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LUXEMBOURG

Luxembourg: A Strategic European Investment Fund Hub

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BIO

Veronica Aroutiunian, partner, is a member of the Investment Management practice group in the Luxembourg office of Loyens & Loeff. She focuses on structuring and formation of alternative investment funds. She is also a member of the Real Estate Industry focus team and the Regional Team France.

Recognised as "Next Generation Partner in Investment Funds" by Legal500 and as "Notable practitioner" in Investment Funds by IFLR 1000, Veronica is among the leading women lawyers in investment funds industry in Luxembourg. She has built a successful practice in structuring and formation of alternative investment funds, with a special focus on real estate, infrastructure, private equity and private debt funds, as well as global transition funds.

She advises clients on the regulatory and corporate aspects of structuring, establishing, operating and marketing Luxembourg regulated investment vehicles (Part II UCIs, SIFs and SICARs) and unregulated investment vehicles (including RAIFs and Luxembourg partnerships). In addition, she possesses a broad experience in funds with liquid strategies (hedge funds) and retail investors (such as UCITS).

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Introduction

Luxembourg has positioned itself as a cornerstone of the global investment fund industry, holding the title of the second-largest investment fund center worldwide, surpassed only by the United States. With an asset pool exceeding €5 trillion in regulated funds as of September 2024, Luxembourg has garnered international acclaim for its robust regulatory framework, adaptable legal structures, and unique ecosystem, including specialized banks, administration houses, and legal and auditing services, all within a multilingual environment that eases operations for international investors. This article explores the factors that make Luxembourg a preferred destination for investment fund managers and investors alike.

Historical Context and Market Evolution

The Grand Duchy's ascent as a financial hub began with the implementation of the first UCITS Directive in 1985. Since then, Luxembourg has consistently demonstrated its ability to align with and adapt to European financial regulations. This proactive approach has facilitated the growth of a versatile fund ecosystem, accommodating both alternative investment funds (AIFs) and retail funds. Over the years, Luxembourg's innovative fund structures and streamlined regulatory practices have enabled asset managers to cater to a diverse range of investor preferences.

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A Versatile Investment Framework

Luxembourg owes much of its success to its well-established regulatory framework. The *Commission de Surveillance du Secteur Financier* (CSSF) oversees the sector, ensuring compliance and maintaining investor trust. A cornerstone of Luxembourg's regulatory appeal is its flexibility in fund structuring, offering an array of vehicles tailored to varying investment strategies and investor demographics.

Key fund structures include:

- Undertakings for Collective Investment (UCIs): Governed by the 2010 UCI Law, these funds are highly regulated, ensuring investor protection and cater to both retail and institutional investors, with UCITS benefitting of the European distribution passport while the so-called Part II UCIs enable investments in non-traditional assets such as private equity, private debt, infrastructure and real estate by retail investors.
- Specialized Investment Funds (SIFs): SIFs target well-informed investors, such as institutions and high-net-worth individuals, offering minimal restrictions on asset allocation.
- Investment Companies in Risk Capital (SICARs): SICARs focus on venture capital and private equity, providing targeted exposure to risk capital. With no diversification requirements, they are an ideal vehicle for investors seeking high-risk, high-reward opportunities.
- Reserved Alternative Investment Funds (RAIFs): RAIFs combine the operational efficiency of unregulated entities with the investor protections of SIFs or SICARs. They are not subject to prior CSSF authorization, allowing fund managers to bring them to market more quickly.
- Special Limited Partnerships (SLPs): These unregulated entities provide contractual freedom and are often used to attract sophisticated institutional investors in alternative private assets strategies.

Each structure is designed to accommodate specific investor needs, with almost all of them offering options for umbrella fund configurations allowing multiple sub-funds under a single entity. This approach is both cost-effective and operationally efficient, enabling fund managers to target a variety of investment strategies under a unified umbrella.

Luxembourg fund structures also offer multiple legal forms, including SICAVs (variable capital investment companies) or FCPs (co-ownership managed by Luxembourg management company). A SICAV is a Luxembourg company (of any type) whose capital constantly fluctuates, without any further formalities, with changes in subscriptions, redemptions and valuation of assets, so that it is at all times equal to the net asset value of the company (i.e., the value of its assets minus liabilities). An FCP is not a legal entity. Investors subscribe for units in the FCP which represent a portion of the net assets, and they are only liable up to the amount they have contributed. Voting rights are typically absent for FCP investors, and decisions regarding investments and operations rest with the management company, unless otherwise specified in fund documentation.

Streamlined Setup and Operational Processes

The process of establishing a fund in Luxembourg is characterized by efficiency and clarity. Regulated funds such as UCITS, Part II UCIs, SIFs, and SICARs require prior CSSF approval, a process typically completed within three to six months, depending on the fund's complexity. In contrast, unregulated vehicles like RAIFs and SLPs bypass this step, enabling faster market entry.

Legal and administrative costs represent the primary expenses for fund setup. CSSF examination fees for regulated funds vary based on the fund type and structure, ranging from EUR 4,650 for standalone funds to EUR 9,250 for umbrella funds.

Luxembourg applies the real seat theory, requiring Luxembourg funds to be administered within the country, with fund administration encompassing three main functions: the registrar function, NAV calculation and accounting, and client communication. The registrar function manages the unit/shareholder register, order execution for subscriptions and redemptions, and income distribution. NAV calculation and accounting involve legal and fund management accounting, valuation, pricing, and tax returns, while client communication focuses on producing and delivering confidential investor documents. Fund administration is a regulated activity overseen by Luxembourg's CSSF and can be conducted by authorized management companies, alternative investment fund managers, or delegated administrative agents.

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Luxembourg substance requirements mandate that entities operating within its jurisdiction demonstrate sufficient economic substance to align with their declared activities. This typically involves maintaining a physical office in Luxembourg, employing qualified local staff proportional to the entity's activities, holding regular board meetings in Luxembourg with directors physically present, and ensuring key management and decision-making occur within the country. For investment funds, this includes compliance with local regulations, such as appointing authorized management companies or alternative investment fund managers, and delegating core functions like administration and portfolio management to regulated entities. These requirements ensure alignment with international standards and support Luxembourg's reputation as a transparent and compliant financial hub.

Finally, UCITS and AIFs managed by an authorized AIFM must appoint a depositary and an auditor. The depositary plays a critical role in safeguarding investor assets and ensuring compliance with applicable regulations. Its responsibilities include the safe-keeping of assets, which involves holding custody of financial instruments and verifying the ownership of other assets. The depositary also monitors cash flows to ensure proper management and reconciliation of the fund's finances. Additionally, it oversees key fund activities, such as the calculation of net asset value (NAV), subscription and redemption processes, and compliance with the fund's rules and applicable laws. By performing these duties, the depositary acts as a key control mechanism to protect investors and maintain the integrity of the fund's operations.

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A Robust Regulatory Environment

Luxembourg's regulatory landscape balances investor protection with market competitiveness. The AIFMD governs the management and marketing of AIFs, offering an EU-wide passport for marketing to professional investors. Luxembourg funds managed by AIFMD-compliant managers are subject to stringent disclosure, risk management, and valuation requirements, ensuring transparency and safeguarding investor interests. Retail funds like UCITS are held to even higher standards, with strict rules on diversification, liquidity, and leverage. These measures contribute to the resilience of Luxembourg-domiciled funds, even in volatile market conditions.

Luxembourg's regulatory authorities, particularly the CSSF, are known for their accessibility and pragmatic approach. The CSSF facilitates dialogue with market participants, supporting innovation while maintaining oversight. The regulator's adoption of digital platforms for submissions and reporting has further streamlined interactions with fund managers and service providers.

Luxembourg as a Global Gateway

Luxembourg's geographic and strategic position within Europe makes it an ideal gateway for global investors seeking access to the EU market. The country's multilingual workforce and deep expertise in cross-border fund administration further strengthen its appeal.

International fund managers benefit from Luxembourg's seamless connectivity, leveraging its infrastructure to distribute funds across Europe and beyond. The availability of an EU passport under the AIFMD and UCITS directives facilitates efficient marketing and distribution, ensuring that Luxembourg-domiciled funds remain competitive on the global stage.

Luxembourg's prominence in the European fund landscape is further underscored by its significant share of the increasingly popular European Long-Term Investment Funds (ELTIFs). As of December 2024, out of 149 ELTIFs authorized across Europe, 90 were domiciled in Luxembourg, representing approximately 60% of the total. This substantial presence highlights Luxembourg's strategic role in facilitating long-term investments within the EU and beyond. Luxembourg's structuring toolbox and considerable cross-border distribution capacity and experience are invaluable for fund managers looking to create ELTIFs.

Alternative Investment Funds: A Focus on Innovation

The alternative investment fund sector in Luxembourg has experienced significant growth, driven by increased demand for private equity, real estate, private debt and infrastructure fund strategies. Luxembourg's ability to adapt its legal and regulatory environment to emerging trends has been instrumental in this success.

Key Features of AIFs in Luxembourg:

- Customizable Legal Structures: AIFs can choose from SIFs, SICARs, RAIFs, and SLPs, each offering unique advantages.
- Rapid Market Entry: RAIFs and SLPs provide expedited setup processes compared to their regulated counterparts.
- Diverse Investor Base: While AIFs traditionally cater to institutional and well-informed investors, recent trends indicate growing interest from retail investors, reflecting the "retailization" of AIFs, with Luxembourg offering a unique structuring option via Part II UCIs.

Luxembourg's regulatory framework for AIFs emphasizes investor protection through requirements such as appointing authorized AIFMs, adhering to reporting standards, and complying with anti-money laundering (AML) policies.

Retail Funds: Gateway to Broad-Based Investments

Luxembourg's retail fund offerings are primarily anchored in UCITS, which enjoy widespread recognition for their investor protection measures and transparency. UCITS funds adhere to strict diversification and liquidity requirements, ensuring stability and accessibility for retail investors.

Highlights of Retail Funds in Luxembourg:

- Global Passporting: UCITS can be marketed across the EEA with minimal barriers.
- Flexible Fund Design: Options for standalone or umbrella structures cater to varied investment goals.
- Rigorous Oversight: CSSF supervision and periodic reporting reinforce investor confidence.

In addition to UCITS, Part II UCIs cater to retail investors seeking exposure to alternative investment strategies, offering fewer restrictions than traditional UCITS funds. Combined with an ELTIF label, a Part II UCI can be marketed to retail investors across the EEA benefitting of the European passport regime.

Operational and Tax Efficiency

Luxembourg provides a cost-effective environment for fund operations, underpinned by modern infrastructure and a competitive tax regime. Key tax incentives include:

- Exemptions: Most funds are exempt from corporate income tax, net wealth tax, and municipal business tax.
- Subscription Tax: SIFs and RAIFs are subject to a nominal annual subscription tax, with exemptions available for specific investment categories.
- VAT Exemptions: Management services for investment funds are generally VAT-exempt.

Moreover, Luxembourg's extensive network of double tax treaties enhances the tax efficiency of cross-border investments, particularly for corporate fund structures.

Sustainable Finance: Leading the Green Transition

As a pioneer in sustainable finance, Luxembourg has embraced the global shift towards environmental, social, and governance (ESG) investing. Approximately one-third of Europe's sustainable funds are domiciled in Luxembourg, reflecting its commitment to fostering green investment initiatives.

Regulation (EU) 2019/2088, also known as the SFDR, introduces mandatory ESG-related disclosure requirements for financial market participants, including AIFMs overseeing the AIFs under their management. AIFMs must disclose how sustainability risks are integrated into the management of these AIFs, how adverse sustainability impacts are considered, and provide other relevant ESG information. The SFDR specifies different methods for sharing this information, such as through pre-contractual disclosures aligned with AIFMD requirements (e.g., in dedicated statements, annual reports, or on websites), and mandates additional disclosures in annual reports and on AIFM websites. The SFDR categorizes funds into three types with varying disclosure requirements: Article 6 funds, which do not include sustainability considerations in their investment process; Article 8 funds, which promote environmental or social characteristics; and Article 9 funds, which focus on sustainable investment objectives. The CSSF closely monitors compliance with SFDR obligations, providing guidance and oversight to ensure consistent application of the regulation across Luxembourg's financial sector.

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Luxembourg's unique combination of regulatory expertise, diverse fund structures, and operational efficiency has cemented its status as a premier investment fund hub in Europe.

Future Outlook and Trends

Looking ahead, Luxembourg is poised to capitalize on emerging opportunities in the investment fund sector. Key developments include:

- Democratization of Alternative Investments: Simplified regulations and innovative fund structures are making AIFs accessible to a broader audience.
- Digital Transformation: Leveraging blockchain technology and digital assets to streamline fund administration and enhance transparency. Luxembourg recently became home to the first blockchain-based UCITS Fund.
- Capitalizing on European Reforms: Luxembourg is pro-actively incorporating updates from the AIFMD II and ELTIF 2.0 frameworks to remain competitive in the evolving regulatory landscape.
- Focus on ESG: Continued emphasis on sustainable finance aligns with global investor priorities, positioning Luxembourg as a leader in green investments.

Conclusion

Luxembourg's unique combination of regulatory expertise, diverse fund structures, and operational efficiency has cemented its status as a premier investment fund hub in Europe. With a forward-looking approach and commitment to innovation, Luxembourg is well-equipped to navigate the complexities of the global financial landscape, offering unparalleled opportunities for fund managers and investors.

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