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Limited partnership law to broaden promoter options

AIFMD and capital rules boost consolidation trend

Luxembourg to benefit from shift to regulated centres

In this issue...

03 Flurry of legislative activity gives new impetus to alternative investment sector
By Simon Gray

05 Legal adaptability provides an international edge
By Simon Henin, Ipes Luxembourg

10 An attractive jurisdiction for private equity
By Pascal Hernalsteen, CACEIS

11 Private equity puts down deeper roots in Luxembourg
By Simon Gray

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Flurry of legislative activity gives new impetus to alternative investment sector

By Simon Gray

A raft of legislative changes, including the transposition of the European Union's Alternative Investment Fund Managers Directive into Luxembourg law and the establishment of a new legal vehicle equivalent to a common law limited partnership, as well as a new tax treaty with one of its most important markets, promise to give the Grand Duchy a significant boost as a centre for the domicile, third-party administration and back office operations of private equity investment.

Over the past decade Luxembourg has carved out a significant role in the sector, thanks in part to its established dominance in the traditional fund industry and growing expertise in alternative investments, but also the creation of two popular and widely-used instruments. The Risk Capital Investment Company or Sicar, launched in 2004 and updated to provide greater flexibility in 2008, is specifically designed for private equity, venture capital, real estate and some other related types of investment.

However, the Sicar has to some extent been upstaged by the introduction in February 2007 of the Specialised Investment Fund, a light-touch regulatory regime up to now largely used in conjunction with mutual fund (FCP) or open-ended investment company (Sicav) vehicles for all types of alternative investment, including hedge funds and 'alternative alternatives'. At the end of May the number of SIFs had reached 1,433 with assets under management of EUR257.6bn.

In March Luxembourg's Parliament passed legislation amending the SIF rules, removing an eye-catching (but seldom used) provision that allowed funds to be established in advance of application for approval from the regulator, the Financial Sector Supervisory

▶ 6

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To find out more, please contact Simon Henin, Managing Director, Ipes (Luxembourg) S.A.

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Legal adaptability provides an international edge

By Simon Henin

These remain difficult times for the private equity industry. Although there are signs that activity is regaining momentum, it remains significantly subdued by comparison with the period before the onset of the financial crisis, especially in terms of fundraising. Private equity houses are having to look to new markets and new investors to attract the same size of funds as in the past, and inevitably it is taking longer.

However, Luxembourg continues to strengthen its position as a centre for private equity activity, including the use of structures as feeder vehicles bringing fresh capital to existing funds, and transactions at holding company level.

The country has a symbiotic relationship with other major private equity centres in Europe, notably the Channel Islands, which remain the main jurisdiction for the domicile of fund vehicles and had fund assets of GBP466.bn under management or administration at the end of March. However, more private equity houses may offer EU-domiciled funds in the future, probably alongside existing offshore structures, to maximise their appeal to different types of investor.

The grand duchy is not positioned as a low-budget jurisdiction in which to provide fund services, although that is equally true of many of its main rivals in the sector. It does benefit from the ability of groups such as Ipes to bring in specialist staff from other locations to supplement local skills in particular areas.

Luxembourg's position within the private equity sector has undoubtedly been strengthened by the creation of the Specialised Investment Fund regime in order to increase its appeal to the alternative investment industry.

Since the introduction of the legislation in February 2007, the number of SIFs has grown to more than 1,400, and the law was updated earlier this year to bring many of the provisions applying to SIFs into line with the future EU Alternative Investment Fund Managers Directive in areas including risk management, conflicts of interest and delegation of functions.

Simon Henin is managing director of Ipes Luxembourg

A further overhaul of the country's fund legislation is planned for later this year to enable Luxembourg to become one of the first EU member states to incorporate the AIFM Directive into national law.

The package is expected to include other measures designed to increase Luxembourg's attractiveness to asset managers. Most important is a proposal to create a vehicle that is genuinely equivalent to the traditional common law limited partnership, which would increase the jurisdiction's appeal to promoters targeting investors familiar and comfortable with this kind of vehicle.

Luxembourg already has the Société en Commandite Simple (SeCS), which is similar to a limited corporate partnership, but the proposed new vehicle would make it significantly easier to structure limited partnership fund vehicles. Our clients tell us that this is something they would particularly appreciate, particularly as it could be used not only for regulated funds but also for unregulated investment structures.

The planned changes to Luxembourg's legislation, including amendments to existing company law, are intended to be completed by the end of this year. For the jurisdiction to have the EU directive provisions in place early should be a significant advantage, and its position as a major centre for retail funds also helps, since a great deal of the AIFM Directive's language has been borrowed from the Ucits regime, while some of the directive's requirements are already close to provisions of existing law. ■

3 ▶ authority (CSSF), as well as incorporating measures in areas such as risk management and dealing with conflicts of interest that bring the regime into line with some of the future requirements of the AIFM Directive.

The stated deadline for the adoption of the directive into national law is July 22 next year. It is highly possible that many, perhaps most EU member states will fail to carry out transposition of the legislation on time. However, Luxembourg is aiming to be one of the first countries to do so, and in all likelihood will be the very first – even though there are still grey areas surrounding some of the issues covered by the European Commission's so-called Level 2 regulation, which will set out detailed implementing measures that will take force directly throughout the 27 members of the union.

"The focus now is very much on the directive," says Yves Courtois, partner and head of private equity and corporate finance at KPMG Luxembourg. "We are moving into a phase where most players are getting prepared. There are still various unknowns, and practical considerations will be shaped in the coming year. Most players have stayed on the sidelines until recently, but now things have really started to get moving as people begin to take concrete steps to get prepared by next July."

Luxembourg's legislation will almost certainly be completed and enacted before the end of the year, according to Raymond Krawczykowski, international tax partner and private equity practice leader at Deloitte Luxembourg. "The aim is to put together a package comprising measures bringing Luxembourg law into compliance with the AIFM Directive, along with a couple of tweaks in the tax regime and a huge piece of legislation in the area of partnerships," he says.

"Luxembourg is very conscious that one of its assets is the rapidity with which it has adopted the various pieces of European legislation, for example the Ucits directives. The AIFM Directive will be difficult and take some time to implement, but being first enables you to build knowledge quickly. You learn from your mistakes and adapt.

"That is one of the benefits for Luxembourg of being small and able to respond quickly to the marketplace. The

"It is a major advantage that Luxembourg will be ready very early for the AIFM Directive."

Justin Partington, Ipes

authorities will listen to general partners, investors and service providers, and after a certain amount of time, if there are things that could be improved to make it easier for funds, they will make changes."

Krawczykowski believes the directive will make European jurisdictions more attractive to the private equity sector because it reflects investors' own priorities in the aftermath of the financial crisis. "It will make investors feel better protected," he says. "In the past they may have derived that protection from knowing the people they were dealing with. However, the trust established between general and limited partners has sometimes been challenged over the past few years.

"Even without the directive, limited partners would still have asked for 80 per cent of what is in it, such as ensuring that assets are in the hands of an independent custodian, and reporting that is more frequent or in a more standardised format. There has also been pressure on the general management fees charged by private equity firms. LPs are probably not willing to pay for the privilege of investing in a fund to the extent that they have in the past. They want better control of risks and market valuation of investments, and they want to ensure that the variable part of the GP's remuneration is connected to the long-term benefit of the fund and of its investors."

Justin Partington, commercial director of specialist private equity administration provider Ipes, adds: "It is a major advantage that Luxembourg will be ready very early for the AIFM Directive. That's partly because its existing legislation is already close to the requirements of the directive, but also because Luxembourg is such an important Ucits centre, since a lot of the language in the directive has been borrowed from the Ucits regime."

There is considerable debate about the extent to which the directive will encourage

alternative fund business to move onshore in Europe, and whether it may also persuade firms that are not targeting investors within the EU to keep their business and structures outside the union altogether. "Asian managers investors may not see any benefit," admits Krawczykowski. "They may still be comfortable with Cayman structures and not see the European rules providing any added value."

However, Pascal Hernalsteen, head of private equity and real estate at Caceis Bank Luxembourg, believes the directive should provide a boost to the Grand Duchy at the expense of non-European jurisdictions. "The domiciles that are threatened most by the AIFMD are the Caribbean and Atlantic island centres," he says. "We have seen some managers moving funds to Europe because their investors require a regulated domicile. Luxembourg is in a good position because the regulator is so proactive regarding the implementation of the directive."

Claude Noesen, a director with Credit Suisse Fund Services (Luxembourg), successor to the former Fortis Prime Fund Services business, agrees: "Luxembourg is very well placed in all domains. Across all strategies and asset classes, we have the expertise, the talent pool, tax transparency and a positive regulatory approach. However, I believe there will be a place for everybody, including offshore domiciles, in the future market environment."

Perhaps of even greater importance to the private equity industry in Luxembourg is the creation of a limited partnership structure, an initiative designed to put the grand duchy on a level playing field with common law jurisdictions, and especially territories such as Guernsey, Jersey, the Cayman Islands and Bermuda that are currently prized as domiciles by the alternative fund industry as much for their legal system and structures as their tax neutrality.

"It is another of the building blocks that had to fall into place to remedy one of our weaknesses," Noesen says. "We recognise these issues, and leading members of the Luxembourg industry have been working on them, influencing the regulator and the government to go down the right route. Obviously the channels are much shorter here than in a big country. The 'think tank' of

Luxembourg is crucial in this area, because the financial industry is the country's largest economic sector. We cannot afford to fall behind."

Ipes Luxembourg managing director Simon Henin believes that offering a limited partnership-type structure will make Luxembourg more interesting for the establishment of private equity funds. "Many fund managers and investors are used to the LP structure, so being able to offer an equivalent vehicle that works in the same way should definitely raise interest," he says. However, he thinks it may take some time to fulfil its potential: "This will be a new vehicle and there may be some questions about practical issues. But it will be useful to have available when an asset manager shows interest in Luxembourg."

The grand duchy already offers a structure comparable with a limited corporate partnership, the Société en Commandite Simple. "This has a legal personality but a very light commercial law requirement," Henin says. "However, it is not necessarily as easy as in other jurisdictions to create that kind of limited partnership structure managers and investors are familiar with. The proposed new vehicle would ease the process."

Courtois argues that the Luxembourg industry should not expect too much, too soon, since industry members are unlikely to take precipitate decisions about new types of vehicle at a time when the fundraising environment remains particularly delicate.

"Most GPs will take careful steps to

evaluate and ponder the various alternatives," he says. "Ultimately it is dialogue with limited partners that will determine whether a particular solution gains traction or not. But it is clearly a positive sign that the political will is there to encourage the industry."

Hugh Stevens, head of private equity and real estate services at BNP Paribas Securities Services, also cautions that the new vehicle may not prove an instant panacea. "I'm not surprised that Luxembourg is looking to widen its product base as managers become more sophisticated," he says. "The ability to complement other fund structures, legislation and regulation enables Luxembourg to provide something of a one-stop shop. It is a good move in that it allows the jurisdiction to provide all types of fund.

"However, just because Luxembourg is developing this does not mean that it will be successful. The limited partnership regime is a competitive fund structure, but not everyone who has introduced that regime has been successful in the past."

He adds: "One of the difficulties faced by managers these days, as they broaden their distribution network into Asia and other parts of the world, and also embrace greater diversity of distribution in Europe, is the need to manage the complexity of their fund structures. If there is one domicile that meets the majority of their requirements, that location will have an advantage. If a manager has to put together a structure covering multiple domiciles, it creates some headaches in terms of operational co-ordination between those locations."

Meanwhile, Luxembourg's role as a domicile for private equity funds is set to benefit from the signature of a revised double taxation treaty with neighbouring Germany, replacing an agreement dating back to 1958, although some aspects of the changes may bring transactions that were previously exempt into the German tax net.

The treaty is due to take effect from the beginning of 2013, subject to ratification by the parliaments of the two countries. According to Hans Stamm, a partner with law firm Dechert in Germany, the new treaty may benefit international private equity funds that often use Luxembourg holding companies (notably financial participation companies or Soparfis) for investment into Germany.

The treaty may make possible a reduction in the taxation of income from German portfolio companies (including dividends). According to Dechert, in the past it was not clear whether certain funds investing in German portfolio companies would benefit from the relief available under the treaty, but the revised agreement now clarifies that, in principle, Luxembourg investment funds (including Sicars) may claim treaty benefits.

However, other provisions may result in tax becoming payable in structures that have not been affected up to now. A new provision covers capital gains from shares in companies that derive more than 50 per cent of their value directly or indirectly from real estate assets. Henceforth, investments in German real estate companies that are held through a Luxembourg holding company may be subject to German tax.

In addition, Dechert says, investments in German portfolio companies that are capitalised through hybrid debt instruments, such as profit participating loans, by which a certain portion of German-derived profits is repatriated, will also be affected. Under the current treaty interest payments from such financial instruments were mostly not subject to German withholding tax.

However, the new agreement will authorise Germany to apply its withholding tax rate of 26.375 per cent to payments under such financial instruments, if they qualify as profit participating instruments, where the interest payment is linked to the profit of the German 'borrower'. ■

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An attractive jurisdiction for private equity

By Pascal Hernalsteen

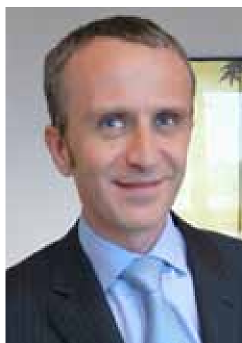
Benefiting from a flexible tax and legal environment, but also from a well-educated, multilingual, multinational workforce, and an exceptional concentration of highly skilled service providers and niche experts, the Grand Duchy of Luxembourg has in a few decades become the world's second largest centre for investment funds, surpassed only by the United States.

In addition to being the leading domicile and servicing centre for cross-border distribution of UCITS worldwide, the country has been taking active steps over the past few years to attract a significant share of the alternative investment industry and has quietly built up a solid reputation for structuring regulated private equity funds and private equity deals. The expertise gained in fund administration has been successfully transferred to the private equity arena, and Luxembourg has built up a robust private equity model and servicing platform.

Luxembourg offers a choice of both non-regulated and regulated structures that meet the different requirements of investors and sponsors. There are five vehicles available to structure private equity investments in Luxembourg: SOPARFI, UCI Part II, SICAR, SIF and Securitisation Vehicle. The majority of private equity sponsors select either a SICAR or a SIF.

The SICAR (Risk Capital Investment Company) was launched in June 2004 and has since become the grand duchy's flagship private equity vehicle. The new SICAR Law of October 24, 2008 introduced a set of further enhancements to the legislation, including the ability to create sub-funds and the upgrading of the Luxembourg limited partnership SICAR structure.

The number of SICARs has increased dramatically every year since their introduction in 2004, reaching 277 as of July 2012, according to the CSSF. This vehicle has been used by some of the top 20 private equity houses, as well as by small- and mid-sized private equity players, to invest in venture capital, private equity, mezzanine and other risk capital investments such as opportunistic real estate, microfinance or, more recently, clean energy technologies. All types of fund structuring are available, including direct funds, funds of private equity funds and master-feeder structures.



Pascal Hernalsteen is head of private equity & real estate at CACEIS

The SIF (Specialised Investment Fund) was created in February 2007 specifically to encourage the development of the alternative investment industry in Luxembourg. By contrast with the SICAR, the SIF can also be used for core property investments and hedge funds.

Over the past five years, following the implementation of the SICAR and SIF, an increasing number of private equity vehicles have been set up in Luxembourg as new lightly-regulated onshore structures, and have proved to be major successes.

These complementary vehicles offer key advantages: tax neutrality for investors and high tax efficiency for GPs, flexibility in structuring through various corporate forms, variable capital and compartments/sub-funds, as well as operational efficiency, provided for example by an explicit consolidation exemption.

Both vehicles have put Luxembourg on the map as a leading jurisdiction for private equity structuring. Even during the recent financial crisis, private equity activity in the grand duchy has shown surprising levels of growth, including the launch of new funds and the establishment or expansion of offices in Luxembourg by private equity houses and managers.

That growth is mirrored by Luxembourg's private equity service providers such as CACEIS, which have developed specialist expertise and bespoke servicing packages to deliver effective support to the private equity industry. ■

Private equity puts down deeper roots in Luxembourg

By Simon Gray

The global private equity industry remains a long way off the glory days of the mid-2000s. Exiting investments can be problematic, especially through initial public offering markets that have blown hot and cold in the past few years, but mainly cold. The public markets have given little help to portfolio company valuations. High levels of leverage that for a time seemed to help make investments a one-way bet, have subsided.

Meanwhile, fundraising remains difficult, even as more and more private equity firms enter the market, having largely been able to find fresh investments to work through the dry powder with which they found themselves at the onset of the crisis. But taking a fund to market is one thing, closing it is another.

Simon Henin of Ipes Luxembourg notes that only around 150 new firms raised a fund for the first time last year, compared to 450 in 2007, according to Preqin's Global Private Equity Report 2012. Nevertheless, at the start of this year there were a record 1,814 funds in the market, a 14 per cent increase in the number of funds on the road, targeting aggregate capital commitments of USD744.2bn.

Says Henin's colleague Justin Partington: "Across Europe, the fundraising market is tough. A placement agent told me recently that top managers are getting two-thirds of their investors to re-up two-thirds of their previous commitments. Good managers may get half the capital of their previous funds from existing investors, so to match that amount, they need to find another 50 per cent from somewhere. Everyone is looking for new investors to private equity, in the Middle East and Asia, and among who have not put money into private equity before. In

this environment, that is a challenge."

Partington says that promoters are starting to close funds early with whatever capital they can actually raise, with the aim of trying to get closer to their target amount through subsequent closings over the following year or two. "Others can't raise a new fund, but they can get smaller amounts of money from a particular investor for a co-investment or side deal," he says.

Things do seem to be improving gradually, with Preqin reporting a decline in the average time taken to raise new funds from 21 months to 17. "Right now there is a dichotomy between traditional European markets and emerging markets such as Russia, Turkey and Eastern Europe, which are still quite bullish," Partington says. "But in the UK firms are struggling to raise capital. They may get there, but it will take longer than expected."

Industry members say that following the slowdown in European and US private equity activity after 2007, there was an upsurge of interest in investment in the Middle East. However, the wave of the political instability and in some cases civil violence that erupted in some countries across the region since the beginning of 2011 has dampened activity there as well.

Caceis Bank Luxembourg's Pascal Hernalsteen says the type of funds being brought to market reflects the changes in the financial environment over the past five years. "Recently we have seen more funds investing in distressed companies and assets, while pure venture capital and buyout funds have been thin on the ground," he says. "This is partly because the leveraged loan business dried up after 2007, but also because investors are looking for true sources of diversification."

He adds: "We are seeing a trend toward funds investing in assets such as wine, jewels, watches and diamonds. We are also seeing sustained interest in infrastructure and particularly public-private partnership structures, where Luxembourg's position as an onshore regulated jurisdiction is important to investors. There is also interest in Certified Emission Reduction, where companies with significant carbon footprints have to offset their emissions by investing in renewable energy or in pre-compliant or voluntary carbon emission reductions."

On top of the market conditions, private equity firms are also facing regulatory issues that are complicating their business. The provisions of the EU's Alternative Investment Fund Managers Directive, which will come into effect in less than 12 months, are an important factor, according to KPMG Luxembourg's Yves Courtois, who says: "The directive is likely to impose an administrative burden on many of these firms, and could create a barrier to entry to the industry.

"We sense that rationalisation of the industry may take place, with the largest players best able to absorb the costs and energy required to comply with the directive, while mid-market and small players may find it much tougher. They will need to ponder their options and the potential benefits of outsourcing some of the requirements.

"An example is the question of valuation. I doubt whether we will see many appointments of pure-play independent valuation specialists, because ultimately valuation is core to the business of private equity – they are closest to the portfolio company. An external review of internal valuations would be a far less costly but sound alternative, and might also help from a fundraising standpoint."

Courtois also notes that other measures might ultimately have an even greater significance for the industry than the AIFM Directive. "Two other pieces of legislation that may have been overlooked, the Solvency II and pension fund directives, potentially could have a more far-reaching impact on private equity," he says.

"Solvency II has been somewhat overshadowed, but it is one of the most

▶ 14

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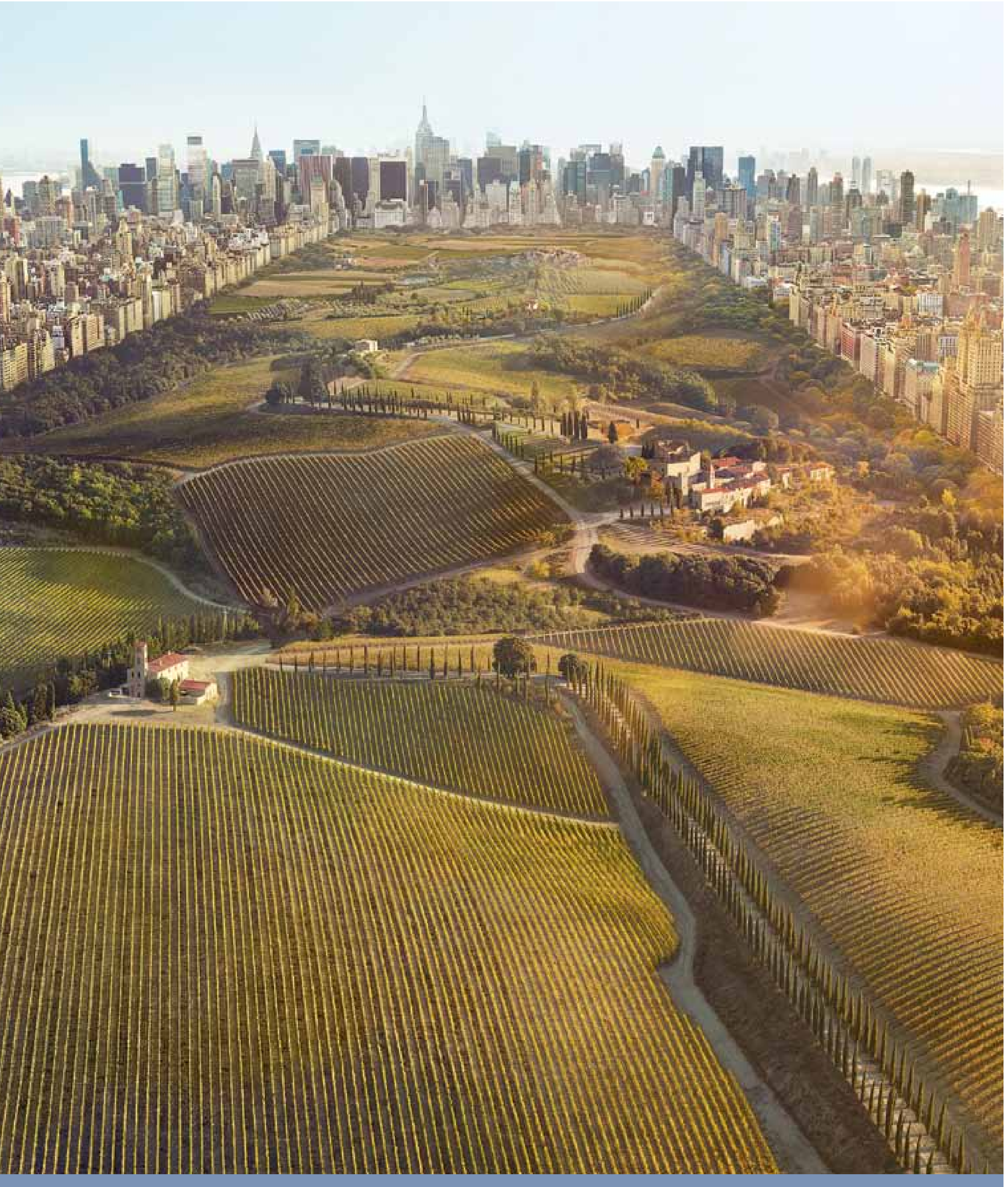

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12 ▶ far-reaching directives because its capital requirements may require investors such as insurance companies to set aside up to 50 percent of the value of their private equity investments. That would be very costly for insurers, but on the other hand, at a time of such low interest rates, they also realise the need to continue to allocate to private equity to maintain the level of returns.

"Most of the largest insurers are building so-called partial models to demonstrate that the risk factor assigned to private equity should be much lower than the standard formula. This could place the larger players at an advantage compared with the smaller insurers, which may not have the resources to demonstrate this lower risk factor to their regulators, and ultimately may simply decide to exit their private equity allocations."

Courtois adds: "Given that insurers in Europe currently manage around EUR7trn and that between 1 and 4 per cent of their assets is allocated to private equity, the amount at stake are quite sizeable. Currently we're still a bit in the dark about the overall impact of all this regulation on future allocations to private equity, but it's not hard to conclude that it may be adverse."

Pension funds, which have accounted for around one-third of total allocations to private equity in recent years, are set to face similar constraints. "Any measures that need to be put in place to demonstrate the risk factor applicable to alternative investment classes through the application of internal models will be very time-consuming and consume a lot of energy," he says.

"In the future the industry will probably have to adapt to requests for much more information about a fund's underlying investments, and that in a look-through manner. It will be no longer be sufficient to provide reporting to the limited partners without thinking about the way the information is framed, because it will in turn be used by these institutional investors as part of their internal models."

That will have implications for service providers to the private equity industry at a time when depositaries in particular are trying to get to grips with the implications of the additional liability they will have to accept for assets in their custody or under their supervision under the AIFM Directive.

According to Hugh Stevens of BNP Paribas Securities Services, the position of bank depositaries in countries such as France and Luxembourg, which are already familiar

with the role they will be called on to play under the directive, contrasts with that in jurisdictions where alternative funds have not historically had a depositary or custodian.

"In markets that traditionally have been relatively unregulated, bank depositaries are working to demonstrate their value to a new audience," he says. "Now it looks as though funds might need one, the question is whether they will go for a non-bank or a banking depositary. We are working with our clients and potential clients to demonstrate the value of the latter."

The way the directive and its subsidiary measures are shaping up, Stevens acknowledges, the industry will certainly have to shoulder additional costs, but he believes a pragmatic approach can ensure that the increase does not fundamentally upset the industry's business model. "There is certainly more work to be done, more risk and more liability in taking that role, and there is a cost involved in providing those services," he says.

"The important thing is that we as a provider work closely with clients to make sure that our services are reasonable, pragmatic and commercially sensible. It's not about taking a standard product and applying to a new market. We aim to ensure that our commercial proposition is appropriate and covers the services required by the client, and that we don't try to over-engineer a solution.

"In the case of private equity it is not a standard depositary function because in this market the assets are different. They are real assets, not fungible and in many cases not assets that can be held by a bank. We need a solution that will provide a good level of due diligence and understanding of those assets that takes into account their different nature."

Despite the scale of these challenges, industry members are confident about the ability of Luxembourg to acquire a growing share of European private equity work, not only because of regulatory issues pushing business toward onshore jurisdictions but the critical mass the grand duchy is acquiring in highly skilled and specialised service functions.

"A number of global fund administrators are looking to set up in Luxembourg," Courtois says. "We have seen players from the US and elsewhere actively looking to acquire or establish a presence here. That is a clear sign that there is underlying demand from their clients. These providers would not come to Luxembourg unless there was a clear-cut business model and an opportunity to be seized."

However, he expects continuing consolidation in response to an increasingly competitive environment. "The days when you could set up operations with just a few people, without a strong infrastructure, are gone," Courtois says. "To be taken seriously now, service providers must demonstrate that they have a resilient structure in place and that their staff have an appropriate level of understanding of private equity.

"Service providers will have to guarantee a seamless and high-quality service. In part due to the new regulations, I expect to see the development of new products such as risk management and risk reporting, which will be critical for some institutional investors. Going forward administrators will increasingly need to expand their service offering and act as a one-stop shop for tasks that general partners don't want to do on their own."

Deloitte's Ray Krawczykowski says firms have the option of competing on price or by offering a much closer partnership-style relationship with the client. "The AIFM Directive will make it possible for non-banks to act as custodians, and that additional pressure will oblige the big custodians to compete on price, efficiency or a broader scope of service delivery, for example offering services in more countries," he says.

"Quality of service has actually improved a lot in Luxembourg. Once upon a time the main differentiator between providers was price rather than service quality, but today the norm is improved quality at an appropriate price. There are a lot fewer complaints from clients than there were four or five years ago. The change has been dramatic."

The country's continuing stability should not be underestimated either at a time when that of competing jurisdictions has been called into question. Caceis Bank Luxembourg private equity senior relationship manager Frédéric Bock notes that one client with a vehicle investing in copyright eventually chose Luxembourg over Dublin because the grand duchy's political, economic and financial environment, and the clear commitment of its political leaders to the fund industry, contrasted with Ireland's financial difficulties.

In addition, says Credit Suisse Fund Services' Claude Noesen, the suggestion that Luxembourg is significantly more expensive than its competitors is a myth. "We are not that much more expensive, or in some cases no more expensive at all, as our own comparisons within Credit Suisse make clear," he says.

"Our competitors are always saying that Luxembourg lawyers are very expensive, but it's not actually the case. One indication of how cost-effective we are is that we service a number of Maltese funds here in Luxembourg. That would not happen if our costs were significantly higher than in Malta."

Another reflection of the country's competitiveness is the sustained trend for private equity houses to establish their own operations in Luxembourg, which has been underway for several years since the arrival of big industry names such as CVC, Cinven and KKR. "Today even smaller firms, whose funds might be between EUR500m and EUR1bn in size, will consider establishing an operation in Luxembourg," Krawczykowski says.

"There are a number of drivers for this. First is the advice of tax specialists that if funds are established in Luxembourg, it makes common sense to have at least some kind of substantial presence involving people on the ground. Firms are unwilling to pay that cost unless they really need it, but many have accepted the logic and the expense of establishing a Luxembourg presence.

"Very quickly, however, they find that they are actually achieving cost savings because an on-the-ground presence improves the efficiency of working with local service providers. The firms have better control over what the providers are doing, there is no duplication of work, and they can rely more on their own people. Ultimately there is a shift to Luxembourg of work that would previously have been done in London or in the US, which isn't going to involve an increase in costs."

Ultimately it helps private equity houses to operate Luxembourg structures from close at hand rather than from another country, Krawczykowski argues, because for example local people have better knowledge of the quality and experience of providers in the market. "You obtain added value through time savings and greater efficiency, and better solutions to your issues." he says.

As a result, firms that may have started in Luxembourg with the bare minimum staff needed to establish a presence are now adding more personnel. "They might initially have been reluctant to invest more than the minimum in their Luxembourg platform, but they are now very happy with a rising headcount, because it's no longer about cost but about efficiency and structure. That is why more and more firms are setting up back office operations. As soon as you have five or six Luxembourg entities, it's worth considering establishing your own office."

Attracting investment operations is another question, and probably not one for the short term, despite the presence of relatively high-profile local firms such as Mangrove Capital Partners and Genii Capital, as well as the presence of the European Investment Fund, which provides financing to small and medium-sized businesses through private banks and funds.

"If Luxembourg were able to attract a few players to base at least part of their investment operations here, it could create a new playing field, but this would take a lot of time," Courtois says. "There are lifestyle and other questions rather than just structuring considerations. That would require not just new laws but rethinking in a much more holistic way how to improve Luxembourg's visibility and make it attractive for this kind of business." ■