcoming regulations framing the digital assets space (MiCAR), the opportunities for the PE space are becoming even more numerous, and exciting times lay ahead. With all this in mind, Luxembourg is well placed to continue being a jurisdiction of choice for PE actors looking forward to embracing them.

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