GP Survey 2018

The Luxembourg Private Equity and Venture Capital Association (LPEA) presents the conclusions of the 4th biennial GP Survey conducted among the general partners (private equity and venture capital fund managers) operating in Luxembourg.

The survey, conducted by LPEA's Market Intelligence Committee between January and March 2018, reflects the views of 55 GPs. The survey covered private equity firms established in Luxembourg without distinction of strategy and size. All input has come from on-line questionnaire and interviews conducted by the members of the committee.

EXECUTIVE SUMMARY

The private equity industry has experienced significant changes coming from regulatory developments and new legislation, as well as a changing tax landscape. This has modified the business model of many actors in the market.

This PE survey has provided feedback on how Luxembourg is perceived to react to these developments as a fund location and structuring jurisdiction.

The outcome of this report is the result of numerous interviews with general partners, from which we concluded the following key messages:

- Luxembourg is reinforcing its leading position as an alternative fund location. Its large offer of different vehicles (RAIF, SLPs, etc.) attracts various type of PE Houses;
- Despite BEPS and AIFM regulations which have impacted the administrative burdens across Europe, Luxembourg continues to enjoy a stable political and tax environment and is perceived as a significant hub;
- The success of competitive vehicles such as the RAIF and the SCSp have strengthened Luxembourg by making it increasingly flexible. As a result small and medium size players are on the increase as are big players;
- Good talent pool of qualified people. Continued training and education remains key to stay competitive and to attract new professionals into the sector;
- Service providers need to increase their competitiveness and focus their pricing model through value adding services;
- Brexit is favoring Luxembourg as primary location for new AIFMs on the continent.

BACKGROUND: MAIN CHANGES

Before going through the survey, it is important to acknowledge what has changed in Luxembourg's private equity environment in the last three years:

- BEPS and AIFM have impacted the administrative burdens;
- Substance is currently increasing, even if it is mainly related to risk and compliance tasks;
- Brexit is re-shaping the European landscape;
- Transparency regulations have improved Luxembourg's reputation;
- New large PE firms established offices in Luxembourg.

PROFILE OF GPs

Investment strategy

There is no dominant strategy with Buy-out taking up 25% of the market and other strategies reporting between 10% and 14%. We observe however that Infrastructure and Buy-Out have grown significantly from last survey. This apportionment shows that Luxembourg is not confined to a limited number of asset management strategies but is rather a diverse marketplace.

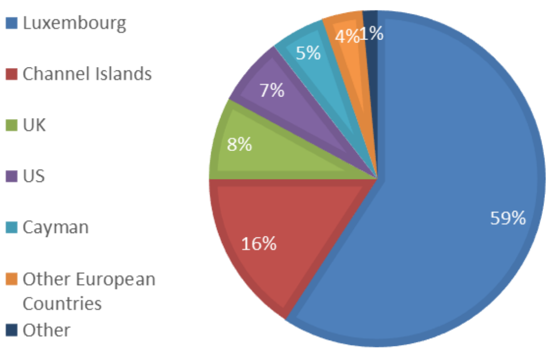
Sector focus

The same diversification applies for sector preference with Financial Services (13%) leading alongside Consumer Services and Consumer Goods & Retail (10%). On the other end Life Sciences (3%) and Agriculture (2%) were less reported.

Jurisdiction of funds

Luxembourg continues to increasing its footprint as an on-shore Fund jurisdiction leader with locally established funds increasing from 37% to 59% in the period 2016-2018.
With many UK and British Channel Islands funds redomiciling in continental Europe, it seems that Luxembourg is one of the first choices. Funds registered in these jurisdictions decreased from 33% to 24%. Cayman funds also decreased from 12% to 5%.

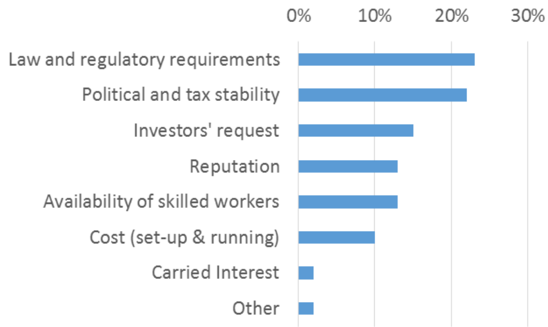
Jurisdiction of funds



The fund jurisdiction of the fund manager followed a similar trend with Luxembourg funds managers increasing from 34% to 53% in opposition to the significant decrease of UK and US based funds.

But what drives fund location? According to the surveyed firms, the critical decision making results of Luxembourg's "law and legal requirements", followed by its political and tax stability. Although the factors do not differ considerably from the last survey, we highlight the increasing relevance of "availability of skilled workers".

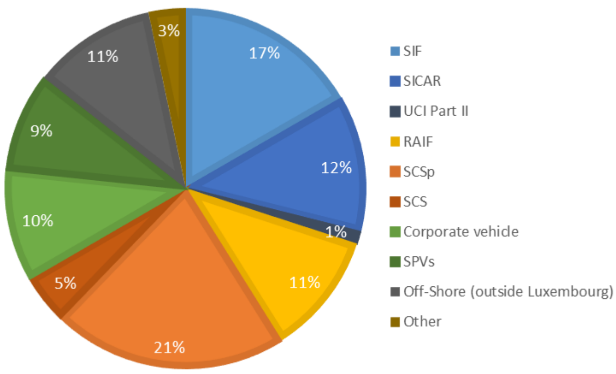
Critical factors for fund location



Adopted legal structure

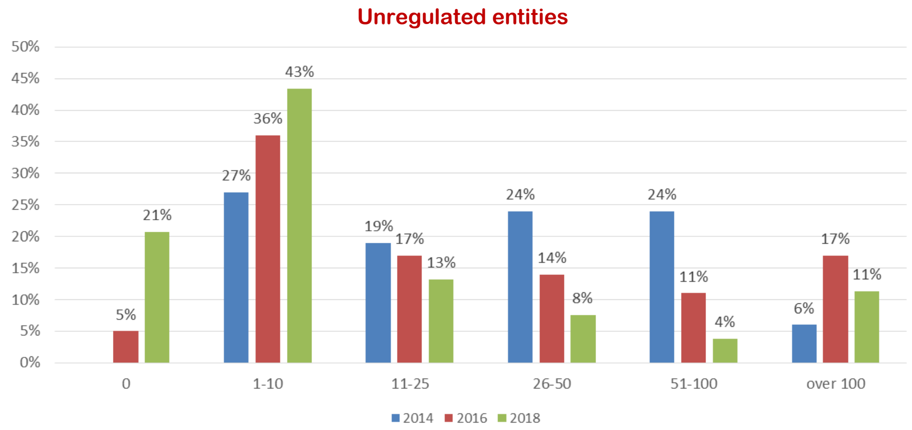
Probably the most striking observation of this survey is the adoption of different legal structures. Along the years Luxembourg developed a complete legal tool box to answer different needs from GPs and investors. The answers to the survey showcase significant diversity, something which will most certainly change in the future with the growing adoption of RAIF and SCSp in detriment of SPVs and off-shore structures.

Legal structures



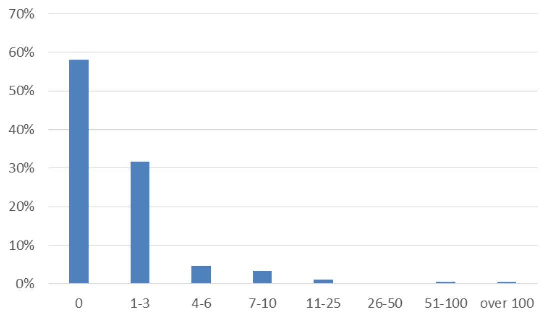
Unregulated entities

With the continuous moving of PE Funds to Luxembourg and with the increase of all tax transparency regulations, the number of SPVs have been rationalized in the last 6 years. The PE Houses are increasing their activity in Luxembourg (new investment vehicles) but decreasing the tax structures.



Regulated entities

Compared to the last survey we can confirm that the market is still preferring non-regulated entities, especially with the SLPs available.



There is also an increase of the vehicles not directly regulated by CSSF but managed by an Authorized Manager (most of them being AIF, such as SLPs, RAIF and SCS) which represent 19% of inquired firms. Among the surveyed firms, 47% already have an AIFM and 6% are in the process of obtaining a license. Nine in every ten AIFMs are regulated by the Luxembourg authorities.

Infrastructure

Luxembourg is more and more attracting Alternative managers and this can be perceived among other factors by their local infrastructure. PE firms with their own office increased from 65% in 2016 to 80% in 2018 while the option for a serviced office space decreased from 21% to 12% in the same period. The utilisation of a domiciliation agent also decreased to 8%.

We read this evolution with PE firms shaping their business model in a way that their Luxembourg operations focus in oversight activities across the different groups.

Employees

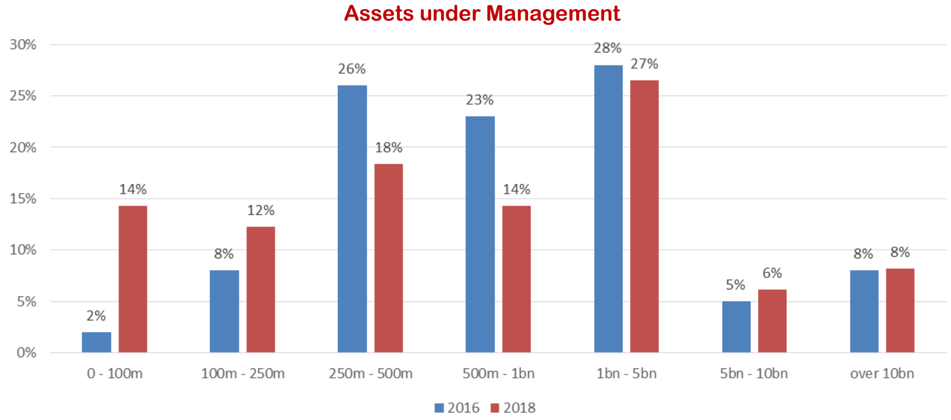
In the last years, we noted a significant increase of the number of employees in the Luxembourg structures. This is usually linked to the regulatory requirements (in terms of substance) and the recognition of the oversight roles of the personnel. The majority of the structures tries to remain flexible with a limited number of staff.

According to the survey, 58% of the firms have now between 1 to 5 employees. Larger offices with 6 or more employees represent now 40% of the market.

Assets under Management

Luxembourg is becoming more diversified and the ideal marketplace to launch any type of vehicle. Its reputation is attracting several type of actors with various strategies and this is perceived by the changes in funds' sizes.

While funds above €1b remained unchanged and representing 41% of respondents, smaller funds of up to €250m increased their representation from 10% to 26%. This is partly explained by the success of competitive vehicles such as the RAIF and the SCSp which give more flexibility to small and medium size players.



LUXEMBOURG AS A BUSINESS LOCATION

According to the survey, Luxembourg's historical strengths - "Flexibility" and "Stability of Business Environment", report a "very good" approval rate of 60% and 76% respectively.

The interaction with the authorities and the regulator showed a positive evolution revealing the "catching up" with the excessive pressure brought in by regulation and which required the regulator, in particular, to reinforce its staff in the past two years.

The perception over the "Tax Environment" has also improved with a "very good" approval rate of 47%.
At the level of existing Infrastructure, the overall conditions for Luxembourg firms to operate, the evaluation has also improved with a "very good" approval rate of 50%.

The quality of life in Luxembourg, perceived by professionals and their families, has seen a slight decrease collecting today 60% of "very good" approval rating. To blame could be the continuous rising of property prices, increasing traffic or the continuous frenzy of construction works across the city of Luxembourg.

Facing challenges
In a sector challenged by multiple factors, most of which emerging from international authorities, general partners believe Luxembourg to be particularly well positioned to address the creation of new legal structures, to offer an overall consistency and to stand for the sector reputation. Other challenges such as Transparency, Global tax harmonisation, regulatory environment, KYC/AML or Brexit, are being positively dealt by Luxembourg with no particular remarks.

Tax reform
Questioned on what to change in matter of tax, general partners give priority to a carried interest taxation regime, the elimination of dividend withholding tax and further reduction of the corporate income tax, today at 26.01%[1].

Service Providers
There is room for improvement in the quality of services delivered, notably by adding further customer orientation, additional value added and a tailored approach in opposition to a "one size fits all" offering.
While industry knowledge can be improved with further training, the implementation of new systems and private equity dedicated software could help in responding to the sectors' increasing complexity.

THE ROLE OF LPEA

The LPEA, as the trade association representing the sector, is also subject to the general partners' opinion on what should be its role:

- Public advocacy towards the government and the regulator in particular to develop the business environment (i.e.: FinTech, SME, etc.);
- Active involvement in the shaping of a post Brexit PE environment;
- Share business practices, reviews and guidelines;
- Reinforce the networking across the players;
- Promote and represent Luxembourg abroad;
- Develop the skills of service providers (i.e.: AML, etc..).

[1] Rate applying to Luxembourg City.

DISCLAIMER

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ACKNOWLEDGEMENTS

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ABOUT LPEA

The Luxembourg Private Equity and Venture Capital Association (LPEA) is the representative body of private equity and venture capital professionals in Luxembourg.

With 170 members, LPEA plays a leading role in the discussion and development of the investment framework and actively promotes the industry beyond the country's borders.

Luxembourg has a stable tax regime and is today at the forefront of international PE regulation providing a flexible, secure, predictable and multi-lingual jurisdiction in which to operate.

LPEA provides a dynamic and interactive platform for its members to discuss and exchange information and organises working meetings and networking opportunities on a regular basis.

www.lpea.lu