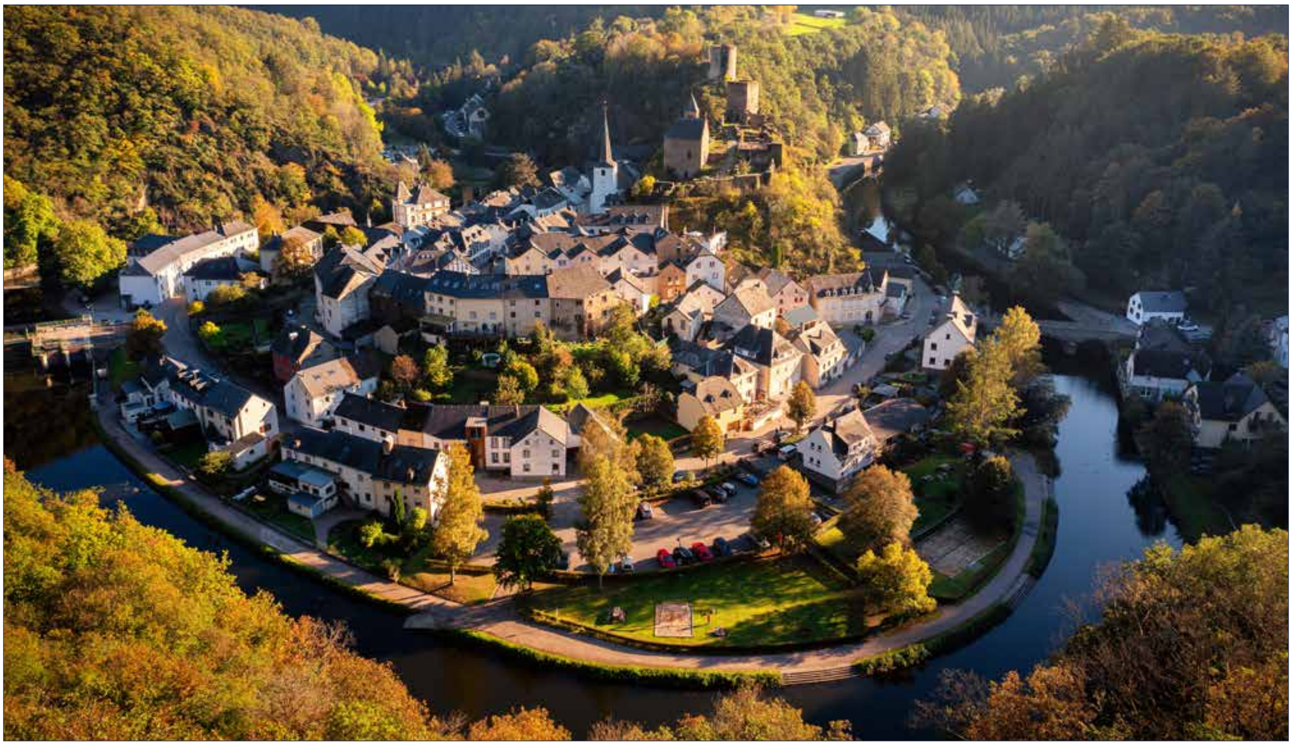
Luxembourg: funds in flux

As Luxembourg updates its legislation and prepares for a potential surge in new types of fund, what do lawyers anticipate?



▲ **The Grand Duchy's investment funds amount to €5.2 trillion, making it Europe's largest fund centre**

For a small country of just 660,000 people, Luxembourg can boast some big numbers. Total net assets in the Grand Duchy's investment funds amount to around €5.2 trillion, making it Europe's largest fund centre, and the second largest worldwide after the United States. The share of net European alternative assets under management held by Luxembourg-domiciled funds increased from 15.6% in 2010 to 61.8% in 2022, according to Preqin.

Luxembourg is also the world's largest distribution centre for investment funds, which are offered in more than 70 countries. Alongside Germany, Denmark, Netherlands, Sweden, Norway, Switzerland, Singapore and Australia, Luxembourg is one of the very few countries to have highest AAA credit rating from all three ratings agencies: S&P Global, Fitch and Moody's Investors Service. It is therefore no surprise that sovereign wealth funds and large pension funds – attracted by robust regulatory control, legal certainty and tax efficient frameworks – choose Luxembourg for their investment platforms, holding companies, and feeder funds.

The investment funds space is evolving in Luxembourg, which has been updating its legislation and preparing for a potential surge in the establishment of European Long-Term Investment Fund vehicles (ELTIFs), while awaiting revisions to the UCITS Directive and the Alternative Investment Fund Managers Directive (AIFMD) from the European Union (EU). Luxembourg is also an EU market leader in ESG – most alternative investments are directed at ESG-compliant investments. The majority are Article 8 funds, which promote environmental or social characteristics and have good governance. A hub for both alternative and retail funds since the introduction of the AIFMD more than a decade ago, Luxembourg looks to be well-placed to continue its dominant position in European funds.

UCITS rebound

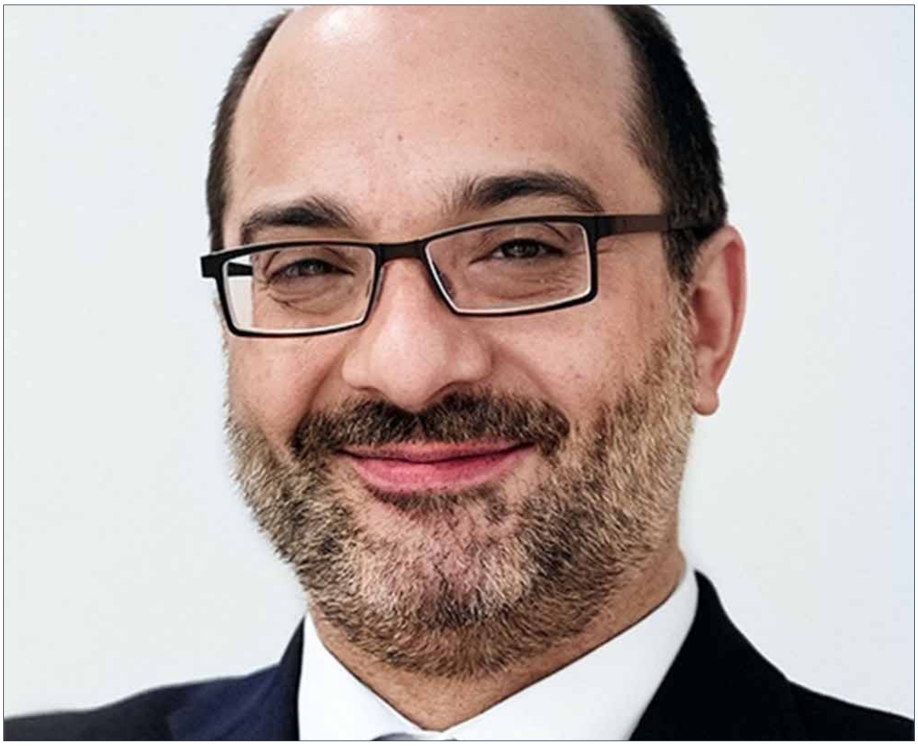
So, what do Luxembourg lawyers think?

"We're optimistic," says Antonios Nezeritis, managing partner of the local Ashurst office. "Luxembourg remains the largest funds market in the world outside the US and is still very attractive. We have a second to none funds toolbox, which makes the country very attractive for sponsors and investors. We've seen asset classes that are typically very strong, such as real estate, take a dip; however, tech and digitalisation areas are still attracting investment. We've also seen many clients setting up successor funds or secondary funds."

He adds that "there is less liquidity in the market, with a lot of capital having already been spent, or many investors putting spending on hold. But we remain extremely busy – setting up new funds, not just successor funds, but brand-new strategies. Many are still in the capital-raising period: set up and waiting for investors."

As an experienced UCITS lawyer, he points to a rebound in activity. "Everyone said that UCITS are dead but we've seen, to some extent, a resurgence. The target investors are different. If you go for UCITS, you should target retail investors with certain strategies that work better in the UCITS space." Luxembourg, he notes is the "high watermark" when it comes to UCITS. "In Europe, the Middle East or Asia, they all recognise Luxembourg as the main UCITS fund centre. We're currently at UCITS V, whereas the first UCITS Directive dates back to 1988. That's 35 years, and it's worked well. Maybe a complete revamping of the UCITS directive is needed."

Ashurst is one of several dozen international firms in Luxembourg competing for work alongside Allen & Overy (A&O), Clifford Chance (CC), and Linklaters, US firms such as Dechert, and strong European firms such as Loyens & Loeff. Their chief local competitors for work are the two traditional powerhouses – Arendt & Mederenach, and Elvinger Hoss Prussen (EHP).



❝ In Europe, the Middle East or Asia, they all recognize Luxembourg as the main UCITS fund centre

Antonios Nezeritis, Ashurst

Pressure to deploy capital

"EHP and Arendt are big local firms – they've been here for many years – we have them as counterparty on a lot of transactions," says Louis-Maël Cogis, head of Simmons & Simmons' Luxembourg office. "On the opposite side, A&O, Linklaters, CC, are the ones we see most, and Loyens, especially. It depends on the profile of the transaction. If you have international funds to be established, you will see Arendt or EHP more as local advisor to your counterparty. When we have big international transactions in banking, that's more often a regional firm or the Luxembourg office of Linklaters or A&O, typically."

Clients hope for activity to recover soon because there's pressure to deploy capital, he says.

"There are two ends of the spectrum: the long-planned transaction on one side – we'll do the deal in six months' time – or the opportunistic one, that's urgent and immediate. On the banking transaction side, that usually occurs within a month." In asset management and corporate services, he adds "there's been some restructuring – for economies of scale and to increase their client portfolio."

According Pieter Leguit, Simmons & Simmons funds partner in Luxembourg: "There isn't a huge dip in funds being set up, it's just that capital raising takes longer – a longer process to get to first close driven by macroeconomic factors, because most funds we work on don't require regulatory approval beforehand." As for the new funds regulation, he says that it is "a change of existing regulation; a good thing, because it harmonises what we have with existing EU rules, and creates more structuring flexibility." ▶

Cogis quotes from the most recent FATF report: Luxembourg has a "high level of technical compliance with FATF requirements, and its AMF CFT regime." It's still a AAA country, he says "one of the very few. A very good environment to do business – that's why we're positive about growth."

Personal relationships matter

Co-Managing Partner of the Loyens & Loeff Luxembourg office and head of the Investment Management Practice Group, Marc Meyers says: "In rankings, we compete with the magic circle, Elvinger and Arendt. Like Arendt and Elvinger, we position ourselves as a fully independent firm. Funds work is generally originated through referrals from other law firms. We believe that personal relationships matter, which is why our representative offices, notably in London and New York, play a big role because it is an opportunity for us to enhance and develop our existing relationships with our clients."

He takes issue with some of the firm's legal directory rankings. "We consider ourselves clearly as Band One for investment funds related work. While this may not be reflected by all legal directories, we believe that those directories still skip the fact that while some of our competitors have built their position historically on UCITS work, the alternatives sector has over the past years become the real growth pillar of the Luxembourg fund industry as a whole.

"We not only have one of the largest fund teams, we are also now the second law firm in terms of number of LPs advised and the third one in terms of all the legal forms of alternatives funds. We are the only leading firm focusing exclusively on alternatives, doing that well, and growing significantly with more than 50 people in our Investment Management practice."

" We believe that personal relationships matter which is why our representative offices, notably in London and New York, play a big role

Marc Meyers, Loyens & Loeff

Meyers believes that the modernisation of fund laws ensures that the Luxembourg toolbox "remains competitive and attractive". He provides an overview of the funds market this year. "Fundraising is challenging for more asset managers who have launched fewer new funds," he says. "However, funds that have been launched have become more complex, requiring much more work overall with fundraising requiring more time. Despite fewer new funds, those we have worked on were more complex."

Consolidation

"There is a consolidation trend at the manager level (for both independent and third-party managers) with big managers taking over smaller managers. We have been busy on various consolidation matters. This means we have had more work than 2022, despite fewer funds being launched." He notes that "some Anglo-Saxon managers still use Delaware or Cayman for non-EU investors, and Luxembourg for European investors thanks to the AIFMD passport. Some very large managers are looking to launch one global fund in Luxembourg for all the investors."

Loyens Corporate partner in Luxembourg, Frédéric Franckx, adds that "there is a substantial amount of dry powder, but a lack of deals. Our clients have raised billions in funds, which have not been invested – so, there is pressure on managers.

"M&A started slowly in 2023, but progressively PE firms have used their dry powder to invest," he says. "We also see more strategic M&A, and more restructuring and reorganisation of ▶

companies. The process itself also takes longer: for example, on the same project we might work for two months, stop for two, work for two, and continue with this process. These M&A transactions will probably emerge next year in better conditions."

Franckx describes the pipeline of work as blurry. "There are lots of discussions, but it is very difficult to say what will emerge in the future," he says. "Most industries are reshaping their model. Before, leverage was key – there were low interest rates; debt was cheap. Now they have to reconsider. We see more restructuring – right here, right now – this area will keep us busy. There has been a delay between expectations and reality but it is currently happening.

"If we look at Restructuring & Insolvency expertise, you can consider that there are two major teams in Luxembourg: ours and the one at Arendt, both gathering specialists in Corporate Law, Financing and Litigation." Eventually, he suggests, there will be more new funds, "potentially combined with restructurings, definitely more exits or deal activity."

Offshore players

Several offshore players have also chosen to have a Luxembourg office. "In 2005, the Luxembourg market had fewer than 500 lawyers; it's now 3,000 and still growing," says Bertrand Géradin, Ogier's head of corporate in Luxembourg. "The firm's Luxembourg office had ten lawyers in 2016; we're now 47."

The four big offshore firms with a local footprint – in addition to Ogier: Harneys, Maples, and the most recent arrival, Mourant – all compete for work with an increasingly broad spread of local and international firms across a range of practice areas, including: finance, corporate, tax, litigation and restructuring.

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Frédéric Franckx, Loyens & Loeff

Initially, funds work acted as the major catalyst for the explosive growth in lawyer numbers, but this has since evolved. Géradin explains his firm's growth story. "We started in Luxembourg in 2012, mainly funds-focused, as the first offshore firm to launch here. Then we added finance and corporate practices. We've since added tax capabilities. We used to do litigation within corporate; now we've litigation partners who joined from a Magic Circle Firm – the team went from one person in February 2023, to seven now. We believe the next core areas will be litigation and restructuring."

So, why Luxembourg?

"There's a drive for international law firms to diversify revenue, while onshore is becoming, for some clients, a necessity – the domicile dilemma is a recurrent question for certain types of investment. One way to keep clients within the firm is to be able to offer services in all main financial centres. It's one reason we opened in Ireland and we've just opened in Dubai."

In terms of competition, he says: "For finance, it's mostly US or Magic Circle on the counterparty, often act for the lender, and they represent the borrower, or vice versa. In litigation, we often act for firms not present in Luxembourg – mostly we're not conflicted, which enables us to take instructions that big firms can't, such as acting against major banks and insurance groups."

Restructuring

Non-contentious restructuring is increasingly important for Ogier in Luxembourg. "Local law is very effective in terms of enforcement of security over company shares," says Géradin. "We've been acting mostly in FinTech, electric cars." He identifies a new trend: "Limited partners (LPs) are not really happy with the general partner (GP) or sponsor, and replacing the GP. ▶

So, we have a new GP entering into some very large funds. They need to restructure the old group. Mostly, this is driven out of London/the US."

He explains the impact of increased regulation at a practical level: "When I arrived in Luxembourg, you could establish a company and open a bank account within a few days. Now it can take four to eight weeks and it is agitating for clients. This is obviously not limited to Luxembourg. We're trying to help the clients with the onboarding process and this is one reason we're starting our fiduciary business.

At a corporate level, he anticipates that "the regulatory wave will not stop any time soon. The EU Council just released the latest draft of AIFMD II. It has been long awaited and the vote is scheduled for February. AIFMD was one of the reasons to open an office in Luxembourg in 2012. It was challenging for clients at the outset, but this has now become an integral part of the EU regulatory landscape.

"We're actively discussing AIFMD II impact with our clients. This will, inter alia, have consequences on the delegation mechanism and the establishment of loan origination funds. Another topic which will remain in the spotlight is the democratisation of private assets and the revamped ELTIF II regime." Ogier is looking to add new partners. "The market in Luxembourg is still growing, and we need more people," says Géradin.

Start-ups

Vanessa Molloy, head of Harneys Luxembourg Investment Funds team, asks: "How do the local markets see us? As one of the offshore firms with a Luxembourg presence similar to Mourant, Ogier, and Maples. Each of these firms has a different presence in different jurisdictions, affecting their referrals to Luxembourg."

> *For start-up managers, if they say it's going to be a Luxembourg fund, investors know what they're getting*
>
> ***Vanessa Molloy, Harneys***

Harneys focus much of their efforts on start-up funds in Luxembourg. "For start-up managers, if they say it's going to be a Luxembourg fund, investors know what they're getting," says Molloy. "It's about the saleability of the product. Ultimately, for new managers they want a well-known product that allows for their future growth plans and is easy to explain to investors.

"Cost always comes up on the initial call. The reality is that the fund's performance has to be good enough to get you over the cost barrier, otherwise you're not going to keep your investors for fund 2. For start-up guys, certain service providers will often reduce their costs for the first year; the market still wants to try and encourage that type of manager, particular if they have worked previously at a big asset manager and are now starting their own business. We're happy to discuss fixed set-up costs with such managers on the legal side. The most important thing is that the manager's first fund is successful."

The additional regulations across the funds piece add to cost and time management, according to Molloy. "The industry would say it's a game changer, but it's not. It's a refinement of what's there already," she says.

The Irish question

Some law firms in Luxembourg focus on what they regard as its superior offering to Ireland. "On paper, there's competition with Ireland," says one prominent funds lawyer. "Maybe US clients go more towards Ireland because of language, culture, common law – historical reasons. But many others choose Luxembourg."

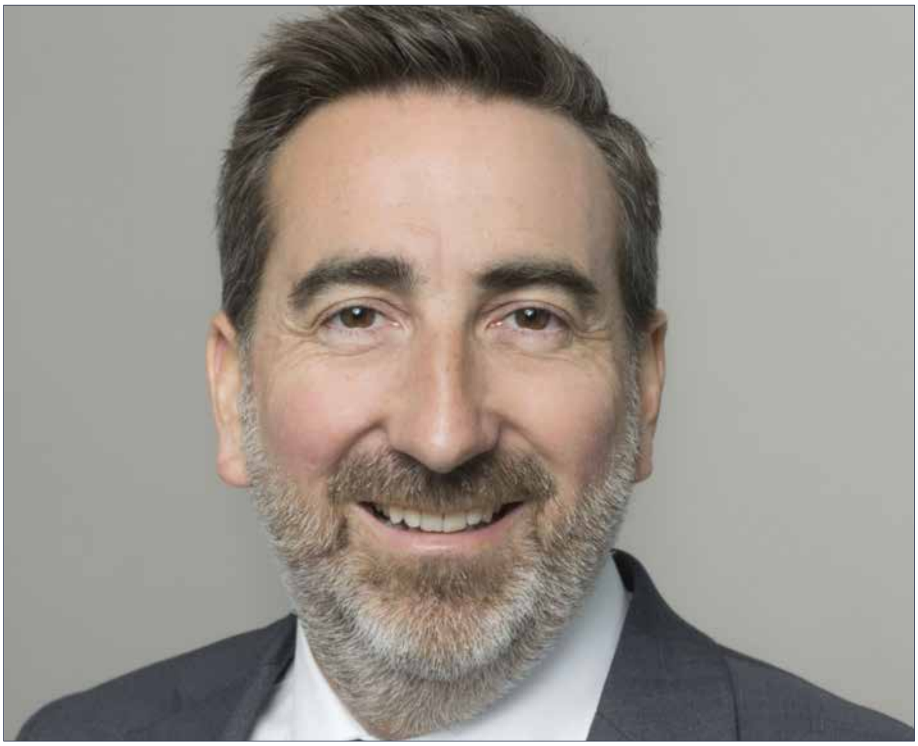
Cogis says: "We have an office in Ireland. There are areas where we are competitors, such as ▶

securitisation. Some sophisticated clients see Ireland and Luxembourg as complementary: they set up two structures, one in Ireland and one in Luxembourg. Sometimes, a client doesn't yet know: the Irish team and the Luxembourg team are on a call to discuss the possibilities. In terms of what's possible, structuring wise, there's not really that much difference between the jurisdictions. It's then: what do your investors expect, who are you marketing to, and what strategy are you using?

"The reality is that if you're marketing your funds to continental European investors and it's an alternative strategy – like PE, real estate – then Luxembourg is very well known to them. It's much easier to get investors to sign on the dotted line in a structure that they're very familiar with."

At Ogier, which also has a large Dublin presence, Géradin adds: If you get new funds wanting to enter into the European market, the choice will depend on the fund sponsor domicile, target investors and choice of strategy. As a fully integrated firm, opening an office in Ireland offers us an additional choice of a major financial centre for our clients and the possibility to accommodate the needs of the grand majority of fund sponsors. Being present in most of the main funds' jurisdictions gives us an agnostic approach on the choice of domicile for our clients."

Harneys does not yet have a Dublin office, but is considering it. Molloy is also agnostic. "Our approach is not to pitch one jurisdiction against the other, as they each have their own strengths. Luxembourg has done excessively well in capturing alternative funds through the innovative SCSp (special limited partnership) option and the Reserved Alternative Investment Fund (RAIF) regime.



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Bertrand Géradin, Ogier

"Ireland has always been known for its abilities with respect to hedge funds, which Luxembourg has not really captured. On securitisation vehicles, Ireland has also been more successful. Luxembourg recently amended its securitisation law to allow for active management of repackaged debt, be it in the form of loans (collateralised loan obligations, or CLOs) or debt securities (collateralised debt obligations, or CDOs)."

Regulatory offering

Not all international law firms focus their primary efforts on funds. Pierre Reuter, Hogan Lovells' Luxembourg office managing partner, explains: "The office opened in 2013. The main reasons for opening were funds, tax and, more generally, real estate acquisitions structured through Luxembourg. Our funds practice is small in comparison to others in Luxembourg, but we work for the same type of clients on the same deals as our competition.

"We've also developed a regulatory practice. It really built up speed with Brexit because we had a lot of questions, particularly with respect to which jurisdiction is the most attractive for UK firms to establish a presence on the continent. We cover all types of financial regulatory areas, including payment services and insurance."

Like Meyers, he has an issue with the legal directory rankings. "Legal 500 and Chambers: we are Tier 3, but we should be Tier 2. Due to the firm's network, we can however compete and are competing with Tier 1 firms – including the big international firms present in Luxembourg. However, we sometimes get the impression that clients might simply go for someone with a larger footprint in Luxembourg."

In terms of more law firms opening a Luxembourg office, he says that the cake is still big enough for everyone. "I see it as generally positive because it confirms the attractiveness of the Luxembourg market. Often, they're simply bringing in new clients – new opportunities for others to pitch for that work and get it. That's the way it works."

CSSF under pressure

Views on Luxembourg's regulator, the Commission de Surveillance du Secteur Financier (CSSF), tend to polarise. Many acknowledge that they are overworked and potentially understaffed.

"The CSSF of today is not the CSSF of five or 10 years ago – there is a much greater oversight of Luxembourg and, as a consequence, of its regulator," says one lawyer. "The CSSF isn't as flexible as it used to be; it's more conservative, careful and cautious, and less approachable." Another volunteers: "There's a lot of frustration with the CSSF; it needs to be more pragmatic and more flexible, as it used to be."

A third lawyer takes a different view: "The regulator has always been, and still is, listening to the market. The CSSF has carried out considerable recruitment as the regulatory burden increases, especially in relation to ESG, AML and funds and IFMS regulations." Reuter concludes: "The people at CSSF are good, there's a lot of pressure on them. Everyone looks at them, they have the reputation of Luxembourg as a top tier financial centre to preserve. But they need to get closer to the market again."

One of the most recent arrivals in Luxembourg is Pinsent Masons, which launched a full-service law firm in July 2022, having recruited a significant number of former Wildgen partners and their teams. In August 2023, Pinsent Masons hired partner Benoît Rose, formerly Co-Head of Investment Management at Ogier, as head of its funds practice. It was a key strategic hire for Michel Bulach who heads the Pinsent Masons Luxembourg office and leads the banking, finance & insurance practice.

▲ Industrial and Commercial Bank of China in Luxembourg: the Grand Duchy is a place where European investors can access the People's Republic

"We're close to 30 lawyers," says Bulach. "We have five key sectors firmwide: energy, financial services, infrastructure, real estate, technology. We're on track to grow the fund practice, which is central to our offering across all five core sectors."

Rose adds: "We want to build and grow a European team, and target managers in Europe

but also the US, wanting to do business in Europe for fundraising. Luxembourg is building bridges with US managers, US firms, to ensure that within the toolbox and the way we operate, we understand the complexities of how to distribute in Asia, in the US and find solutions in Luxembourg that are compatible."

In terms of referral work, Bulach says: "We have a mix of direct instructions from asset managers and US firms, but also through the UK and Pinsent Masons. Many US managers either have UK offices or use the UK as a hub. Luxembourg has historically been successful in working for banks, insurers, and asset managers. Switzerland is a very important market for us. We get work directly from asset managers in Switzerland. We also get a lot of work from Pinsent Masons' three German offices."

Bulach notes that Luxembourg has been very good in economic diplomacy as a gateway for Europe. It works both ways," he says. "Luxembourg is a place where European investors can access China. In Luxembourg city centre, you'll see more and more Chinese employees on the street, and the banks get bigger and bigger with more and more office space."

Looking ahead, he says: "We'll continue to grow the fund team, plus other teams. We plan to double the size of the lawyer team in three to five years. Much of the growth will come from financial services."

Likewise, most of Luxembourg's future growth will continue to come from financial services. ●