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FEATURING *Crestbridge*

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AIFM's as a point of entry for funds in Luxembourg and Europe

Daniela Klasén-Martin of Crestbridge discusses the change in the scrutiny offered by modern regulators when it comes to private equity in Luxembourg

Q What are the main trends you have observed in Luxembourg's private equity markets?

A I would say, private equity (PE) as an alternative asset class continues to be of focus alongside real estate, as Luxembourg has been developing as a jurisdiction of choice for PE and real estate managers, who have been used to going through Luxembourg for the structuring of their investments, predominantly through unregulated vehicles such as Special Purpose Vehicles (SPVs).

Since the introduction of the Alternative Investment Fund Managers Directive (AIFMD), there has been a real shift towards funds which has led to the continued success of Luxembourg as a domicile for PE and venture capital (VC) funds. This new trend has been supported by the introduction, in Luxembourg, of unregulated fund structures, such as the Reserved Alternative Investment Fund (Raif) and the Luxembourg Limited Partnership appointing an alternative investment fund managers (AIFM), to get EU passports.

Daniela Klasén-Martin
Crestbridge

Daniela Klasén-Martin is group head of management company services, managing director, Luxembourg. She joined Crestbridge to lead the development of the Luxembourg office and launch the management company services. Previously, Klasén-Martin spent nine years as head of finance for a major global asset manager and four years as CEO for one of the first independent management companies. She is a member of ILA, ALRiM, sits on various ALFI committees involved in risk management and fund governance and is a regular speaker at industry events on topics such as AIFMD, risk management and management company.

Luxembourg accounts for 4.3% of the global PE fund industry and unregulated investment vehicles such as Raifs and limited partnerships now represent 51% of all Luxembourg funds.

Q What opportunities do you see for private equity managers?

A Private equity remains a very attractive asset class. We are managing a broad range of asset classes, from hedge funds to real estate, we see a great majority of new fund launches are either PE, VC and private debt.

Institutional investors continue to be attracted by these asset classes as an element of diversification, and when it comes to institutional investors, we see that Luxembourg is the preferred jurisdiction.

This is because of the political and economic stability of the domicile, the flexibility of fund vehicles available to structure investments and the proven expertise of service providers.

This is combined with a robust implementation of the regulatory framework providing increased investor protection.

Q What are the key challenges to consider?

A The key challenge is the regulatory environment and the increasing substance requirements. The AIFMD regulatory framework has been prominent for several years, but it has been evolving recently with increased expectations and its implementations as the Luxembourg regulators in 2018 published a thorough regulation, the circular 18/698, which gave a clear outline of what is expected in terms

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of substance and governance requirements. So the challenge is that when you launch a fund with the intention to distribute widely in Europe, you now need to have an AIFM and with only two choices available – you either have your own or you appoint a third party.

Launching your own AIFM can become a challenge as the regulator has set very clear expectations with regards to the minimum staff requirements, i.e. three people or more depending on the size of the fund. It is to be noted that people should be senior and should have proven expertise to cover the day-to-day functions that they are responsible for in front of the regulator.

In addition, the regulator puts strong emphasis on proper oversight on all delegations, such as risk or portfolio management and distribution, but also outsourced services such as IT and accounting. These requirements coupled together can present a challenging operation and a considerable investment in non-revenue, generating ongoing costs.

Q: Can you explain how the regulatory environment has changed?

A: We have observed that there is more scrutiny from the regulator. In the past, they mainly focused on ad hoc thematic onsite inspections. We note that they have enhanced their controls and become more methodical, starting from the analysis of reporting provided by the regulated entities such as; internal audit reports, management letters and compliance reports combined with AIFMD reporting and ad hoc questions.

The number of onsite inspections has increased. With the introduction of 18/698 the regulator has communicated clearly their intention to visit all management companies and perform a complete governance visit to assess compliance with the circular.

We certainly observed an increased rigour and a higher focus on strict compliance, non-compliance resulting in fines, sanctions and name and shame.

Finally, it is to be noted that there is a key focus on AML/CFT and that the regulator has been keen in ensuring that the business is prepared in view of the planned FATF visit in 2020, analysing the AML questionnaires requested from the regulated entities and providing training based on the results of the questionnaires.

Q: How do you see the landscape evolving in the next few years?

A: What I've seen certainly, is a role change. While in the past, when I started working in the financial services, compliance and regulatory services were seen as a necessary evil, now we see a shift towards such services, these services now are being perceived as a true value-add.

AIFMD contributed largely to such a shift of behaviour – if you want to distribute a fund in Europe using the passport you need an AIFM and therefore you need to adhere to a more robust regulatory framework.

We see a lot of new players coming into the market as the AIFM is becoming the point of entrance for any fund services. This is leading to a price compression to gain market share which in the long term I fear can be damaging to the quality of the services.

We will continue seeing consolidation of service providers through mergers and acquisitions, in particular by administrators wanting to expand to third-party management company services.

Finally, I see a continued investment in technology led by the need to scale the operations to foster efficiencies and protect margins in an increasingly competitive and cost-intensive environment. HFM