

Private Equity in Luxembourg: Overview

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MARKET OVERVIEW

1. What are the current major trends and what is the recent level of activity in the private equity market?

The vast majority of private equity (PE) funds are unregulated funds. The PE industry has a strong appetite for Luxembourg limited partnerships, a fund structure that is universally understood by investors who are familiar with common law partnerships. The special limited partnership (*société en commandite spéciale*) (SCSp) is the most used and differs essentially from the common limited partnership (*société en commandite simple*) (SCS) in the fact that it has no legal personality.

However, as a result of the implementation of the Anti-Tax Avoidance Directive ((EU) 2016/1164) (ATAD 2), addressing hybrid mismatches with third countries, the partnership limited by shares (*société en commandite par actions*) (SCA) has been increasingly used in combination with traditional limited partnerships over the past year. This is because the SCA is considered as a taxable corporation for Luxembourg tax purposes, usually in the investor's jurisdiction, which avoids any hybrid mismatch issue in relation to ATAD 2.

In relation to PE funds and their managers, the Sustainable Finance Disclosure Regulation ((EU) 2019/2088) (SFDR) aims to prevent greenwashing by private investment fund managers and the financial services industry more generally. This compelled PE managers and portfolio advisers, as well as non-EU managers managing a Luxembourg fund or marketing funds in the EU under applicable national private placement regimes, to look into their compliance with the high-level principles in the SFDR. The PE industry must consider strategy on sustainable finance, taking into account and disclosing in the funds' documents how sustainability risks are integrated in investment decisions, and assessing the likely impact of these risks on the fund's returns.

The recent inclusion of the Cayman Islands in the EU list of non-cooperative jurisdictions for tax purposes has increased the appetite of managers for Luxembourg parallel fund structures.

On the deals side, the 2019 novel coronavirus disease (COVID-19) pandemic has affected various aspects of buyouts and exits that will continue to impact on transactions in the short- to medium-term. Key underlying trends driving changes on processes to run a deal include pressure-test adjustments to growth projections and reviewed diligence to consider the impact of COVID-19 on the targeted asset. The assessments of market risks and mitigants in the transaction documents have been adjusted, taking into consideration technology, personnel and changes in consumer/client requirements. This lead to:

- Difficult valuations with transaction documents catering (to some extent) for that risk.
- A shift in focus to resilient targets.
- A surge in blank-check company or special purpose acquisition company (SPAC) listings in Luxembourg, boosted by the

financial sector with floatation in the technology sector, and health care listings.

Fundraising

Global PE fundraising in 2020 dropped year-on-year amid the economic downturn in the wake of the COVID-19 pandemic (*PE International, Fundraising Report FY 2020*). A total of 237 funds closed in Q3 of 2020, which is the lowest quarterly total since 2015. That said, fundraising efforts by general partners (GPs) remain strong, with a record number of funds in the market (3,968 seeking capital, a record number since 2015). In total, 1,502 PE funds closed for an aggregate amount of USD628,26 billion, which is a 13% drop from 2019 (*Preqin*). This slowdown continued in Q1 of 2021, although mega funds were raised through Luxembourg and are continuing to raise, with expected closings for billion euro-plus European PE funds (with at a Luxembourg sleeve even if the main fund is not Luxembourg based) in Q2.

It is difficult to provide an accurate estimate for the time needed to raise funds. This varies significantly depending on the characteristics of the fund, the track-record of the initiators, commitment sizes, the limited partners' familiarity with the model of the fund, the investor's appetite for investing in a particular region, and other variables. Despite these issues, 2020 was seen (by Preqin) as a year where fundraising activity remained resilient despite the COVID-19 challenges and 2021 has seen much activity for mid-market funds with a focus on strategic sectors such as digital infrastructure, health care, food technology, and so on.

Investment

The level of activity in Luxembourg in relation to investments by regulated vehicles (see *Question 6*) is:

- **Risk capital investment companies (*sociétés d'investissement en capital à risque*) (SICARs).** Based on the provisional figures as at 31 December 2020, net assets in SICARs totalled EUR54,720 billion (EUR8,142 billion in VC and EUR43,981 billion in PE).
- **Undertakings for collective investments (UCIs).** This includes specialised investment companies (*fonds d'investissement spécialisés*) (SIFs). Based on the provisional figures as at 31 December 2020, net assets in SIFs totalled EUR596,526 billion.

(CSSF's Newsletter No. 241 of February 2021.)

There are no overall statistics relating to the volume of activity of non-regulated funds (see *Question 6*). Based on the statistics published by Invest Europe, EUR36 billion of equity was deployed in 3,401 companies in the first half of 2020. With respect to VC investments, EUR5 billion was invested into European companies during the same time period (*Invest Europe, H1 2020 European PE Activity*).

Despite COVID-19, 2020 was generally a strong year for European PE deal activity, with an increase in the number and value of deals compared to 2019, and 4,179 deals closing for a total of EUR449,1 billion (*Pitchbook, 2020 European PE Breakdown*).

The investment policies followed by SICAR units as at 31 December 2020 were:

- Public-to-private: 3.
- Mezzanine: 12.
- VC: 75.
- PE: 266.

With sector-based distribution, a lot of entities preferred not to limit their investment policy to a particular investment sector. Among the entities having adopted a specialised policy, there is a concentration in the real estate, energy, technology and services sectors.

SICARs' net assets, according to the main investment policy, were:

- Public-to-private: EURO.125 billion.
- Mezzanine: EUR2.752 billion.
- VC: EUR8.280 billion.
- PE: EUR43.563 billion.

(CSSF's Newsletter No. 241 of February 2021.)

In addition, SIFs include a considerable number of vehicles investing in clean technologies. These are infrastructure projects with equity investments not included in the above statistics as they were made by unregulated PE funds set up, in most cases, as SCSps.

Transactions

The uncertainty surrounding COVID-19 in Q1 of 2020 halted deal-making. However, activity continued to grow steadily, demonstrated by the large amount of capital that continues to be raised. In fact, PE deal-making activity surged in the second half of 2020. Firms must keep pace with investments as income is generated both by management fees and investments. Luxembourg should, therefore, see much activity in 2021 as many acquisition structures flow through Luxembourg and many funds are based in Luxembourg. There is still an unprecedented amount of dry powder for investments by PE firms, which makes competition for assets intense. In February 2021, PE funds were sitting on a record USD3.1 trillion in unspent capital.

However, the European economic landscape remains challenging, valuations are high for European assets (despite the impacts of COVID-19) and the European regulatory/economic landscape remains uncertain. Brexit triggered a challenging environment for investors that will last for some time, particularly for sterling-denominated funds. This will not be an issue for investments in the UK only, as the impact of the UK's decision to leave the EU will continue to affect existing portfolio companies and pending deals. However, there will also be opportunities stemming from Brexit.

Categories of investments remained strong despite the crisis:

- Growth investments totalled:
 - EUR16 billion in 2019; and
 - EUR5,3 billion in H1 of 2020.
- Buyout investments totalled:
 - EUR65 billion in 2019; and
 - EUR24,6 billion in H1 of 2020.
- VC totalled:
 - EUR11 billion in 2019; and
 - EUR 5,6 billion in H1 of 2020.

(Invest Europe, H1 2020 European PE Activity and PE Activity 2019.)

Exits

A total of 3,533 European companies were exited during 2019, an 11% decrease from 2018. Divestments at cost in 2019 were down 16% from the year before to EUR31 billion.

The most prominent exit routes by amount were:

- Trade sale: 29%.
- Sale to another PE firm: 34%.
- Public offering: 11%.

(Invest Europe, Investing in Europe: PE Activity 2019, May 2020.)

2. What are the key differences between private equity and venture capital?

The structural considerations for VC funds are the same as for PE funds and are driven by three key factors:

- The source of fund capital, taking into consideration the type and location of investors and whether the fund will use leverage at asset level or a subscription line.
- The fund's targeted investments, taking into consideration:
 - whether real estate needs to be considered;
 - whether the companies are operating at a very early stage or later;
 - when cashflow would be expected; and
 - whether the investment will be equity and/or debt.
- The fund's investment strategy.

The corporate and regulatory structures available are the same as for PE funds (and the related tax treatments are therefore the same), although there is also a regime specifically for VC fund managers known as European venture capital funds (EuVECA). The EU legislators recognised the positive impact VC fund managers can have on small businesses in need of capital for growth. However, the number of managers using the regime has is low.

FUNDING SOURCES

3. How do private equity funds typically obtain their funding?

Pension funds, funds of funds and family offices were the main contributors to fundraising in the French and Benelux regions in 2019. According to the 2019 European PE Activity report of Invest Europe of May 2020, contributions to the total amount of funds raised in 2019 came from the following sources:

- Funds of funds: 35%.
- Sovereign wealth funds: 5%.
- Pension funds: 12%.
- Government agencies: 9%.
- Family offices and private individuals: 17%.
- Corporate investors: 2%.
- Banks: 6%.

No numbers have been published for 2019 with a purely Luxembourg focus.

The main fund players in Luxembourg are PE houses. Information is not publicly available for non-regulated vehicles.

The market share of fund initiators in Luxembourg by country of origin (in terms of assets under management) as at December 2020 was:

- US: 20.7%.
- UK: 17.0%.
- Germany: 13.7%.
- Switzerland: 14.2%.
- France: 9.9%.
- Italy: 6.8%.
- Belgium: 4.5%.
- Luxembourg: 3.4%.
- The Netherlands: 2.2%.
- Denmark: 2.1%.
- Other countries: 5.4%.

(Association of the Luxembourg Fund Industry (ALFI))

TAX INCENTIVE SCHEMES

4. What tax incentive or other schemes exist to encourage investment in unlisted companies? At whom are the incentives or schemes directed? What conditions must be met?

Incentive Schemes

Luxembourg non-regulated vehicles benefit from several tax incentives. These are generally available to all Luxembourg-resident companies (irrespective of their underlying investments or the nature of their shareholders).

Participation Exemption Regime

This regime applies to a financial interest holding company and provides that if certain holding thresholds (percentage or value) and subject-to-tax requirements (only required for non-EU subsidiaries) are fulfilled, dividend payments and capital gains are fully tax exempt in Luxembourg. In the same way, dividends paid to shareholders are generally not subject to domestic withholding tax in the case of corporate shareholders established in the EU or tax treaty countries. Finally, Luxembourg has a far-reaching network of treaties avoiding double taxation.

Reserved Alternative Investment Funds (RAIFs)

Under the general tax regime, RAIFs are exempt from Luxembourg income and wealth taxes. They are subject to an annual subscription tax charged at an annual rate of 0.01% based on the RAIF's total net assets, valued at the end of each calendar quarter. The following are exempt from the subscription tax:

- Assets invested in other Luxembourg-based UCIs, SIFs and RAIFs subject to the subscription tax.
- Certain institutional cash funds.
- Microfinance funds.
- Pension pooling funds.

A different tax regime applies to a RAIF that invests in risk capital and that is not a mutual fund (*fonds commun de placement*) (FCP), which is similar to the one applicable to SICARs as provided below:

- The RAIF is fully subject to corporate income tax and municipal business tax (unless it is established as a SCS or SCSp, in which case, as a transparent entity, it is as a rule exempt from corporate income tax and municipal business tax), but income and gains derived from securities is exempt.

- It is exempt from net wealth tax, except for a minimum net wealth tax amounting to EUR4,815 (for 2021), unless it is established as a SCS or SCSp, in which case it is also exempt from this minimum net wealth tax.
- The management of RAIFs is VAT exempt in Luxembourg.
- Its distributions are generally not subject to any withholding tax and must not be subject to Luxembourg taxation in the hands of non-resident investors.

SIFs

A SIF is not subject to tax, apart from a registration tax (*taxe d'abonnement*) of 0.01% calculated on the net asset value at quarter-end. This is subject to certain exemptions.

At Whom Directed

These tax incentives are available irrespective of the profile of the investors and the nature of the underlying investments.

Conditions

See above, *Incentive Schemes*.

FUND STRUCTURING

5. What legal structure(s) are most commonly used as a vehicle for private equity funds?

The structures most commonly used for PE funds are similar to the structures used for VC funds (other than the EuVECA).

Non-Regulated Vehicles

SCSps, SCSs and *soparfis* are non-regulated vehicles that have the object of holding and financing participations in portfolio companies.

Limited partnerships. By far the most commonly used forms of non-regulated vehicles are the SCSp and the SCS. There is a strong appetite for Luxembourg limited partnerships, due to their key features:

- **Confidentiality is guaranteed.** Registration of the SCS/SCSp at the Luxembourg trade and companies register (RCS) is minimal and includes their name, the name of their GPs, their object, their address and their duration. There is no publication of the performance of the SCSp, and the SCSp's accounts are not filed at the RCS.
- **Safe harbour for actions by limited partners (LPs).** In Delaware and the Cayman Islands, the scope of decisions made by LPs without compromising their limited liability is uncertain. In Luxembourg, the Luxembourg act dated 10 August 1915 on commercial companies, as amended (Companies Act) introduced a non-exhaustive list of actions that may be taken by LPs, which do not, as such, put their limited liability at risk.
- **Wide choices for contributions.** Contributions to an SCS and SCSp can be made in kind, cash or industry, and may include loans granted to the partnership, with no debt-to-equity ratio to be complied with. A mere statement in the limited partnership agreement (LPA) by the partners suffices for non-cash contributions. Contributions, withdrawals, loans, allocations to profits, losses and expenses can be booked for each limited partner in a capital (and loan) account.
- **GP and LP creditors cannot seize the SCSp's assets.** The assets contributed to the SCSp are registered in the name of the partnership and can only satisfy the rights of creditors that have been created in relation to the SCSp's business. The SCSp's assets are not available to the GPs' or the LPs' creditors.
- **Flexibility on power and economic distributions.** Limited or multiple, as well as non-voting partnership interests (which may be represented by securities issued by the SCS/SCSp), are

permitted. This enables investors to distribute powers as they deem fit in the LPA. In addition, there is no claw back on distributions in the case of insolvency, unless there is fraud.

- **Freedom to organise transfers of partnership interests.** The LPA organises all conditions relating to the redemption, transfer, splitting or pledge of their interests by the LPs. The Companies Act attaches conditions to transfers if those transfers are not dealt with in the LPA. The Companies Act also provides that partnership interests may be listed on a stock exchange or a regulated market. The limited partnership is considered a tax transparent entity (that is, investors are considered as direct beneficial owners of the underlying proceeds received by the limited partnership, and are directly taxable on these profits depending on their status and jurisdiction).

Limited companies and partnership limited by shares. Other unregulated fund structures include:

- **Private limited company (*société à responsabilité limitée*) (SARL).** This is commonly used for investing in PE, since it offers significant flexibility. The minimum share capital is EUR12,000 and the number of shareholders is limited to 100.
- **SCA.** The SCA is increasingly being used as it generally does not create anti-hybrid mismatch issues under the Anti-Tax Avoidance Directive. The SCA requires at least:
 - one GP with unlimited liability being in charge of the management (*commandité*);
 - one LP with limited liability (*commanditaires*), who cannot be involved in the management of the SCA.
- Its minimum share capital is EUR30,000. The rules applicable to public limited companies (*société anonyme*) (SA) generally also apply to SCAs. The SCA regime has been modernised by the Alternative Investment Fund Managers (AIFM) Law. When the SCS or SCSp are structures available to sponsors, these are now much preferred in comparison to the SCA (see *Question 4*).
- **SA.** Its minimum share capital is EUR30,000. There is no restriction on the number of shareholders and its shares are freely transferable. The board of directors requires in principle at least three directors. It can also be listed.

RAIF. Many sponsors consider a RAIF instead of a regulated vehicle as it avoids the over-layering of supervision due to the implementation of the AIFM Directive (2011/61/EU) in Luxembourg.

RAIFs combine the legal and tax features of regulated AIFs like SIFs or SICAR, without the regulatory licensing or oversight of the Financial Sector Supervisory Commission (*Commission de Surveillance du Secteur Financier*) (CSSF) (www.cssf.lu). RAIFs are subject to favourable tax and legal regimes.

Whether or not existing funds should become a RAIF requires a case-by-case analysis from tax, legal and regulatory perspectives. For example:

- Unregulated sub-threshold funds that cannot market in some jurisdictions and must appoint an authorised AIFM, should consider closely the tax regime applicable to RAIFs for their conversion.
- Unregulated SCSs and SCSPs may wish to benefit from an umbrella structure and benefit from a marketing passport.
- SICARs, SIFs and FCPs may wish to benefit from the lighter requirements on redemptions, and so on.

In addition, the absence of a regulatory approval requirement allows managers to reduce the time to market their fund and reduces costs compared to other types of regulated fund vehicles. A RAIF is the structure of choice in comparison to Luxembourg regulated funds.

The assessment of whether a RAIF should be preferred to an unregulated fund structure depends on the initiator's key drivers.

RAIFs can be set up as one of the following corporate forms:

- SCS.
- SCSp.
- SCA.
- Co-operative (*société cooperative organisée sous forme de société anonyme*).
- SARL.
- SA.

These various possibilities offer significant contractual freedom.

Regulated Funds

The following vehicles are supervised and authorised by the CSSF.

SICARs. These were implemented to offer a new lightly regulated vehicle for investment in PE to well-informed investors (see *Question 12*). They combine a flexible corporate structure for investing in risk capital, with the benefits of light supervision by the CSSF and a neutral tax regime.

SICAR is an optional regime, and must be formalised in the object clause of the company's articles of association. SICARs can be incorporated as one of the following companies:

- SCS.
- SCSp.
- SCA.
- Co-operative.
- SARL.
- SA.

While general corporate law provisions apply to SICARs, they have substantial flexibility in determining their articles of association:

- The share capital of the SICAR must be at least EUR1 million. This minimum must be subscribed to within one year of incorporation and paid up in principle to at least 5% of the capital, including share premium. It is also possible to opt for variable capital, whatever the corporate form, since the introduction of the SICAR Amendment Law. This new development should attract more foreign investors familiar with the tax incentive vehicles of common law limited partnerships.
- Although SICARs are supervised by the CSSF (see *Question 10*), their reporting obligations are lighter than those of UCIs, although they must prepare and publish annual accounts, and update the prospectus on the issue of additional shares. An independent auditor (approved by the CSSF) must audit the annual accounts. However, a SICAR is not required to publish a bi-annual report.
- Since the SICAR Amendment Law, there is no mandatory legal requirement to calculate the net asset value on a compulsory bi-annual basis. The net asset value must be based on the principle of fair value (similar to the SIF regime).
- SICARs must invest in risk capital and have no obligation of investment diversification (unlike UCIs). Therefore, SICARs can invest all of their funds in a single company or project. A SICAR can also be structured as an umbrella vehicle with separate compartments enabling it to run different investment policies in each compartment.
- The duty of the custodian is the same as for SIFs (that is, its monitoring duty is restricted to the general safekeeping of the assets).

SIFs. SIFs are subject to lighter statutory rules than other UCIs. The following can create or invest in a SIF (see *Question 12*):

- Institutional investors.
- Professional investors.
- Other well-informed investors (whether legal or physical persons).

The SIF aims to be an attractive vehicle through its flexible functioning rules, and the extensive scope of assets open to investment. A SIF can be used to invest in any kind of assets without limitation, to the extent it complies with the general risk spreading rules (see *Question 13*). It is authorised and supervised by the CSSF and has a neutral tax regime. A SIF can be created as:

- A common fund (*fonds commun de placement*) (FCP). This is a contractually drawn up set of jointly owned assets with no legal personality, managed by a Luxembourg management company.
- An investment company with a variable share capital (*société d'investissement à capital variable*) (SICAV), incorporated as any of the following:
 - SCA;
 - SCS;
 - SCSp;
 - co-operative;
 - SARL;
 - SA.
- A company with a fixed share capital (*société d'investissement à capital fixe*) (SICAF), which is incorporated as any of the following:
 - SCS;
 - SCSp;
 - SCA;
 - co-operative;
 - SARL;
 - SA;
 - unlimited company (*société en nom collectif*) (SNC);
 - civil company (*société civile*).

The legal provisions and types of companies under which a SIF can be incorporated allow investors to set up their own corporate governance rules in a flexible manner:

- The subscribed share capital (including share premium) must be at least EUR1.25 million, within 12 months of the date of CSSF approval. The shares need only be paid up to a minimum of 5%.
- SIF supervision and its reporting obligations are the same as for a SICAR as are the issuing document requirements (that is, information necessary for the investors to form their view on the investments proposed and its related risks). The SIF's issuing document must provide for the quantifiable limits to be complied with (*CSSF's circular 07/309 relating to the risk-spreading principle for the SIF*) (see *Question 10*, *Question 11* and *Question 13*).

A SIF can be organised with several segregated sub-funds.

6. Are these structures subject to entity-level taxation, tax exempt or tax transparent (flow-through structures) for domestic and foreign investors?

RAIF

A RAIF is subject to two different tax regimes, depending on whether it has opted for the special tax regime (see *below*):

- Under the general tax regime, a RAIF, irrespective of its corporate form, benefits from the same taxation as a SIF. That is:
 - it is subject to subscription tax at a rate of 0.01% per year (with certain exemptions available);
 - it is exempt from corporate income tax, municipal business tax and net wealth tax;
 - its distributions are generally not subject to any withholding tax; and
 - there is generally no Luxembourg taxation in the hands of non-resident investors.
- Under the special tax regime, a RAIF that invests in risk capital and that is not an FCP is subject to a tax regime similar to the one applicable to SICARs. That is:
 - it is fully subject to corporate income tax and municipal business tax (unless it is established as a SCS or SCSp, in which case, as a transparent entity, it is as a rule exempt from corporate income tax and municipal business tax), but income and gains derived from securities (*valeurs mobilières*) are exempt;
 - it is exempt from net wealth tax, except for the minimum net wealth tax (unless it is established as a SCS or SCSp, in which case it is also exempt from this minimum net wealth tax); and
 - its distributions are generally not subject to any withholding tax and should not be subject to Luxembourg taxation in the hands of non-resident investors.

SICAR

The tax status of SICARs depends on the legal form chosen (see *below*).

SCS and SCSp. These are tax transparent and therefore not subject to tax in Luxembourg, except for municipal business tax if they perform or are deemed to perform commercial activities (see *Question 4*). Tax is levied at investor level, according to the law of where they are tax resident. Double tax treaties or EU directives may apply in the country of the investor and the country of the portfolio company, depending on the relevant regulations.

SICARs as corporations. They are in principle fully taxable in Luxembourg at 24.94% for 2021, including contributions to the employment fund and municipal business tax for the city of Luxembourg (this can vary slightly for other municipalities). They should in principle benefit from double tax treaties and the Parent-Subsidiary Directive (2011/96/EU), at least from a Luxembourg perspective. If a country does not recognise the SICAR, alternative structuring is available.

The tax regime applicable to SICARs incorporated as a corporation is as follows:

- Gains or income from transferable securities are not subject to tax.
- Income from cash arising from investment in risk capital is not subject to tax, subject to certain conditions.
- SICARs are not subject to net-wealth tax.

- SICARs are not eligible for the tax group regime (see *Question 5*).
- Distributions by SICARs are free of withholding tax.
- There is generally no tax in Luxembourg on the disposal of an interest in a SICAR by non-resident investors.
- Management services for these vehicles are exempt from VAT. SICARs are considered as VAT taxable persons but their activities are generally exempt from VAT. Therefore, they cannot in principle deduct input VAT. Active VAT strategy should therefore be implemented to mitigate VAT costs for these vehicles, notably on deal fees (for example, the use of a VAT exemption on certain services received, recharge of costs, and so on).
- SICARs are subject to a fixed annual fee of EUR4,000 (EUR8,000 or more for umbrella SICARs, depending on the number of sub-funds) and a registration fee of EUR4,000 (EUR8,000 for umbrella SICARs) payable to the CSSF.

SIF

SIFs are not subject to:

- Corporate income tax.
- Municipal business tax.
- Net-wealth tax. They are subject to a subscription tax on the net asset value (0.01%), which is calculated quarterly. The law allows some specific exemptions.

A SIF is subject to either:

- An annual fee of EUR4,000 (EUR8,000 or more for umbrella structures, depending on the number of sub-funds).
- A registration fee of EUR4,000 (EUR8,000 for umbrella structures).

SIFs formed as SICAFs can benefit from double tax treaties. The application of double tax treaties to SIFs is generally complex and must be reviewed on a case-by-case basis. SIFs formed as FCPs generally do not benefit from double tax treaties.

Management services for these vehicles are exempt from VAT. SIFs are considered as VAT taxable persons but their activities are generally exempt from VAT. Therefore, they cannot in principle deduct input VAT. Active VAT strategy should therefore be implemented to mitigate VAT costs for these vehicles, notably on deal fees (for example, use of VAT exemption on certain services received, recharge of costs, and so on).

The following tax treatment applies:

- **Domestic investors.** Income received by both individuals and corporate domestic investors from SIFs is taxable under the usual tax rules. Capital gains realised by individual investors are taxable if the sale occurs less than six months following the purchase of the units and the seller holds more than 10% of the SIF.
- **Foreign investors.** No Luxembourg tax applies. Income derived from a SIF is taxed in the country where the investors are resident.

VAT Exemption Applicable to the Management of AIFs

Under current Luxembourg VAT legislation, the management of AIFs benefits from a VAT exemption. The Luxembourg VAT legislation was amended by the Luxembourg Law of 12 July 2013 on Alternative Investment Fund Managers (AIFM Law) to specifically cover AIFs in the VAT exemption regime. This VAT exemption applies, in principle, to administration, portfolio and risk management services rendered to a fund. Services delegated to a third party may also benefit from a VAT exemption. VAT exemptions are, however, to be interpreted strictly and in the light

of Luxembourg and European case law. A case-by-case analysis is advisable.

7. What foreign private equity structures are tax-inefficient in your jurisdiction? What alternative structures are typically used in these circumstances?

The use of a foreign structure is unlikely as Luxembourg is typically used as a platform for holding and acquisition vehicles in operating groups, either in Luxembourg itself or abroad. The features of Luxembourg as a holding location are equally strong for Luxembourg targets and foreign targets. Therefore, it is unlikely that foreign holding vehicles would be set up to acquire a Luxembourg group.

Foreign investment vehicles commonly used for PE funds in other jurisdictions are generally tax transparent (subject to review on a case-by-case basis) in Luxembourg, such as:

- UK Channel Islands limited partnerships.
- Caribbean alternative investment vehicles.
- Delaware limited liability companies.

FUND DURATION AND INVESTMENT OBJECTIVES

8. What is the average duration of a private equity fund? What are the most common investment objectives of private equity funds?

Duration

Despite the recent trend in the market for longer term funds, in large buyouts the majority of funds are still ten years, either from the first or final closing date. There are then typically two possible extensions of one year each. In some cases, the first extension can be at the manager's discretion, but both extensions usually either require advisory board consent or often an investors' 50% consent.

Investment Objectives

The main objective of PE and VC funds is to have the highest return on capital possible at the time of the exit (capital gain) and a seamless repatriation without tax leakage.

VC funds focus on promising private companies with high growth potential, taking usually a minority participation with the view to realising a return from their investment only on the occurrence of a liquidity event. PE funds usually hold more than 50% of the equity of the company they invest in (which has growth possibilities and where they can improve profitability). PE investment objectives include, in some cases, distributions before liquidity, although the largest part of their return occurs when a liquidity event occurs (that is, the acquisition of the company or a public offering of its shares). Accordingly, VC and PE firms insist on certain rights as part of their investment, to ensure that there is an opportunity for liquidity. In this respect, the interests of founders and investors in both PE and VC (that is, achieving significant financial return from an appreciation in the value of their equity holdings) are aligned.

The volume of equity bridge financings for both VC and PE funds has increased considerably because, in the current market conditions, they boost the internal rate of return (IRR) of these funds.

FUND REGULATION AND LICENSING

9. Do a private equity fund's promoter, principals and manager require authorisation or other licences?

Whether the management bodies require CSSF approval depends on the type of investment vehicle used.

The AIFM Law imposes new requirements on Luxembourg based alternative investment fund managers (AIFMs), which must now be authorised by the CSSF when managing assets acquired with leverage in the fund of EUR100 million or more, or assets under management with no leverage in the fund of EUR500 million or more. These requirements include, among other things:

- The obligation to retain eligible conducting officers.
- The enhancement of the central administration and substance of the structure.
- The necessity to introduce rules or policies on risk management, compliance, internal audit, transparency, remuneration and conflict of interest situation.

The CSSF is also the competent authority for approving SICARs and SIFs, and specifically requires the following:

- SICAR or SIF directors and managers must prove their ability to perform their duties. The AIFM Law implies changes in this respect (see *Question 4*).
- Constitutive documents to be produced (that is, prospectus, issuing documentation, management regulations or articles of incorporation), which must comply with the applicable laws.
- The appointment of a custodian with whom the SICAR's or SIF's assets are deposited.
- The appointment of an independent auditor (for monitoring obligations, see *Question 6*).

There is no requirement for a promoter.

In respect of VC funds, in addition to the above, the establishment of an EuVECA is subject to CSSF prior approval. CSSF prior approval ensures compliance with rules relating to diversification, the conduct of business, investment policy, treatment of investors, delegation, and conflicts of interest.

10. Are private equity funds regulated as investment companies or otherwise and, if so, what are the consequences? Are there any exemptions?

SIFs and SICARs are regulated entities, and are, therefore, subject to prior approval by the CSSF before they are launched. These vehicles must issue a prospectus or issuing document, which is examined or approved by the CSSF (see *Question 14*). The central administration of the fund (that is, bookkeeping, share registrar and transfer agent services) must be located in Luxembourg. RAIFs are supervised through the AIFM managing them.

Soparfis are non-regulated vehicles and therefore do not require regulatory approval. For the avoidance of doubt, this includes the limited partnerships. However, for those *Soparfis* whose equity can be offered to the public, a prospectus complying with the rules of the Prospectus Regulation ((EU) 2017/1129) must be approved by the CSSF.

Exemptions from publishing a prospectus apply in some circumstances.

11. Are there any restrictions on investors in private equity funds?

Number of Investors

A SARL must have a minimum of one shareholder and a maximum of 100. An SCA, an SCS and a SCSp must have a minimum of two shareholders (at least one unlimited partner, who often is the general partner, and one limited partner) with no maximum limit. The minimum required for an SA is one shareholder.

Type of Investors

The investors in a SICAR, SIF or RAIF must be well-informed investors, which are any of the following:

- An institutional investor.
- A professional investor.
- Any other investor that:
 - confirms in writing that it adheres to the status of a well-informed investor; and
 - invests a minimum of EUR125,000 or is certified by a credit institution, an investment firm or a management company as having expertise, experience and knowledge in adequately appraising an investment in the SICAR or in the SIF.

Managers and other persons who are involved in the management of a RAIF, SICAR or SIF are no longer required to certify their status as a well-informed investor to be an eligible investor. Further, as for any fund, the manager is responsible for the compliance with anti-money laundering requirements for any investor in the fund it manages.

12. Are there any statutory or other maximum or minimum investment periods, amounts or transfers of investments in PE funds?

There are no statutory or other limits on maximum or minimum investment periods, amounts or transfers of investments in SICARs and SIFs, as well as in any unregulated fund vehicle. Any limits are subject to the contractual terms agreed by the parties themselves. The investments in a SICAR must be made for a certain period of time with the intention of a later sale at a profit. For a SICAR or a SIF, the Commission for the CSSF can also give some additional requirements for a specific investment policy. Risk spreading rules apply to RAIFs that both:

- Do not invest in risk capital.
- Are subject to the application of the special tax regime described below.

While no specific rules are included in the RAIF Law, the position taken is to apply the diversification rules applicable to SIFs.

13. How is the relationship between the investor and the fund governed? What protections do investors in the fund typically seek?

The prospectus or issuing document and the articles of association or management regulations regulate the relationship between the investors and the fund. No best practice guidance is published in Luxembourg.

The main aim of the prospectus or issuing document is to protect the investors by giving them information on the nature of the

investments to be made. Among other provisions, the prospectus states the rules relating to:

- The investment strategy.
- Distributions.
- Information rights.
- Key man provisions.
- Fees, expenses and the remuneration policy.
- Commitments.
- Exit.
- Divorce.
- Carried interest.
- Hurdle rates.

Regarding key investor protections trends, with no fault provisions, voting thresholds are usually 75%, whereas for fault provisions only a simple, or occasionally two-third, majority is typically required. The pendulum tends to swing in favour of investors in relation to no fault removal provisions. A key feature of the investor protections is the treatment of carried interest following removal of the GP or termination of the fund. In the overwhelming majority of cases, GP are permitted to retain all the carried interest from investments made before the no fault event. On a fault removal or termination, the carried interest treatment is generally much more investor-friendly.

INTERESTS IN PORTFOLIO COMPANIES

14. What forms of equity and debt interest are commonly taken by a private equity fund in a portfolio company? Are there any restrictions on the issue or transfer of shares by law? Do any withholding taxes or capital gains taxes apply?

Most Common Form

PE funds commonly take securities or financial instruments in a portfolio company (that is not situated in Luxembourg but in the country of the target to be acquired by the PE or VC fund), which may carry specific financial or voting rights (such as preferred dividend rights). More complex and hybrid instruments can be used, depending on the financial arrangements and ultimate tax planning at investor level, which enable profit repatriation, capital gains or dividend flows in a tax efficient manner. The nature of certain hybrid instruments is currently being revised in the light of the OECD base erosion and profit shifting project (BEPS), as well as based on the Anti-Tax Avoidance Directive ((EU) 2016/1164). As a general rule, a pure *Soparfi* can be financed up to 85% by debt, provided equity represents the remaining 15% of the company's total financing.

The issue or transfer of shares is subject to statutory legal requirements and the specific provisions of the company's articles of association. Generally, transfers or issues require approval by an extraordinary general meeting of shareholders (general meeting), or by the board for authorised capital.

Other Forms

PE funds can take a preferred equity interest in an investee company. However, debt investments or a mix of preferred equity and debt are also common.

Restrictions

The legal restrictions on the transfer of shares depend on the type of company:

- **SARL.** A SARL's shares can be transferred to non-shareholders if a majority of the current shareholders, representing at least three-quarters of the corporate capital, agree to this in a general meeting. Specific clauses can also be included in the articles of association relating for example to pre-emption and rights of first refusal for the benefit of the remaining shareholders.
- **SCA and SA.** The general partners' and limited partners' shares of an SCA are freely transferable. An SA's shares are also freely transferable. Other provisions relating to restrictions on transfers, pre-emption and first-refusal rights are generally allowed, but are subject to certain restrictions, as a shareholder of an SA or SCA cannot be fully restricted from selling its shares.
- **SCS and SCSp.** The general partners' and limited partners' shares in a SCS or a SCSp are generally not freely transferable. The conditions of transferability are usually provided in the limited partnership agreement.

Taxes

The potential levying of withholding tax and capital gains tax is assessed on a case-by-case basis depending on the type of fund and investor.

BUYOUTS

15. Is it common for buyouts of private companies to take place by auction? Which legislation and rules apply?

Auctions are common even for smaller and medium-sized buyouts. Most recent transactions for the acquisitions of financial services companies were done by auction. Auctions are not specifically regulated as such, but competition law is always considered.

16. Are buyouts of listed companies (public-to-private transactions) common? Which legislation and rules apply?

Buyouts of listed companies in Luxembourg are not common, as few companies have their shares (as opposed to debt instruments) listed on the regulated market of the Luxembourg stock exchange. Until recently, Luxembourg did not have specific legislation regulating takeover bids. The hostile takeover bid by Rotterdam-based Mittal Steel for steel producer Arcelor prompted the Luxembourg Government to implement the Takeover Directive (2004/25/EC). As a result, security holders are now protected, and have enough time and information to allow them to reach a properly informed decision on the bid. In addition, new principles on mandatory offers, squeeze-outs, sell-outs and rights of withdrawal all regulate takeover bids and allow for better security for this type of transaction.

Principal Documentation

17. What are the principal documents produced in a buyout?

Equity Documents

These documents usually include:

- Letter of intent.
- Binding offer or memorandum of understanding.
- Confidentiality agreement.
- Share purchase agreement.
- Shareholder agreement.

- Amended and restated employment and service contracts.
- Documents relating to the guarantees concerning the purchase price payment and the satisfaction of potential liabilities (for example, in the case of breach of a representation and warranty).

Financing Documents

These documents usually include:

- Senior or mezzanine facility agreements.
- Security documents granting security over the shares and assets of the acquisition vehicle and the target.
- Inter-creditor agreement.

Buyer Protection

18. What forms of contractual buyer protection do private equity funds commonly request from sellers and/or management? Are these contractual protections different for buyouts of listed companies (public-to-private transactions)?

Representations and Indemnities

The most standard representations and warranties include the following:

- The organisation of the target and its ownership.
- The target's capitalisation (equity and shareholder debt, if any).
- Legal and regulatory compliance.
- The target's financial position (particularly the accuracy of the accounts on which the purchase price is based).
- Important contracts relating to the business of the target.
- Litigation.
- Employment.

Usually, warranty and indemnity protection are provided from both the seller in the sale and purchase agreement and management in the investment and shareholders agreement. If the seller is a PE fund, the scope of the representations and indemnity deal protection is more limited.

Purchase Price Adjustment

Lockbox arrangements are much less common since the financial crisis. Earn-out provisions are now the preference with a substantial part of the purchase price dependent on the target's financial performance after closing.

Information Rights in Favour of the Sponsor

The sponsor is usually represented at the board of the target and obtains (as a shareholder) regular reporting from management.

Management Continuity

The fund can also require an undertaking from the target's management to remain in office for a minimum duration. Some service contracts (such as IT and accounting) can be extended for an agreed duration.

Exit

The articles of association of the target include the sponsor's rights to various exit routes, for example:

- IPO.
- Sale of all or part of the target.
- Liquidation.

- Merger.

19. What non-contractual duties do the portfolio company managers owe and to whom?

Non-contractual duties, such as duties of confidentiality and loyalty to the portfolio company, derive from general civil law obligations to act in good faith in the execution of any contract. These obligations are also usually set out contractually (common in employment contracts, but less common in the corporate mandate between the company's management body (managers or directors) and the company).

Managers with a corporate mandate must also exercise their mandate in line with the principles of good management, and act in the company's best interest.

20. What terms of employment are typically imposed on management by the private equity investor in an MBO?

A PE investor typically imposes the following terms on management in an MBO:

- Exclusivity.
- Non-solicitation.
- Confidentiality.
- Non-competition clause.
- Management incentive plan with an economic return to management in line with the performance of the target.
- Good leaver or bad leaver rights and obligations for those managers leaving the target before an exit.

21. What measures are commonly used to give a private equity fund a level of management control over the activities of the portfolio company? Are such protections more likely to be given in the shareholders' agreement or company governance documents?

The measures depend on the outcome of negotiations between the fund and its management, and the legal rules regulating the target.

However, a fund typically requires from its portfolio company:

- Shareholder approval of some major decisions, stricter quorum rules, majority voting for some decisions and veto rights.
- The right to submit a list of candidates from which the shareholder meeting must choose a manager.
- Stricter quorum rules and majority requirements for board resolutions.
- The right to receive certain relevant information.
- The creation of internal committees in the portfolio company (right of information and consultation).

Whether these protections should be inserted in the articles of association or in a shareholder agreement is considered on a case-by-case basis.

The remuneration of key managers of the target or target group is usually tied to the performance of the target or target group with a management incentive plan often set-up as one of the various corporate vehicles.

DEBT FINANCING

22. What percentage of finance is typically provided by debt and what form does that debt financing usually take?

Financing by debt can come either from the investors (to benefit from the deduction of interest) or from third parties.

Investors' debt financing can take several forms, ranging from straightforward shareholder loans to hybrid, convertible or subordinated instruments. Interest paid to investors must be at arm's length. In addition, as far as holding activities are concerned, an 85:15 debt-to-equity ratio is generally regarded in practice as acceptable (other ratios may be acceptable provided the overall interest is not excessive). There are interest limitation rules from 2019 (*Anti-Tax Avoidance Directive*).

Third party financings usually take the form of senior or mezzanine loans (syndicated or otherwise). Bond issues are also an option (parties enjoy a large degree of freedom in their terms and conditions), with bonds becoming very common for financings from EUR200 million for add-on and refinancing. Debt-to-EBITDA (earnings before interest, taxes, depreciation, and amortisation) ratios have been, in most cases in 2016 and 2017 around 7x EBITDA, with a general trend towards weaker covenants, larger credit lines and narrower pricing, although the European lenders have been more cautious than US lenders.

Lender Protection

23. What forms of protection do debt providers typically use to protect their investments?

Protection for debt providers is regulated by the Law of 5 August 2005 on collateral arrangements, implementing the Financial Collateral Directive (2002/47/EC).

Security

Pledge of assets (*contrat de gage*). This is the most common way of taking security over Luxembourg assets. Pledges over shares or intra-group receivables and bank accounts are usually taken over all securities issued down to the target and certain members of the group. Ring-fencing is usually one level below the fund and the management company set-up for the management incentive plan (if any), to ensure that:

- The fund and management are not a party to the inter-creditor arrangements.
- In the case of small PE funds, the thresholds under the AIFM Directive (2011/61/EU) are not reached.

Depending on the business of the target or target group, a pledge over various items such as the business, IT rights and insurance contract rights will be granted in favour of third-party lenders. Mortgages remain rare in the practice of leveraged finance deals.

Transfer of ownership by way of security interest (*transfert de propriété à titre de garantie*). This transfer can apply to the same assets as for a pledge of assets. On default, the transferor does not need to transfer ownership back, in accordance with the terms and conditions agreed in advance by the parties.

Contractual and Structural Mechanisms

Contractual subordination, acceleration and netting mechanisms are frequently used to secure investments.

Financial Assistance

24. Are there rules preventing a company from giving financial assistance for the purpose of assisting a purchase of shares in the company? If so, how does this

affect the ability of a target company in a buyout to give security to lenders? Are there any exemptions?

In principle, an SA or SCA can advance funds, make loans or provide security with a view to the acquisition of its shares by a third party, under the following conditions:

- Transactions must take place under the supervision of the board of directors or the management board (which must issue a specific report), and gain prior approval at a general meeting of shareholders.
- The transaction must be at fair market value, particularly in relation to interest received by the company and in relation to security provided to the company for the loans and advances.
- The credit standing of the third party must be duly investigated.
- The aggregate financial assistance granted must at no point result in the reduction of the net assets below the amount specified in the Luxembourg Act dated 10 August 1915 on commercial companies, as amended (Companies Act).
- The company must include a reserve in the liabilities in the balance sheet, which is unavailable for distribution, of the total amount of the financial assistance.

However, this rule does not apply to the acquisition of shares by, or for, the company's employees.

The above rules do not apply to a SARL, SCS or SCSp.

Insolvent Liquidation

25. What is the order of priority on insolvent liquidation?

Insolvency procedures are regulated by law, notably the:

- Commercial and Civil Codes.
- The Law of 24 May 1989 relating to employment contracts.
- The Law of 5 August 2005 on collateral arrangements and the Insolvency Regulation ((EC) 1346/2000).

All creditors, other than secured and privileged creditors, must be treated equally. Payments to secured and privileged creditors are made in the following order:

- The receiver's fees and the liquidation expenses.
- Privileged claims, for example, money owed to employees, certain social security contributions and outstanding taxes.
- Payment of the lower ranking privileges and secured creditors.

However, pledges and transfers of ownership through security interest remain valid and fully enforceable, despite the start of insolvency proceedings against the grantor, to the extent they apply to financial instruments (including all types of securities) or receivables (including those resulting from bank accounts), as well as netting arrangements. Secured assets covered by these security interests are, therefore, not included in the assets available for distribution to the general pool of creditors.

Shareholders' capital contributions are only repaid once all other creditors have been fully satisfied.

Equity Appreciation

26. Can a debt holder achieve equity appreciation through conversion features such as rights, warrants or options?

It is possible, and common in some circumstances, for debt holders to achieve equity appreciation through using conversion features on convertible debt instruments, warrants and/or options.

Typically, these instruments are highly subordinated and have a lower interest rate, as their remuneration or appreciation is embedded in the conversion feature. Through the conversion feature, the instrument appreciates in value according to the appreciation of the shares into which the instrument is convertible. The law permits high legal flexibility for the design of these instruments, combined with extensive administrative tax practice. It is advisable to confirm the tax treatment with the Luxembourg direct tax authorities depending on the circumstances.

PORTFOLIO COMPANY MANAGEMENT

27. What management incentives are most commonly used to encourage portfolio company management to produce healthy income returns and facilitate a successful exit from a private equity transaction?

There is no specific legislation regulating management incentives. Share options are most commonly used to encourage management to be involved in the company's development, since they can benefit from favourable tax treatment in certain circumstances (see *Question 28*).

The following are also used:

- Share purchase plans.
- Phantom share plans.
- Other types of bonus schemes linked to the company's results.

Ratchets are used and their mechanism is defined contractually, as they are not regulated and can take different forms.

28. Are any tax reliefs or incentives available to portfolio company managers investing in their company?

Share options are most commonly granted to encourage management to be involved in the company's development, as they may benefit from favourable tax treatment in certain circumstances.

The 2021 budget law dated 19 December 2020 introduced a new tax regime providing for a 50% tax exemption for bonuses granted to employees, within the limit of 25% of the employee's gross remuneration and 5% of the employer's commercial profits of the preceding year. Despite the exemption, the bonus also remains fully deductible for the employer.

29. Are there any restrictions on dividends, interest payments and other payments by a portfolio company to its investors?

Article 30 of the AIFM Directive provides (subject to certain exceptions) limitations on distributions, capital reductions, share redemptions or purchases of own shares by a private or public portfolio company during the first two years of ownership by a PE fund managed by an AIFM. Although drawn from European company law applicable to public companies, the restrictions

under Article 30 of the AIFM Directive apply to private and public companies owned by PE funds, and therefore are more burdensome than the regulatory regimes in place in many EU member states at the moment.

The AIFM:

- Must not facilitate, support or instruct any of the prohibited actions.
- Must not vote in favour of the prohibited actions.
- Must use "best efforts" to prevent the prohibited actions.

Therefore, the acquisition structure considers such restrictions to accommodate necessary cashflow to upstream in light of the overall transaction with equity/quasi-equity financing by the sponsor (for example, repayment of loan notes is not covered by the Article 30 provisions, so if an investment is structured by way of loan notes the Article 30 restrictions would not apply).

Further, interim and annual dividends require distributable reserves. *Soparfis* must retain a legal reserve of 5% of the yearly profit, up to an amount of 10% of the share capital of the company.

There are no other restrictions on interim dividend distributions for limited liability companies or SARLs. SCAs and SAs can only distribute interim dividends in certain circumstances, and if their articles of association allow this.

Distribution of dividends is generally subject to a 15% withholding tax, unless the rate is reduced (even to nil) by a:

- Double tax treaty or the rules implementing the Parent-Subsidiary Directive (which have been extended and adapted to dividend distributions).
- Funding instrument allowing repatriation of the profits free of withholding tax.

There is no withholding tax on liquidation proceeds or on interest payments (except in specific circumstances) (see *Question 4*).

30. What anti-corruption/anti-bribery protections are typically included in investment documents? What local law penalties apply to fund executives who are directors if the portfolio company or its agents are found guilty under applicable anti-corruption or anti-bribery laws?

Anti-corruption provisions are usually included in the warranties and restrictive covenants of the acquisition agreement. In addition, it is increasingly common to include principles of good governance into the rules of procedure for the management.

In general, it is prohibited to corruptly solicit, receive, promise or offer any gift, reward or other advantage, whether directly or indirectly, as an inducement to a person to do or forbear from doing anything (*Articles 246 and 247, Luxembourg Criminal Code*).

Active and passive corruption in the private sector is punishable, for natural persons, by one month to five years' imprisonment and a fine (*Article 36, Luxembourg Criminal Code*).

EXIT STRATEGIES

31. What forms of exit are typically used to realise a private equity fund's investment in a successful company? What are the relative advantages and disadvantages of each?

Trade sales and secondary buyouts remain the most common form of exit. The form of exit used mainly depends on:

- The form of the corporate vehicle.
- Where the portfolio company is located.

- The contractual and commercial reasons for the exit.

With corporate vehicles, an exit (full or partial) can be made through the following ways, or a combination of all or some of them:

- Redemption of the funding or debt instruments.
- Redemption of shares.
- Voluntary liquidation of the corporate vehicle.

Distribution of dividends. This is used less frequently as it is generally subject to withholding tax.

32. What forms of exit are typically used to end the private equity fund's investment in an unsuccessful/distressed company? What are the relative advantages and disadvantages of each?

Forms of Exit

In most cases, the form of exit from an unsuccessful portfolio company depends on the foreign law applicable to that company. The usual forms of exit are the sale to another fund or to the management. An asset sale is rarer in practice, as is an insolvent exit. However, a voluntary winding-up is most likely to be the preferred exit of the Luxembourg holding vehicle. In some cases, the bankruptcy rules can also apply.

Advantages and Disadvantages

There are no particular advantages or disadvantages to the different methods. Liquidation should not trigger any adverse legal (in particular, tax) consequences.

REFORM

33. What recent reforms or proposals for reform affect private equity?

Heavier compliance rules were introduced in 2018:

- On 1 January 2018, the PRIIPs Regulation ((EU) 1286/2014) entered into force. Its scope is broad, as PRIIPs are defined as investments where, regardless of the legal form, the amount repayable to the retail investor is subject to fluctuations due to exposure to reference values or to the performance of one or more assets which are not directly purchased by the retail investor. The PRIIPs Regulation introduced the obligation for any persons who manufacture a PRIIP (including, among others, funds, carry and co-invest vehicles) to provide EU retail investors with a key information document (KID). Well-informed investors of a SIF, SICAR or RAIF may fall within that category. The KID must comply with certain criteria (size and language of the document), and be provided before the sale, to give the investor enough time to make an informed decision. The PRIIPs Regulation provides a clear definition of retail investor, which broadly comprises EU individual and small companies (unless they can be defined as a professional investor). It applies to sales of both newly created investments and existing investments. In many cases, it requires sponsors to adjust existing offering documents to ensure that securities in funds

were marketed to well informed investors qualifying as professional clients for the purposes of the AIFM Directive.

- Since 3 January 2018, all portfolio managers must review their policies and procedures to ensure that, following the implementation of the MiFID II Directive (2014/65/EU), all marketing materials and other communications to be made to clients and potential clients are reviewed to ensure compliance with the MiFID II requirements before they are sent. Communications to all client categories must now comply with the fair, clear and not misleading rule. However, the most significant change is that MiFID II extends to professional clients.
- The General Data Protection Regulation (GDPR) ((EU) 2016/679) replaced the existing data protection framework from 25 May 2018. While the GDPR retains core data protection definitions and requirements, it introduces enhanced obligations and establishes new rights for individuals with respect to personal data. The GDPR introduces a competition-like sanction regime with potential fines for:
 - violation of core data protection requirements (including processing without valid consent, breach of individuals' rights and unlawful data transfers) of up to the higher of EUR20 million or 4% of global annual revenues;
 - violations regarding notification of data breaches, data processor terms and other requirements of up to the higher of EUR10 million or 2% of global annual revenues.
- This marks a substantial increase in potential fines compared to the current regime. Funds businesses handle significant amounts of personal data relating to investors, business contacts and employees. Therefore, sponsors have prepared for the implementation of the GDPR by assessing their data protection policies and practices, performing a gap analysis to identify the areas requiring changes, and starting to implement the required changes.

More generally, uncertainty as to what the regulatory environment looks like following Brexit remains and affects many Luxembourg AIFs currently managed by authorised UK-based AIFMs, and current fundraisings of Luxembourg funds. Progress on a third-country passport is out of reach since the end of the transition period. EU Law ceased to apply on 1 January 2021 and the passporting right of UK entities has been terminated. Currently, Luxembourg funds with managers who do not fall under the AIFM Directive, either because they are regulated outside the EU, or because they operate in the EU but are too small to be within its scope, have few options. By 31 December 2020, all Luxembourg funds managed by a UK AIFM needed to either appoint an EU AIFM to maintain their passporting rights, or obtain prior investor approval and submit a notification to the CSSF. Alternatively, managers actively fundraising must comply with the national rules of each of the countries in which they wish to market their fund (unless they are managing the fund within the EU and either qualify for the VC passport under the EuVECA Regulation ((EU) 345/2013), or voluntarily opt-in to full compliance with the AIFM Directive). These national private placement rules (NPPRs) are not easy to navigate, and compliance burdens range from relatively light to almost impossible.

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