Pascal Bouvier:

VC with a Cause

Private Equity Opening Up (ELTIF 2.0)

The Case of Fund of Funds by Golding Capital Partners

Issue 25, March 2023

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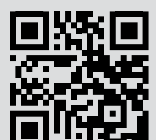

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Dear members, friends and partners,

2023 is supposed to endure a potential "slowdown" after an immensely successful decade and growth phase of our favourite industries, with some delays to be expected around prospective fundraising and exit activities. High inflation is still a serious topic, the increase of interest rates and intrinsically the cost of financing/capital is not over yet, certain valuations of portfolio companies could face some robust discussions and the recent incidents in certain sectors remind us that the failure of some "strategic" corporations can create a wave of panic and lead to adverse effects for new promising businesses and economies. The collapse and bankruptcy of such "outliers", had and will probably continue to affect their former sectors for some time with long-lasting reputational damages, distrust, financial consequences and even some casualties in the entrepreneurial space. Such situations are not new and due to a mix of negligence, incompetence, inadequate governance, inappropriate risk management, some entire fields could suffer once again (!) from these bad behaviours and be forced to adopt in the future some additional regulatory constraints. Regulation per se, if well calibrated, smart and enabling new opportunities, can help young industries to better structure themselves, grow tremendously and also facilitate the entry of new players or investors. Trust is at the centre of all sane business relationships and should always be nurtured!

In this lightly troubled context, we remain optimistic and confident that our sector will smoothly steer its way through these obstacles and pursue what it does best: create value, performance and returns. Our model will prove its resilience, worth and underline that the long-term and patient approach of PE/VC will pay off. The continued interest for our sector has absolutely not diminished in the meantime as witnessed during a great IPEM conference in Cannes and very promising roadshows in Poland and Switzerland. The LPEA will soon discover new regions (frontiers) in the US and continue its European tour accompanied by local experts, home-grown specialists and passionate practitioners. Our strength lies in this fabulous community and collective intelligence which continues year after year to evolve, reinvent itself and attract more support.

We wish you a good read and hope to see you soon again.

Stephane Pesch
CEO, LPEA

Claus Mansfeldt
Chairman, LPEA

The magazine of the Luxembourg Private Equity & Venture Capital Association
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LPEA on the Road

Following its event in IPEM (Cannes), Warsaw, Zurich, Austin, Dallas and San Francisco in Q1, the LPEA will continue to promote the Luxembourg ecosystem abroad in the aim to connect new PE & VC players to the Grand-Duchy.

During the second quarter of the year, the team will travel to Madrid, Frankfurt, Berlin – in the context of SuperReturn – and London. Later this year LPEA will join IPEM again – this time in Paris - and travel to Milan, New York, Miami, Hong Kong and Singapore. The LPEA can benefit from the knowledge of its international members to create agendas addressing local markets challenges and opportunities always with the aim of creating synergies with Luxembourg.

LPEA Sustainability Commitment

This certification represents a commitment of the association in various areas such as sustainability strategy, governance, social and environmental responsibility. It also aligns the management of the association with one of the main trends of the Private Equity and Venture Capital industries today: the implementation of ESG criteria (Environment, Social and Governance).

While some sustainability actions were already in place, this certification process contributed to formalise some of existing initiatives and to lay the ground for further commitments. Because of this exercise and as an example, the LPEA will introduce from 2023 on a Code of Conduct to its members and will further promote gender diversity in the sector. Additionally, the LPEA will also start to compensate C02 emissions related to its initiatives and will affect a dedicated budget to ESR activities.

LPEA Mentorship

The LPEA Mentorship programme connects mentors willing to transmit their passion for the PE/VC sectors to young talents and professionals interested in changing their career path and seeking hands-on knowledge. The initiative led by the Private Equity for Women Club (PE4W) was launched on the 1st of February and the first mentees are already connecting to our pool of mentors.

Mentors stem from the LPEA community, while mentees come from varied horizons.

The LPEA team and volunteers are convinced that mentoring and the act of sharing experiences with young talents can help them to better cope with their professional career and aspirations, analyse and find solutions to specific and sometimes complex situations, as well as to become more efficient, driven and potentially find "purpose" in their career.

Join LPEA Mentorship programme as a mentor and as a mentee by scanning the QR Code.

The LPEA Academy is back following the Easter break **with the following modules:**

17- 19 April
PE Risk Management by KPMG, Threestones Capital Management & Avega

20-21 & 24-25 April
Foundations of Valuation for PE by EY, Astorg & Kroll

2-4 May
Multi-Strategy & Fund of Funds by EIF & SwanCap

15-17 May
Secondaries by EIF & Van Campen Liem

22-26 May
The Legal Academy by Allen & Overy

Scan the QR code to Register

Schroders Capital launches its first ELTIF

Schroders Capital announced this March the launch of its first European Long-Term Investment Fund (ELTIF) named Schroders Capital Private Equity ELTIF 2023.

Setup as an article 8 under the SDFR, the fund will offer investment opportunities to a broader group of investors, including retail, seeking to deploy their capital in the alternative assets sector. The fund will focus on buyout and growth investments in the lower and mid-market segments, primarily in Europe, but with the flexibility to also invest in non-European companies with a high operational exposure to Europe.

The launch of this fund represent an important development in providing high net worth investors with additional opportunities to access private assets. Following the recent reform of the ELTIF, this trend will consolidate and many other market players are set to launch their ELTIF in the coming months.

The Luxembourg Women in Finance Charter

LPEA is pleased to share the Luxembourg Women in Finance Charter supported by the Luxembourg Ministry of Finance. We therefore encourage our members to be part of the signatories to break down gender barriers, ensuring gender diversity and inclusivity in the financial sector.

This Charter reflects the industry's ambition to see increased participation of women at all levels within financial services organisations and representative bodies in Luxembourg.

Sign the Charter

EIB Group Launches New Fund of Funds to Support European Tech Champions

On the 13th of February, five EU Member States and the European Investment Bank Group (EIB, EIF) have signed today the European Tech Champions Initiative (ETCI) mandate, a Fund of Funds that will channel much-needed late-stage growth capital to promising European innovators - especially for companies seeking to raise amounts of over €50 million. ETCI will help plug financing gaps and thus reinforce Europe's strategic autonomy and competitiveness. The new Fund of Funds has secured initial commitments of €3.75 billion from EIB Group, Spain, Germany, France, Italy and Belgium and the size of the fund is expected to grow with upcoming commitments.ETCI will help create an asset class for European institutional investors to diversify their portfolios, thus maintaining a continuous flow of funding to European scale-ups.

Launch of Luxembourg Future Fund 2

On Friday, 17 March 2023, the Ministry of Finance, Ministry of the Economy, Société nationale de crédit et d'investissement (SNCI) and the European Investment Fund (EIF) officially launched the Luxembourg Future Fund 2 (LFF 2).

LFF 2 is the successor initiative to the existing Luxembourg Future Fund (LFF 1), which reached the end of its active investment period.

The launch of LFF 2 highlights the successful cooperation between SNCI and EIF aiming to stimulate the diversification and sustainable development of the Luxembourgish economy via funding activities. With € 200 million in total financing commitments between SNCI (up to € 160 million) and EIF (up to € 40 million), LFF 2 provides additional firepower in support of innovative projects in Luxembourg.

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By **Stephane Pesch,**
CEO, LPEA

↘ Pascal Bouvier (MiddleGame Ventures)

VC with a Cause

Pascal Bouvier is a well-known face of Venture Capital in Luxembourg. He is at the helm of MiddleGame Ventures, a fund focusing on fintech investments. This interview provides insights into Pascal's professional path, which eventually led him to setting up his own fund in Luxembourg.

Please explain in a few words what you and MiddleGame Ventures stand for?

I am the Managing Partner and Co-founder of MiddleGame Ventures (MGV). We are a fund that invests in early stage start-ups in the fintech space – we focus on innovative technologies that will be applied to the worlds of lending, payments, insurance, capital markets and asset management. We roughly invest from seed level to series B, in B2B and B2B2C start-ups – sometimes in D2C startups too but rarely. We do so across Europe, mostly within the EU but also outside of it.

I have been investing in fintech and Venture Capital for over 16 years now, and MGV is the last incarnation of that particular segment of my career in Venture Capital (VC).

MGV brought you to Luxembourg in 2020, but tell us more about your career path before Luxembourg.

I arrived in Luxembourg in January 2020. However, our first fund and the firm were created in 2018. It took us two years to close our first fund - the average time to raise a first VC fund. By the time we had finally closed the first round of our fund, I hopped on a plane and became a Luxembourg resident in January 2020. I must admit it was quite interesting, maybe challenging, to move to Luxembourg during Covid times while not knowing many people.

You came from Washington, is that correct?

Indeed, I have been based in the US for 28 years. I originally came to the US for my MBA and I ended up staying there after graduation. I worked on Wall Street for a US Bank as an analyst, focusing on equities sales research on the buy side, since that was what I wanted to do at the time. Prior to the US, I had actually been working in Europe, for a French commercial bank and a Japanese bank. So these few years on Wall Street marked the end of a chapter i.e. working in banking and traditional finance.

Back then, I realized I wanted operational expertise. I moved from the East Coast, to Boulder in Colorado to seek employment outside of the financial sector. I worked with a variety of start-ups and small sized businesses, in enterprise software and software services between Boulder and Denver, and then also a little bit in San Francisco. That is where I discovered how to operate a business, how to grow a team, all in a variety of positions, as COO, CFO and as Head of sales and business development. This was done in businesses ranging from two to approximately 400 people, sorting a wide range of pain points.

I then moved back to the East Coast where I operated and ran a couple of businesses and finally joined back the world of investments through a friend of mine – one of my co-founders at MGV – who asked me to join him in a family office interested in diversifying its investments. That family office was interested in diversifying its holdings and investments.

I joined their team and I did a bit of research. After five months, I proposed building a team to invest in early stage startups in the financial technology field. I was happily surprised when the proposal was approved. That led to building – from scratch – the second dedicated fintech fund in the world at that time and building a network both in the US, in Europe and also a bit in South East Asia where we ended up investing in the most promising start-ups. I then moved on and helped a large bank with their VC fund as a Venture partner. I assisted them with best practices both investment and operational wise, growing the team, helping with the investment process and supporting the portfolio companies. Finally, around 2018, I said to myself “instead of doing it for someone else, why not do it for yourself?” This is when I started fundraising and, two years later, closed the fund and moved to Luxembourg.

To conclude on my time in the US, I was able to invest early stage in startups such as Ripple and DriveWealth which went on to become highly successful in their own rights, as well as other first and second generation fintech start-ups. One of my first learnings in the American market was that the key to understand financial services at large and fintech in particular is to become an expert in payments. Payments are indeed the bedrock of all financial ser- ↘

> **“The ease with which one is able to reach out to public and private decision makers in Luxembourg is amazing.”**

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> **"The long term liquidity at the end of the investment spectrum is the number one factor missing to boost the VC community's resilience in the EU."**

vices, and one is forced to understand pricing, credit risk, counterparty risk, AML/KYC, onboarding, identities, authorization, authentification, collateral, the basics of lending, clearing and settlement, custody, tokenization (from a payments perspective), data, cybersecurity when attempting to learn about payments. If there is one advice I can give to new entrants in the world of fintech, financial services or venture investing, it is to learn about payments whether in the US or Europe or other parts of the world.

Why did you choose fintech?

The family office I worked for knew financial services very well, and the affinity for fintech was easy to establish and build upon. They were naturally interested in deploying money within the financial services industry. That specific sector was somewhat lagging in terms of innovation and adoption of new technologies compared to other industries. I therefore naturally focused on fintech. At that time it was still in its infancy and called financial technology innovation (we were just starting to use the word fintech). It was hence a combination of luck, design, and a little bit of analysis. Frankly, I did not enter the venture world on purpose, but my career naturally led me there.

When did Luxembourg come into the equation?

It helps to have investors that are EU based. We have the European Investment Fund as an investor, and we also have the Luxembourg Future Fund sponsoring us. I'm French, but I am not overly keen on Paris. London was difficult to envisage as a location due to Brexit and we wanted to be at the core of the EU and in a place where the fintech ecosystem was evolving and interesting. Furthermore, as we are travelling a lot while visiting start-ups, it's good to have a base that is international, easy to live in and central. I think that there are not many places that fit the mould quite like Luxembourg. That, plus the Luxembourg Future Fund was keen on a senior MGV partner relocating to Luxembourg.

> **"I like to give back. One should always try to enhance and add value to the ecosystem they are part of, without any particular views on how to be paid back."**

What did you find most important once you arrived in Luxembourg?

Following the first and the second wave of Covid, I didn't find much as everything was closed. However, the past year and a half, the ease with which one is able to reach out to public and private decision makers in Luxembourg is amazing. Furthermore, the fact that you have a lot of international actors in the country is very powerful. I have a lot of ideas on how to help the ecosystem and on how to invest. Being able to test these ideas with a variety of sparring partners who live in Luxembourg and act within the financial services is really quite unique. The proximity and the ability to enter a variety of networks is unmatched by any other big cities where key stakeholders are completely out of your reach.

You connected with the local ecosystem very well and soon had your Youtube series Office Hours with the LHoFT. You also started the VC Scholar programme in 2021. What are your goals with such initiatives?

I like to give back. One should always try to enhance and add value to the ecosystem they are part of, without any particular views on how to be paid back. It is important for me to leverage my experience as an entrepreneur and as an investor and figure out ways to help the ecosystem. I've been focusing on the world of start-ups but also on other verticals such as the fund industry. I've also been focusing on education by sharing tools, frameworks, best practices with PhDs, Master students and fresh graduates who are entering the world of financial services. I help them navigate an industry which is rapidly changing due to the technology.
Together with the LHoFT, we launched the VC Scholar Program. We started out with five people for the first edition, then ten for the second and we are currently launching the third one. The vision is, fast forward 15 years from now, to have 15 cohorts of ten people each year – assuming we run 15 editions of the scholarship – who at some point have been exposed to Luxembourg's financial services, the innovation and start-up ecosystem. Some may stay in Luxembourg and get a job, others may stay and then leave or will come back – but all of them will be able to share the word and hopefully create a ripple effect.

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I am currently also working on a new accelerator for the funds industry, in collaboration with the LHoFT. We select tech start-ups, we bring them here and help them interact with the industry. This works both ways as we also help out actors of the industry to flesh out solutions and address their problems. I can't say much more about this project yet, but hopefully will once it is officially launched.

How would you describe the Luxembourg VC community today?

I was asked to become Co-chair of LPEA's VC Club, so I am slowly learning and understanding what the Luxembourg VC community is like. It is small to start with, but it is vibrant, and it needs to grow and to attract other GPs and other investment teams to the country.

> **"I believe that we are entering a world of assets that are going to be fully digital."**

It is important to share how easy it is to do business in Luxembourg and how easy it is to network for your funds, whether with LPs, regulators or service providers, that have a full understanding of investments in start-ups from beginning until the end. Furthermore, it is important to approach political or regulatory bodies to optimize attractiveness for the general partner of a venture fund.

What could be done in Luxembourg to increase the attractiveness and resilience of VCs?

That answer is not specific to Luxembourg. It's an EU wide answer. In comparison to the US, the EU lacks a unified and deep capital markets structure, where start-ups that have scaled and continue to scale can eventually IPO, or find sources of stable long term capital. The US has such funding continuum, from angel investors, early stage, growth and late stage VC, to Private Equity and eventually public listing. Such arrangement in the EU would make the VC scene much more resilient as the source of exits and liquidity would remain constant and unlikely to vanish at the wind of market fluctuations. We have various member states' stock markets, but they are not unified pools of liquidity. This long term liquidity at the end of the investment spectrum is the number one factor missing to boost the VC community's resilience in the EU. Currently such liquidly pools are deployed by large US investors and corporations, and they are the ones capturing the upside linked to the buyout of European scale-ups. This is not done by European investors, European savings, and it's not European supply and demand.

> **"VCs that will be more successful are those that are a little bit generalist but also owning an expertise that makes them standout."**

You are always looking into the future with every start up you meet. How should we expect the financial and VC sectors to change in the next 5-10 years?

My answer is two-fold. Firstly, I believe that we are entering a world of assets that are going to be fully digital. A share of ArcelorMittal is electronic and traded, but it's not yet fully digital with the richness entailed by the code that is associated with an asset. With digital assets, we will be able to better leverage the various corporate actions that are entangled to the asset itself. This will change the entire value chain from the period before an asset is issued, at issuance and then post-issuance with servicing and exchange. Capital markets and the asset management industry will then evolve, and we at MGV are looking very closely at the world of future digital assets. Those digital assets will also be issued differently than assets are currently being issued, they will be tokenized.

Secondly, the VC profession has not been fully impacted by technology yet. This business is very much based on relations. You are investing in people and you are investing with other people, whether they are other VCs, angels or corporates. The profession is all trust based, and anchored in your reputation over a long period of time. Over the past six years we have witnessed ways to add technology such as CRM solutions, data analytics solutions to track or uncover new startups, portfolio management solutions adapted to the VC world and startups…. This trend will accelerate but we are still late in comparison to others such as the Hedge funds or PE industry, where leveraging data is fundamental across an operational stack is crucial. Furthermore, LP relations and fund services are somehow still archaic and I expect new solutions to appear for the VC industry. This lag can be explained by VC funds' size. They tend to be smaller than PE funds or Real Estate funds and solutions have not yet been tailored to their needs. I expect that to change and for VCs to become way more tech savvy in their daily operations.

The way VCs find their LPs is probably also going to increasingly change. We are witnessing a democratisation of alternative assets. An increasing amount of people, are able to invest in the asset class, where traditionally it was the backyard of professional investors or very wealthy individuals. I also witness an increasing concentration of larger VC platforms as it's very, very difficult to create a new fund. Regulations, especially in the EU are not making life any easier. This factor will force successful VCs to be a little bigger and to deploy different teams to work in different verticals. VCs that will be more successful are those that are a little bit generalist but also owning an expertise that makes them standout. This can be finding unique talents, finding new start-ups in countries that are somewhat different or choosing a specific a theme that is very different than others. Specialisation will be key. ●

MORE INSIGHTS ON THE VC MARKET IN LUXEMBOURG

Watch the April 2022 video

Watch the March 2023 video

INSIGHTS

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By **Christian Harz,**
CFA, Director at Golding
Capital Partners

and **Lukas Eckhardt,**
Director at Golding
Capital Partners

Advantages of Private Market Funds-of-Funds

Alternative investments are an important portfolio component for institutional investors and offer numerous advantages over traditional investments, not only in times of a global pandemic, economic uncertainties, volatile financial markets and low interest rates. These include significant diversification effects, stable performance and an attractive risk-return profile. In addition, alternative investments have proven in the past that they are among the most crisis-resistant investments.

Professor Oliver Gottschalg of the HEC School of Management Paris, in cooperation with Golding, has shown in a 2022 study that the excess return (alpha) of private market investments compared with similar transactions in the listed equity market is significantly positive in every market phase, but at 35.4 percent is by far the highest in crisis periods. Accordingly, Private Equity transactions achieve a significant alpha of 9.9 percent across all market phases compared with similar transactions on the stock market.

Institutional investors can use a combination of primaries, secondaries and co-investments to put together an individual portfolio of alternative assets and thus achieve optimised cash flow with attractive risk-adjusted returns. In this regard, fund-of-funds solutions facilitate a diversified investment in this alternative asset class.

Fund-of-funds are an opportunity to optimise the risk-return profile

A fund-of-funds is a pooled investment fund that invests in other types of funds. The main advantage of a fund-of-funds is broad diversification, which has been shown to significantly reduce the risk of loss and stabilise the portfolio performance. Broad risk diversification and thus overall low volatility of returns is achieved by investing in different regions, sectors, currencies and vintages. At the same time, the investment structure gives many investors who would not otherwise have the opportunity to invest in this asset class access to (usually restricted) alternative investments.

As important as alternative investments are, they are also complex. This means that the investments must be understood not only in a commercial sense, but also from a technical perspective. A professional and consistent fund selection process by an experienced fund-of-funds manager therefore also reduces the risk of selecting underperforming managers.

An experienced Alternative Investment Fund Manager (AIFM) such as Golding, whose services include portfolio, risk management and administration services offer investors the assurance that their investments are being optimally managed in all aspects.

Quantification of the diversification effect

In a study conducted in June 2022, Golding quantified the diversification benefits of private market funds-of-funds over individual funds and direct investments. While it is immediately obvious that funds-of-funds can contribute to greater diversification and thus reduce portfolio risk, this effect has arguably never been quantified before on a larger scale and with statistical accuracy. Based on more than 100,000 data points from the years 2000 to 2021, the study measured both the short-term and long-term performance of investments over their entire lifetime, or more precisely, the quarterly return on investment and multiple of money (TVPI).

The short-term analysis of the buyout segment, for example, showed that funds-of-funds could significantly reduce downside risk. For example, with 15 percent of investments in portfolio companies, investors recorded negative quarterly returns of around -9 per cent or more. For individual funds, the risk was still -3 percent and for funds-of-funds only -2 percent. In more extreme scenarios, a fund-of-funds investment paid off even more.

In the long-term view based on the TVPI, the trends described are even more pronounced. While 25 percent of all observed investments in individual portfolio companies returned no more than the capital invested, with the same probability target fund investments delivered a multiple of money of up to 1.23 and up to 1.5 in the case of funds-of-funds. For five percent of the cases observed, investments in individual portfolio companies proved to be total losses, target fund investments sustained a loss with a TVPI of 0.8 and funds-of-funds, on the other hand, still generated a positive multiple of money of up to 1.15 in this quantile. A look at the distribution function of the observed data shows that the diversification of funds-of-funds strongly suppresses the variance of total returns and, in particular, significantly reduces the risk of loss. Since the underlying data also included active investments that may still have their maximum appreciation ahead of them, the actual statistics are expected to be even more significant.

For the infrastructure and private credit segments, the risk-return distributions are comparable. Compared with buyout, however, both segments are fundamentally lower-risk, so that the effect of risk reduction is less pronounced.

> **“Funds-of-funds reduce the volatility of quarterly returns by around 90 per cent compared with individual investments.”**

Diversification is key

In summary, the study shows that funds-of-funds reduce the volatility of quarterly returns by around 90 per cent compared with individual investments. In addition, it was shown that the vast majority of funds-of-funds generate positive returns over the long term, while a significant proportion of individual investments can prove to be loss making for investors.

In the current environment, which is characterised by uncertainties regarding the economy, monetary stability and geopolitical developments, there are thus strong arguments in favour of broadly diversified private market investments. In particular, risk-averse investors, who are increasingly turning to private markets due to the risk-return profile of liquid markets, can be helped by funds-of-funds to limit the risks associated with investments in illiquid or alternative asset classes.

The current environment certainly makes a case for alternative investments, since they can generate alpha compared with traditional investments and stabilise portfolios. Funds-of-funds are an appropriate vehicle for managing the risk associated with certain alternative investments. ●

Golding Capital Partners is one of Europe's leading independent asset managers for alternative investments, focusing on the asset classes infrastructure, private credit, Private Equity, secondaries and impact. With a team of more than 180 professionals at its offices in Munich, London, Luxembourg, New York, Tokyo and Zurich, Golding helps institutional and professional investors to develop their investment strategy and manages more than €13 billion in assets. Golding has been active in Luxembourg since 2007. Since 2014, Golding Luxembourg has acted as the alternative investment fund manager (AIFM) for all Golding products and acts as the investment advisor for external accounts.

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By **Joaquín Alexandre Ruiz Tarré,**
Head of Secondaries,
European Investment Fund

Challenges and Opportunities in the Secondaries Market in 2023

Now that we are still in the first quarter of the year, it is a good time to look backwards and see how the Secondaries Market has performed since 2021. Also, let's try to gauge what we may reasonably expect for 2023.

Figure 1: Secondary market volume Bn USD
(Source: EIF based on data from Evercore, PJT Partners, Campbell Lutyens and Jefferies)

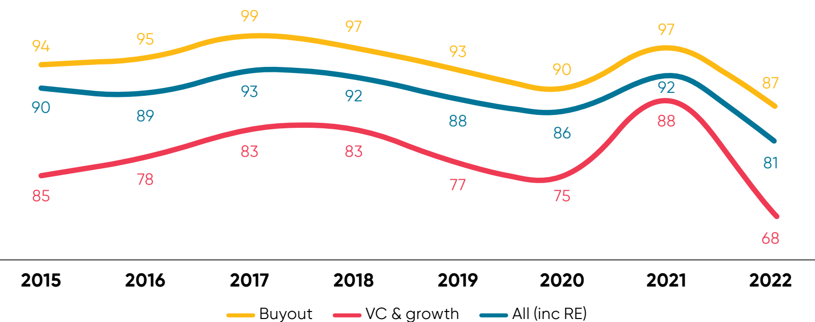


Figure 2: LP portfolio pricing as % of NAV
(Source: EIF based on data from Evercore, PJT Partners, Campbell Lutyens and Jefferies)

Setting the scene...

2021 saw a speedy return to global economic growth, following 2020's COVID-19 downturn. This was largely due to the progressive reopening of major economies, in parallel to a widespread deployment of vaccines and arguably broad immunization through omicron. However, high energy prices and supply chain pressures spurred a very high inflation. In public equities, we saw a rally in 2021, partially powered by massive pandemic support packages all over the world.

In the Secondaries Market, 2021 was a record year with volumes of c. USD 132bn, which is more than twice the amount reached in 2020 (c. USD 60bn), according to leading investment banks and/or advisors in secondaries[1]. Secondaries pricing also soared in 2021 with an average of c. 91-92% of NAV[2] (All Strategies)[3] for LP portfolios, slightly below the all-time high seen in 2017 (c. 93%).

In 2022, momentum turned and public markets went down significantly. For instance, S&P 500 (-19%)[4], Nasdaq (-33.1%)[4], Stoxx 600 (-12.8%)[4] and volatility became mainstream throughout the year. The war in Ukraine marked another black swan event in just 24 months. Beyond the humanitarian tragedy, and unprecedented sanctions to Russia, energy supply has been significantly impacted, thus adding higher energy prices to the already high levels of inflation. As a result:

1) Central Banks have had no choice but to continue raising interest rates (raised even more in 2023: Fed 4.75%[5], ECB 2.5%[6] and BoE 4%[7]) to strive to get inflation under control;

2) Major economies are expected to enter recession, according to Evercore[4]: USA (2023 expected GDP Growth of 0.3% vs 1.9% in the preceding year), Eurozone (2023 expected GDP Growth of -0.1% vs 3.2% in 2022) and the UK (2023 expected GDP Growth of -1.0% vs 4.4% in the prior year).

Secondaries pricing also declined significantly in 2022, from c. 92% of NAV to c. 81% (All Strategies), albeit with significant dispersion between buyout (c. 87%) and venture (c. 68%)[1].

How has all this impacted the Private Equity industry and the Secondaries Market, in particular? Let us first have a look at three main metrics: deal value and volume, valuations and exits

Despite a tighter policy environment, latest geopolitical events and continued volatility, European private equity deal making continued to be resilient; according to PitchBook. Yet, valuations measured by EV/EBITDA multiples went down. Not as much as some Secondary Buyers would have expected based on the performance of public markets. There has been an apparent disconnect between public and private equity valuations.

European private equity exit volumes reached EUR 221bn through Q3 2022, declining from the elevated figures reached in 2021. Exit values via public listings reached EUR 11bn through Q3 2022 (on pace to record the lowest annual total since 2012).

> **"We predict continued opportunities on the LP-led side as some investors in the asset class may still be in need to offload some of their positions in 2023."**
> Joaquín Alexandre Ruiz Tarré

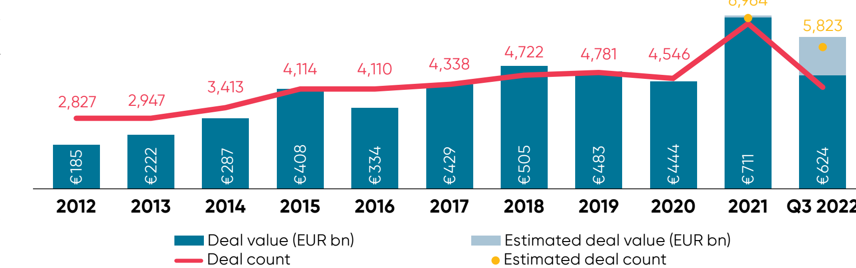


Figure 3: PE deal activity until Q3 2022 (Source: EIF based on data from PitchBook)

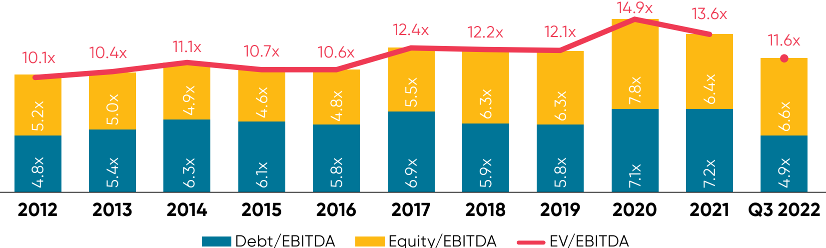


Figure 4: Median buyout multiples (Source: EIF based on data from PitchBook)

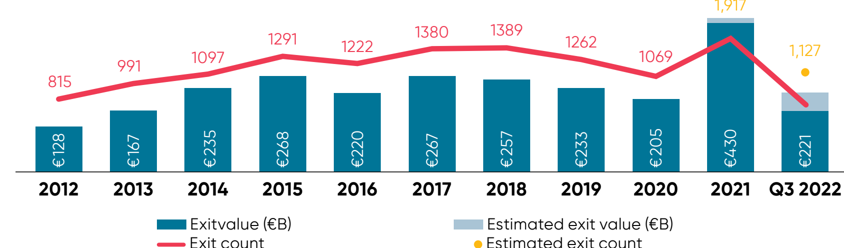


Figure 5: European PE exit activity (Source: EIF based on data from PitchBook)

Regarding secondaries...

2022 marked its second largest year ever with an estimated c. USD 105bn of volume transacted (average of several sources) vs. the all-time record of 2021 (c. USD 132bn transacted)[1]. Transactions were largely concentrated in the first and the last quarter. In Q1 22, many transactions that had been underwritten in Q4 21 closed, before the market entered into a perceived wait-and-see mode (following the invasion of Russia in Ukraine). By Q4 22, the market revamped, mainly fueled by LP-led activity benefiting from the impact of the so-called denominator effect[8] and a loosening of seller's expectations in terms of pricing which materially impacted deal volume. In parallel, a lot of GPs returned to the market at the same time with their primary fundraisings, forcing LPs to decide how to (re)allocate their commitments.

In terms of transactions type, LP-led volumes went back to pre-COVID times, surpassing GP-led volumes (estimated to be c. USD 55bn, i.e., 54% of total transacted volume). Finally, the difficult fundraising environment overall also impacted secondaries, with most of the players still in the market at the time of writing this article. This inevitably slowed down deployment pace in 2022 (arguably building dry powder for 2023).

What to expect in 2023...

We predict continued opportunities on the LP-led side as some investors in the asset class may still be in need to offload some of their positions in 2023. They could not do so in 2022, possibly due to unmet pricing expectations.

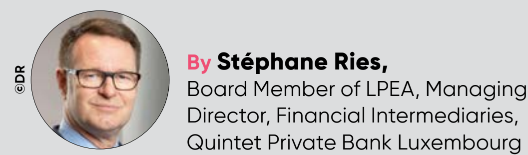
Abundant supply of GP-leds expected, in particular on single asset deals, fueled by delayed natural exits at the underlying funds level. The latter results in slower distributions, and likely negative cash flow for LPs, as capital calls outpace distributions. Multi-asset GP-leds will probably be also in high-demand, as secondaries funds are deemed to seek diversification.

Volumes are estimated to surpass 2022, reaching USD 140-150bn if no other major macroeconomic or geopolitical event impacts the market in 2023. One of the factors possibly contributing to it, if private market valuations decline, is a reduced pricing gap (bid-ask); which is still perceived as significant.

As the old saying goes: "a river whose waters are rough rewards the fisherman"... Setting aside all the uncertainty, a favorable upcoming market momentum lies ahead for secondaries. As previous crises have shown, secondaries are usually well placed to perform strongly in or during post-crisis environments. ●

1. Evercore, Jefferies, PJT ParkHill, Campbell Lutyens and Setter Capital.
2. Net Asset Value.
3. Buyout, Growth, Venture and Real Estate.
4. From 1st of January 2022 to 31st of December 2022. Evercore: 2022 Capital Markets Overview – Equity and Debt Capital Markets.
5. Fed Funds rate as of February 1st, 2023, lower bound: 4.5%, upper bound 4.75%.
6. European Central Bank deposit facility as of February 8th, 2023.
7. Bank of England base rate as of February 2nd, 2023.
8. That is, the over-allocation to private assets due to a drop in public equities and bonds.

INSIGHTS



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Private Equity and Nonprofits: Common Cause?

At first glance, private equity firms and nonprofit organizations seem like extremely strange bedfellows. Among the general public, PE firms are widely seen as "barbarians at the gate," coldhearted capitalists focused on maximizing profitability no matter the social consequences. Nonprofits, by comparison, are perceived in diametrically opposite terms: benign do-gooders that strive to help those who cannot help themselves, with no expectation of any financial return.

Look closer, however, and you'll see that private equity and nonprofits have a surprising amount in common.

For starters, both are multibillion-dollar activities. US private equity firms, for example, raised $340 billion in capital in 2021. Americans gave $500 billion to charity in the same year.

Both employ millions of people, directly and indirectly, and both use vehicles to collect money from institutions and individuals, especially HNWIs. The populations tapped by both PE firms and nonprofits typically give serious consideration to governance factors, including use of funds, prior to allocating capital.

Both review many opportunities – the deal flow, if you will – before selecting the projects in which they ultimately invest. And both seek a return on those investments, even if one seeks financial ROI and the other a return that is purely social.

Redefining private equity return on investment

"To prosper over time, every company must not only deliver financial performance, but also show how it makes a positive contribution to society," BlackRock CEO Larry Fink wrote in his 2018 annual letter to CEOs. "Companies must benefit all of their stakeholders, including shareholders, employees, customers, and the communities in which they operate."

BlackRock runs a $40 billion private equity arm but is of course not a pure PE player. Nevertheless, and no matter what you think about the sincerity of some of Fink's claims, when the world's largest asset manager tells business leaders they need to contribute to society, that's guaranteed to make global headlines.

Fink's 2018 promotion of a stakeholder-centric approach to investing was not by any means new. By then, it was already conventional wisdom that smart business decisions could not be made by focusing exclusively on shareholder value with no regard for environmental, social and governance factors.

Venture philanthropy

If investment decision-making is changing, so is the approach to charitable activity.

Consider, for example, the rise of so-called "venture philanthropy," which applies the principles of venture capital to achieve charitable objectives. Unlike impact investing – which aims to generate social or environmental benefits on top of financial gains – venture philanthropy isn't concerned with financial ROI. Instead, it differs from a traditional nonprofit through the high degree of investor oversight and engagement and, critically, its VC-style approach to catalyzing growth.

Or take the example of New Profit, a philanthropic fund supported by Bain Capital and backed by professionals from that and other PE firms. New Profit provides social entrepreneurs with funding and strategic consulting services, just as a traditional PE firm would with any target investment.

Redefining nonprofit return on investment

Today's private equity firms increasingly consider ESG factors when calculating ROI. In parallel, an increasing number of nonprofits are taking a more performance-driven, PE-style approach to evaluating the return on the investments they make.

Historically, nonprofits provided audited financial statements that showed the amount of funds received, the amount dispersed and the amount allocated to administration. That kind of information is helpful but does not tell a potential donor anything about the organization's effectiveness. This is now changing.

The Bill & Melinda Gates Foundation, the world's largest nonprofit, has an entire department focused on evaluating the impact of its grants. "Evaluation is a high priority when program outcomes are difficult to observe and knowledge is lacking about how best to achieve results," the Foundation explains, noting that "evaluation is a low priority when the results of our efforts are easily observable."

This may sound like common sense, but nonprofits have historically lacked the kind of rigorous evaluation frameworks that are so essential to a successful PE firm. That's of course partly the case because social good is frequently so hard to measure – especially compared to calculating an internal rate of return.

Towards a common foundation?

Over time, private equity firms and nonprofit organizations can continue to learn from one another – and, each in their own way, contribute to strengthening the social fabric.

Already, there are significant PE capital flows to countless charitable causes and foundations; ESG factors will also continue to influence how and where PE firms invest. And while it's hard to see nonprofits turning to leveraged buyouts, they can apply PE-style strategies to advance the common good.

> **"Both Private Equity players and nonprofits employ millions of people, directly and indirectly, and both use vehicles to collect money from institutions and individuals, especially HNWIs."**

Investing in local organizations, becoming involved in management, delivering coaching and training, and then continuously evaluating outcomes. That's the foundation of private equity. Someday, it may be the foundation of nonprofit organizations too. ●

Disclaimer: The statements and views expressed in this document are those of the author as of the date of this article and are subject to change. This article is also of a general nature and does not constitute legal, accounting, tax or investment advice. All investors should keep in mind that past performance is no indication of future performance, and that the value of investments may go up or down. Changes in exchange rates may also cause the value of underlying investments to go up or down.

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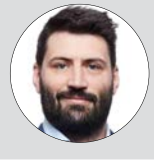

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Securitisation – a Solution of Choice?

Whereas securitisation is governed by the EU Regulation 2017/2402 on securitisations in the EU (the Securitisation Regulation), Luxembourg securitisation undertakings are further governed by the law of 22 March 2004 on securitisation, as amended (the Securitisation Law). The Securitisation Law provides a broader definition of the securitisation concept than the Securitisation Regulation, making it a very attractive solution to investors, originators and sponsors in the EU.

The popularity of securitisation in Luxembourg has been increasing for the last decade, and it is considered a very efficient financing method used sometimes as alternatives to investment funds, under certain conditions. The principle of securitisation is the transfer of risk. It specifically consists in a transaction by which a securitisation undertaking acquires or assumes, directly or indirectly, risks relating to claims, other assets, or obligations assumed by third parties and issues financial instruments or any form of loan whose value or yield depends on such risks.

Due to its proven value and efficiency in the capital markets sector, the Securitisation Law was amended on 25 February 2022 with the purpose of making this tool more flexible to sponsors and originators while keeping a high level of protection to investors. As a result of the amended Securitisation Law, market players may benefit from the following innovations:

- the possibility to incorporate a securitisation vehicle (SV) as as "société en nom collectif", "société en commandite simple", "société en commandite spéciale" and "société par actions simplifiée", which represents an important structuring change in the context of SV partnerships;
- new methods to finance SVs' acquisitions with financial instruments other than securities (such as warrants, loans, promissory notes etc.);
- rules relating to compartments allowing the SVs' bylaws to organise (i) shareholder votes on the approval of annual accounts, (ii) distributions of profits and reserves, and (ii) allocations to the legal reserve per compartment, rather than at the level of the SV;
- the possibility for SVs (or a third party) to actively manage debt portfolios insofar as the financial instruments issued by the SVs in connection with such portfolio are not offered to the public;
- the incorporation of clear definitions of issuance of securities "to the public" and "on a continuous basis"[1]; and
- the possibility for SVs to grant any kind of security interests to third parties other than investors or creditors if this is done in the context of a securitisation transaction.

The amended Securitisation Law has been welcomed by the Luxembourg financial market which is already experiencing the positive impact created by it. As a result of this new legal regime, Luxembourg intends to increase its attractivity as a jurisdiction of choice in the EU for certain financial instruments such as collateralized loan obligations (CLOs).

Tapping into opportunities

The attractiveness of the securitization regime in Luxembourg has been noticed by numerous private investors, among others HNWI, family offices, and financial institutions on behalf of their clients or alternative investment funds. There is also a trend towards the fact that investors prefer a subscription through a clearing system, which is potentially increasing the liquidity and the visibility of the securities. In terms of underlying investments, the asset range is unlimited as long as a risk is embedded into the assets. A few examples: bridge financing backed by different kind of assets, real assets (real estates, jets, yachts, classic cars, art, etc), private equity, litigation financing or impact financing.

> **"The attractiveness of the securitization regime in Luxembourg has been noticed by numerous private investors, among others HNWIs, family offices, and financial institutions."**

The amendment of the securitization law has clearly facilitated the daily business of SVs. Regarding the new possibility for SVs to grant any kind of security interests to third parties other than investors or creditors, a concrete example may be found in the case where a subsidiary of the SV apply for a bank financing in order to buy a real estate. It is usual in this kind of transaction that the bank requests, in guarantee of the financing, a pledge over the shares of the borrower. Before the amendment of the law, it would have been necessary to insert a holding company between the SV and the borrower to grant the pledge to the bank. With the amendment of the law, the SV may now grant it directly.

The possibility for SVs to actively manage debt portfolios is also interesting, even indirectly. For example, before the amendment of the law, the proceeds of a sale / divestment of assets owned by a compartment could not be kept at the level of the compartment and re-invested directly. It had first to be paid back to the investors, through a reimbursement of notes and accrued interests and then reinvested through a new issuance of notes (involving the burden of the legal documentation and the risk that the investor decides not to re-invest). Thanks to the active management, it is now possible to draft the terms and conditions in a way that will allow the SV to directly re-invest into another asset.

SVs are not spared by the recent retailisation wave within the alternative assets range. The private investors have been showing deep interest in private assets for many years but they were unable to reach these markets until recently. For a couple of years now, numerous projects and initiative are launched, on a smaller scale than in the past, allowing "retail" investors to find exposure to assets that used to be out of their reach; premium real estate, art works, collectible cars, jewelry and watches, wines, etc. In the vast majority of cases, structuration of such endeavor is made through securitization, topped up with tokenization.

Tokenisation & retailisation

Securitisation vehicles are relevant in the context of assets' tokenisation due to, inter alia, their flexible legal and regulatory regime which allows, under certain conditions regulating notably the vehicle as well as the offering, to raise retail money while remaining a reasonably affordable investment structure. Tokenisation is increasingly viewed as a gateway for retail investors to illiquid assets, such as real estate, artworks, or intellectual property rights, providing retail investors with the unique opportunity to invest into new asset classes that were previously unavailable to them, and diversify their investment portfolios.

Thanks to automation and digitalisation allowed by the blockchain, tokenisation leads to, inter alia, reduced transaction times (e.g., investors' onboarding and subscription process), enhanced risk management, lower costs for investors, improved and more technological management (e.g., registry management and maintenance). It also contributes to the effectiveness of the secondary market, notably using virtual billboards, by speeding up transactions and removing all unnecessary intermediaries.

Under the combined trends of retailisation and tokenisation, securitisation vehicles are likely to remain a solution of choice in the Luxembourg investment toolbox.

On 23 March 2023, most of the provisions of Regulation (EU) 2022/858 of the EP and of the Council on a pilot regime for market infrastructures based on distributed ledger technology (the DLT Pilot Regime) will enter into force, aiming to provide so-called DLT market infrastructures which operate securities trading and settlement systems based on DLT with a set of rules suited to crypto assets that qualify as financial instruments within the meaning of Directive 2014/65/EU, further enhancing the efficiency of DLT market infrastructures. ●

1. "offer to the public" shall be understood as an offer that is not addressed to professional clients, the minimum investment amount is lower than EUR 100,000 and where the financial instruments are not distributed via private placement.
"on a continuous basis" shall be met when an SV makes more than 3 offers to the public within a financial year taking into account the offers made by all the compartments.

INSIGHTS

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Luxembourg as a Hub for Asset Tokenisation: Vast Opportunities Ahead

Asset tokenisation presents an opportunity for Luxembourg fund managers, third-party management companies and service providers in the alternative asset management industry to widen the range of products and services in a changing world.

The next generation of investors is digital native, seeks greater autonomy in the digital space and is looking for true 'ownership'. Asset tokenisation unlocks the potential to reach out to new investor types and enables fractionalisation with reduced risks.

What is asset tokenisation?

Asset tokenisation means creating a digital representation of legal rights to a real asset on distributed ledger technology (DLT). Such digital representations are further referred to as digital securities.

Important in this context is the difference to crypto currencies which mostly do not provide access to the underlying economic rights. Classic examples are ETH (Ethereum).

The digital securities can be issued, traded and settled on the DLT and certain rights like voting and corporate actions can be embedded in the tokens via smart contracts.

Asset tokenisation allows for the mapping of financial instruments on DLT so investors may hold their digital securities directly in their self-custodied DLT wallets (like Ledger or the SideSwap wallet) or via a custodial solution.

Fund managers and management companies can have easy access to investor data without requiring complex third party solutions. In addition, tokenisation allows them to have direct information about the ultimate holder of the digital securities and to better understand the investor behavior, the investor preferences and expectations.

As BlackRock CEO Larry Fink said that "the next generation for markets, the next generation for securities, will be tokenization of securities."

How does it work?

In principle, tokenization allows an investment fund, a securitisation vehicle or any other investment vehicle or company to hold its investor register directly on the DLT. Tokenisation ensures that the investor register of the issued fund units or notes (digital securities) is up to date 24/7. The general partner or management company creates a direct link with their investors without the need of an intermediary. Any change in ownership of the digital securities is recorded instantaneously as settlement takes a few minutes.

Digital securities can only be held by investors who are whitelisted, a process by which only identified blockchain wallets can be allowed to hold digital securities. A Luxembourg regulated Virtual Assets Service Provider (VASP) as STOKR can for example enable the whitelisting process for asset tokenisation.

The whitelisting process for investors involves several steps to ensure compliance with regulatory requirements and protect the interests of all stakeholders. The potential investor must provide KYC/AML information and eligible criteria data so that the management company or service provider can make sure that the investor is eligible to invest into the financial instrument.

This information is checked against various databases and sources to confirm the investor's identity and ensure they are eligible to invest and also they understand the risks. Investors are also required to connect their blockchain wallets which act as the securities account. As mentioned before such blockchain wallets can either be self-custodied or can be custodian solutions. The whitelisting process links the KYC/AML and investor criteria with the blockchain wallets.

Linking the two allows the fund manager or management company to know who holds the financial instruments of a given investment product at all times, as the register of investors will be automatically updated with the blockchain 24/7.

Once linked, the smart contract managing the functioning of the digital securities ensures that only a whitelisted investor can interact, hold and transfer digital securities. This automates the entire compliance value chain.

The whitelisting process ensures that no non-whitelisted blockchain wallets can hold the digital securities.

> **"Luxembourg as a worldwide financial hub and number two investment fund center after the US has the best prerequisites to become a center for global tokenization initiatives."**

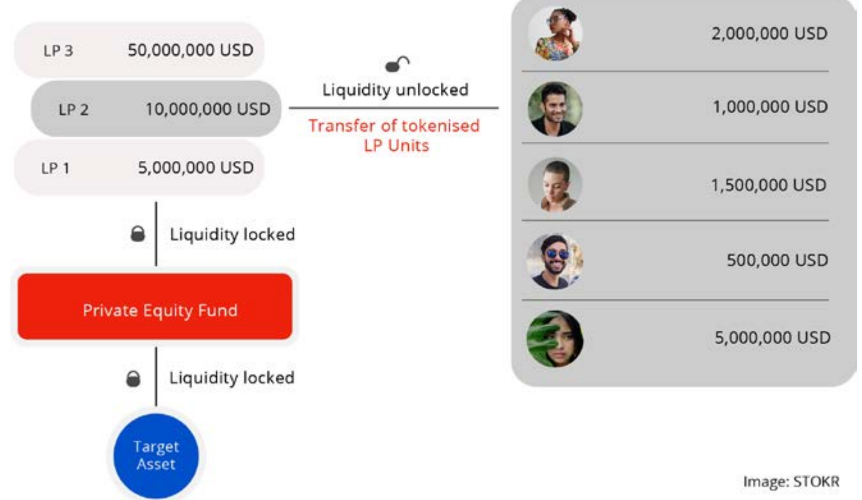

Image: STOKR

Tokenisation solves liquidity problem

Rising interest rates and falling asset prices will be a challenge in the coming year for investors who seek to have access to cash.

Closed-end funds do in general not allow for redemptions and even if opened after the lifetime they may have difficulties to allow for redemptions as the underlying assets are difficult to sell. The result is that the cash is trapped and liquidity is locked.

So far the alternative investment fund industry and its service providers did not have a solution to this problem so investors who seek liquidity will think twice whether they put their money in new alternative investment fund structures.

Fractionalisation enabled by tokenisation provides far more flexibility than traditional fractionalisation in the private markets which are slow, manual, opaque, and have high overheads.

Tokenisation enables part or all of the fund units to be sold in smaller fractions to investors who did not so far have the possibility to invest with smaller tickets in alternative investment products.

This will allow existing investors of a closed ended fund (for example pension funds) to get access to liquidity and a new generation of investors (like high net worth individuals and family offices) to access alternative investment products.

In the graph above the limited partner cash is trapped as the asset is illiquid to sell and the fund in turn cannot allow redemptions. The holder of limited partner units (LP 2) maybe offered to tokenise its units and make them transferable. This will allow the limited partner to access cash and new investors can participate in the fund.

Luxembourg, a hub for asset tokenisation

Luxembourg as a worldwide financial hub and number two investment fund center after the US has the best prerequisites to become a center for global tokenization initiatives.

The very flexible corporate law is the most suitable for issuing financial instruments in tokenised form. The law allows companies to keep their own register of investors which gives an edge over other jurisdictions in the European Union as company law is not harmonized within the EU.

We are still early in terms of adoptions. Large asset managers like Hamilton Lane, KKR, Apollo are launching pilot projects. For fund managers and management companies it is the perfect time to add digital asset capabilities and provide add-on services, reducing the threat of disruption and also increasing the possibility to serve a wide range of clients. ●

If you have any questions on asset tokenisation, please reach out to us at hello@stokr.io.

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The EU DLT Pilot Regime: a Game Changer for the Luxembourg Investment Funds Community?

The European Union (EU) has acknowledged the potential of distributed ledger technology (DLT) by adopting the DLT Pilot Regime[1]. With this legislative initiative, the EU is leading the pack of major economic hubs seeking to boost capital markets and fund product offerings. The DLT Pilot Regime comes into effect on 23 March 2023.

What are DLT and the DLT Pilot Regime about?

DLT is a system for recording and sharing data across a network of nodes, without relying on a central authority or intermediary. DLT enables consensus, transparency and security among network participants, and can support various applications such as cryptocurrencies, smart contracts, and digital financial assets (like digital fund units solely residing in DLT networks).

This rapidly evolving technology is revolutionising the way financial assets are issued, traded and custodied. The tokenisation and digitalisation of financial assets is on the path to adoption by established market players. For instance, several high-profile bond issuances have been carried out successfully over recent years relying solely on DLT networks[2].

Due to a complex gap in the EU legal framework, however, it has not been possible to trade such digital financial assets on trading venues which have deep liquidity. It has also not been possible to settle trades on these instruments in the traditional clearing systems that are home to the overwhelming majority of financial products. These two factors have been seen as the shackles preventing digital financial instruments from being actively traded.

The EU intends to tackle these structural issues with the DLT Pilot Regime. This legislative framework will allow certain market infrastructure operators (Multilateral Trading Facilities (MTF) and Central Securities Depositaries (CSD)) to use DLT in their operations under certain conditions. Under the DLT Pilot Regime, these operators are granted exemptions from certain provisions of EU legislation such as the Markets in Financial Instruments Directive II (MiFID II) and the Central Securities Depository Regulation (CSDR) to use DLT in their operations. This will enable trade and post-trade services to be provided by these players for digital financial assets under a clear legal framework.

As such, certain investment funds[3] will be able to capitalise on the technological and operational benefits of DLT while still having access to these services of DLT market infrastructures. Luxembourg, as the funds hub of Europe, is well positioned to reap the benefits of the DLT Pilot Regime.

> **"This legislative framework will allow certain market infrastructure operators to use DLT in their operations under certain conditions."**

What's in it for the Luxembourg funds industry?

We anticipate that DLT may offer multiple potential benefits for fund industry players, such as:

- Automating and decentralising various tasks that normally require human intervention through smart contracts, such as debt servicing, AML/KYC compliance, and certain investor reporting and communication.
- Providing instant and consistent visibility of deal flows for all the participants in the fund industry value chain.
- Saving the time and costs incurred by the reconciliation activities between different parties, as the transactions are verified and recorded directly on the distributed ledger.
- Serving as a single source of truth where all the information is consolidated and consistent.
- Increasing significantly operational efficiency by eliminating the necessity to manually coordinate with various intermediaries or to wait for the processing of outstanding orders before the publication of net asset value (NAV).

DLT is also built for resistance to fraud and hacking, and to facilitate real-time visibility into ownership and transaction history. These are interesting focus points for investors and funds alike.

All these advantages of DLT improve the efficiency and reduce the costs of intermediaries and back-office functions for fund structures. This, in turn, will enhance their competitiveness and the market position of fund hubs embracing this tech-offering. Moreover, the use of DLT for issuing and trading funds units also has the potential to improve the investor experience, by enhancing liquidity, accessibility, transparency and efficiency.

In other words, the DLT Pilot Regime creates a safe and secure environment for both investment funds and investors while fostering innovation and growth through the DLT ecosystem.

Looking towards the future

Tokenising fund units requires initial technical and operational resources, expertise, and coordination, as well as compliance with high standards of cybersecurity and interoperability. It involves the selection and implementation of suitable blockchain protocols, a token standard, and issuance platform, as well as the integration and alignment of the tokenisation process with the existing fund structure, governance and administration. Moreover, careful scrutiny from the regulatory and legal perspectives is needed including, for example, the fund interests distribution rules, the regulatory functions of relevant parties in the fund ecosystem (e.g. depositary, authorised independent auditor, and administrative agent), as well as any potential contractual restrictions (e.g. restriction on transfer of interests) imposed in fund documents.

Luxembourg law firms and tech-providers have developed interesting tokenisation solutions to assist issuers on such projects.

The DLT Pilot Regime is an opportunity not to be missed by the Luxembourg investment funds ecosystem. ●

1. Regulation (EU) 2022/858 of the European Parliament and of the Council of 30 May 2022 on a pilot regime for market infrastructures based on distributed ledger technology, and amending Regulations (EU) No 600/2014 and (EU) No 909/2014 and Directive 2014/65/EU (Text with EEA relevance).
2. These recent high-profile digital bond issuances include the following:
https://www.eib.org/en/press/all/2021-141-european-investment-bank-eib-issues-its-first-ever-digital-bond-on-a-public-blockchain
https://www.eib.org/en/press/all/2022-448-eib-innovates-further-with-project-venus-the-first-euro-denominated-digital-bond-on-a-private-blockchain
https://www.eib.org/en/press/all/2023-030-eib-issues-its-first-ever-digital-bond-in-british-pounds
https://www.santander.com/en/press-room/press-releases/santander-launches-the-first-end-to-end-blockchain-bond
https://www.abnamro.com/en/news/abn-amro-registers-first-digital-bond-on-public-blockchain
3. Pursuant to Article 3(1)(c), eligible fund units are shares or units in UCITS, excluding structured UCITS, the market value of the assets under management of which is less than EUR500 million.

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Interview by **Luis Galveias,**
COO, LPEA

My Ambition: Grow the Clients, Nurture the Talents

Recently promoted Managing Partner at Clifford Chance, Katia Gauzès, shares the milestones that led to her becoming one of the key persons in the alternative assets industry in Luxembourg.

Congratulations on your promotion! From the early days at the Law University in Lille to becoming a Managing Partner at one of the five 'magic circle' law firms, what was your journey like?

Many thanks! It all started in Catalonia, a family place I have been visiting every summer since I was very young. My interest in law probably stems from my godfather, who often worked on legal projects at his law firm in Barcelona and who welcomed me there for my first internship. After high school, I decided to do a bachelor degree at the Faculty of Law in Lille, and then to pursue my studies at Panthéon-Assas University Paris II for two years. At that point, I wondered whether law was my true and only interest and started, in parallel, an MBA at ESSEC. Following my ESSEC years – where I met my husband – I graduated a Master 2 in Law from Assas University and passed the bar exam in Paris. I then started my legal career in Luxembourg at Arendt & Medernach, where I spent 14 years. What attracted me at the time was the opportunity to join a leading domestic law firm in the Luxembourg market. It was interesting to be active in a cornerstone sector of the country. During these 14 years I went from trainee to Junior Associate, Senior Associate and finally Partner.

Following that period, I received a call from Christian Kremer, the Founding, and then Managing Partner of Clifford Chance Luxembourg, who was looking for a Corporate Partner. Joining an international firm, at that point in my career, seemed to be a challenging and interesting step to take. Back then, I would never have imagined that, six years later, I would be replacing him as Managing Partner. I have to say that I am really honoured and also very excited to take on this role. It is quite an important milestone in a lawyer's career, but in particular for a woman and a person who is not a native of Luxembourg. It also shows that we are working in a truly changing environment which embraces diversity.

Being a woman in the legal and financial world may not always be easy, but it is definitely manageable without sacrificing one's personal life! I realised that having a woman appointed as Managing Partner of a Magic Circle law firm was still exceptional when I received over 2,000 congratulations from people all over the globe telling me that my promotion was a really incredible

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> **It is important that our team members have an enjoyable working experience and that we allow them to grow, both professionally and personally. In this way, we can provide the high-quality services that our international clients are looking for. "**

achievement. That was quite impressive and I am trying to manage expectations and live up to that standard!

You were one of the first lawyers to deal with alternatives funds, which brought you close to the LPEA in its early days, is that right?

I did indeed start in the Private Equity field and was mostly active on the corporate side, so the downstream part of the funds industry. I then worked with corporate partner Guy Harles (a founding partner of Arendt & Medernach), one of the founding members of the LPEA. Back then, I assisted Guy with the association's Executive Committee and used to call myself the 'shadow secretary' – accompanying him and taking notes at every meeting. I have now been part of the industry for the past 20 years and have seen it evolving quite substantially. As for the LPEA, I was very involved in the Legal Technical Committee as from inception and I am very pleased to have been a member of the Board since 2016.

What priorities have you set for yourself and Clifford Chance?

My ambition is the following: grow the clients, nurture the talent. It is very important to combine both.

Our strategy is really to be in constant growth mode and I think there is still potential for the market to evolve in this direction. In a continuously changing environment, increasingly complex advice has to be provided, and our clients are clearly seeking that sophisticated legal advice. We cannot provide this legal assistance if we do not have the right talents within our teams. It takes a lot of effort to attract, train, retain and manage talented people. It is therefore important that our team members have an enjoyable working experience and that we allow them to grow, both professionally and personally. In this way, we can provide the high-quality services our international clients are looking for. We are working on these two key priorities in Luxembourg, in complete alignment with our global growth-oriented strategy regarding financial investors.

We have 31 offices in 21 jurisdictions. Our clients are international and institutional, exploring opportunities on a cross-border basis. Typically, they are looking for teams that can serve them throughout the world, on various competencies. This is where we concentrate our efforts. Financial investors are one of our key strategic focus areas, which is fully aligned with Private Equity. In Luxembourg, cross-border work is part of our DNA and we are involved with a variety of such financial investors clients to a larger extent than any other Clifford Chance office in the world.

Going back to the teams, what can be done to bring foreign talent to Luxembourg?

We put a lot of effort into attracting talents. The HR team is certainly a key driver to reach our recruitment objectives and in combination our Business Development team helps develop our talent-attraction initiatives. Our lawyers also become actively involved with our recruitment initiatives. We believe that the best way to recruit people is to showcase lawyers working within the firm who are both fulfilled and happy to work with us. This represents the main focus of our efforts in Luxembourg, along with the main countries where our lawyers come from, i.e. France, Germany, Belgium and the United Kingdom. We have dedicated initiatives in each of these countries, such as hosting dinners for students in London and Paris during this month of March. We always bring in Associates from our teams that have studied in these cities as they can share their experiences of how their careers have evolved after university.

Both attracting and retaining the right talents requires a lot of commitment. Once new people join our teams, we need to ensure that we provide the right training. Through the Clifford Chance Academy, people can learn either online or via specific training sessions hosted in our offices Amsterdam, Frankfurt, Madrid, Paris and London. This also introduces a networking feeling, which, in our region, we refer to as the "One Europe" mindset. I think this is very important in order to cement the international culture of the firm. In this regard, we have launched last summer a European Secondment Exchange Program for mid-level associates. A member of my corporate team has just started an exchange in Madrid for four months, while our banking team is welcoming an Associate from our Frankfurt office, and we aim to develop such initiatives further. This is also the case with client teams, as we want Associates who are working with specific clients to evolve together regardless of their country of legal practice and cater to the clients' needs. As we serve both financial investors and Private Equity houses, we seek to provide training using a product-based approach. The funds team will advise clients during the course of the fund formation, the corporate team during the structuring, acquisition or selling of their underlying assets, and the banking team for the fund financing, all of this being done with the support of our tax and litigation colleagues. We are fully equipped to be the one-stop shop for Private Equity clients and to serve them internationally.

The alternative asset industry represents more than a quarter of assets (NAV) in the Luxembourg market. Is this substantial size reflected in Clifford Chance's activity?

Yes, definitely. It represents even more in terms of percentages for us in Luxembourg. The majority of what we do is around financial investors, which represent approximately two-thirds of our legal work. Luxembourg is a global hub for investment funds. Since most of the major international funds have a presence in Luxembourg, this is the best place to serve them. Within our Clifford Chance global network, financial investors are also one of the three pillars of our firm's client strategy, next to banks and corporates. Our local strategy perfectly aligns with the global one and, as mentioned above, our teams can accompany financial clients through all stages of their investments.

You have been in the sector for many years. What has particularly impressed you during the "spectacular" growth of Private Equity in Luxembourg in recent years?

When I started working in Luxembourg – about 20 years ago – the funds industry was already vibrant, with UCITS at the forefront. Since then, the alternative sector has grown substantially. In comparison to UCITS, where the assets under management are known, it remains difficult to measure the exact volume of the alternative industry since it is not fully regulated. What strikes me most is how quickly Luxembourg professionalised itself as a country. The LPEA has a similar story: it started as a small association in 2010 and has now grown to include more than 420 members.

Luxembourg has moved over the years from a back-office to a more middle-office centre. I hope that, in the years to come, we will be able to move further along the value chain, i.e. developing relationships with investors, working on our compliance assets, and focusing on the distribution element. There are nevertheless certain constraints, as we are facing more and more regulations. For instance, for ESG, we have started

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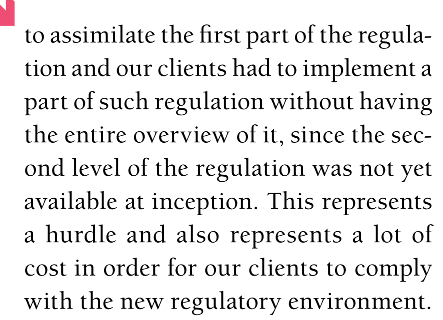

> "Luxembourg has also been innovating a lot. We need to keep that on track and constantly come up with ideas to add new features to the famous Luxembourg toolbox."

to assimilate the first part of the regulation and our clients had to implement a part of such regulation without having the entire overview of it, since the second level of the regulation was not yet available at inception. This represents a hurdle and also represents a lot of cost in order for our clients to comply with the new regulatory environment.

What are the legal "revolutions" to monitor closely in 2023?

I see three main topics: AIFMD II, ELTIF II and ESG.

For 2023, AIFMD II will definitely be on the funds agenda, but we do not expect a revolution there; rather, continuity.

ELTIF II is also on our radar, in particular since the first ELTIF version was not as successful as the market had anticipated. We are not expecting a drastic change in this space but a strong evolution. We will see if the regulation is able to create a bridge between UCITS and the alternative assets industry via the retailisation trend we are currently witnessing. This trend, which started a few years ago, will potentially be the next important step for the industry. We have worked with major market players, including on the biggest retailisation project to date in Europe, and we witness appetite from other investors that equally want to position themselves in this market. It is a hot topic for the moment, so there are many opportunities to be seized.

Finally, ESG is permeating all sectors. It started with the funds industry and is now entering the banking industry, too. The next step will be the corporate sector with the Women on Boards Directive and The Corporate Sustainability Reporting Directive (CSRD). All those trends have to be taken into serious consideration and will be part of the new due diligence that our clients will have to carry out when targeting new assets.

Luxembourg has also been innovating a lot. We need to keep that on track and constantly come up with ideas to add new features to the famous Luxembourg toolbox. This is crucial to maintain the attraction of Luxembourg for the funds industry. Keeping the status quo is not an option: this would imply regression and a loss of market share. We need to continue to develop ourselves, to think ahead on how to attract new business. And we may all contribute to that, so these are very exciting times!

What is your advice to young legal professionals to move ahead in their career?

It is very important to be curious and dare to be bold. Try to identify your area of interest and the team in which you would best fit and accomplish yourself. In the legal industry, career options are numerous as well as diverse, and you can have several careers in your life. It is a demanding profession that requires working long hours on certain transactions, for instance. Therefore, it is important that you like what you are doing. Try to find an environment where you feel accomplished and have a purpose. This is the reason for which we invite our people – beyond their legal work – to join us on business development and recruitment events or corporate responsibility initiatives. We want to include them in activities that broaden their scope of expertise and experience. There are many opportunities in a law firm; you just have to choose your own path. But do not worry if it is not immediately the right one, as you can always switch fields and departments. Find the right environment, that is very important! ●

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By **Alexandre Hector,**
Partner at KPMG

"Democratization" and "Retailisation" of Private Assets, a New Paradigm Shift (?)

The Private Equity ("PE") industry's performance over the last few decades has been outstanding and outclasses the public equity markets. Despite current critical and complex global issues, this growth might actually be just the beginning, especially if we take a closer look at today's current macro-environment and the trending democratization of private assets.

State of play

Whilst several economic sectors desperately need investments and funding to support their growth (e.g., green projects, new technology, healthcare, fintech, datatech, etc.), money is not actually flowing to them. Financial institutions are rather reluctant to finance risky projects in the current unstable macro environment and European States lack proper private equity expertise and investment capabilities as a result of significant deficits and the rise in interest rates.

Meanwhile, on the other side of the spectrum, we see family offices ("FOs"), (Ultra) High-Net-Worth-Individuals ("(U)HNWI") and even clients from retail banks with significant cash reserves that are seeking diversification and enhanced returns.

One of the most critical challenges ahead for European economies will be to bridge these two worlds and unlock this great potential.

Private Equity funds happen to be in the best position to build up this connection and channel the uninvested cash reserves to fuel up the real economy in its broadest sense (e.g., start-up, early-stage companies, small and medium cap companies, etc.). This is not without any challenges though for asset managers, administrators, and distributors.

The challenges of the democratization of private assets

Widening access of private equity to individual investors is obviously not straight forward and would mean a change of the current paradigm.

Private equity funds have always had a limited number of professional and institutional investors with significant entry tickets, and fund managers operations were built on an absence of liquidity. However, the democratization of private equity will require the entire fund ecosystem — from the fund managers themselves to the asset servicers and service providers — to completely rethink their operating models to be able to deal with the specificities of such new investors: higher number of investors that are not always well-informed, increasing information flows, additional transparency requirements, liquidity windows, digitalization and complex on-boarding to name just a few.

The IPEM conference held in Cannes in September 2022 confirmed the trend toward democratization was in everyone's mind (i.e., it is a critical priority in GP and PE houses' distribution strategies) and that the main objective of the stakeholders (in particular administrators, transfer agents, management companies and depositaries) was to enhance their operational skills in order to tackle the above challenges.

It is still unclear to what extent PE investments can reasonably be democratized. Over the last decade in Europe private banks and other distributors have successfully started opening private equity, private debts and real estate funds to (U)HNWI and FOs. Such investors class still has a huge potential but one of the objectives of ELTIF 2.0. and other initiatives from disruptive actors is to target retail investors as well. We know from experience that distribution to (U)HNWI and FO is already challenging as we mentioned above but targeting all individuals investors, especially mass affluent and retail, will represent a revolution in terms of volume of operations and required communication and pedagogy.

> **"We know from experience that distribution to (U)HNWI and FO is already challenging but targeting all individuals investors, especially mass affluent and retail, will represent a revolution in terms of volume of operations and required pedagogy."**

Regulatory and operations frameworks

As the main European hub for Private Assets structuring and administration, Luxembourg will necessarily be (and rightly so) on the front line to develop concrete solutions to "make it happen". The flexibly and diversity of the Luxembourg vehicles structures remain an important strength to support that trend. UCI part II funds in Luxemburg were (and still are) historically the main option for the alternative industry targeting (U)HNWI and FOs. The classic use of feeder-master structure through RAIF or SCSPs are also common, but would not always provide the necessary flexibility when targeting individuals.

The European Commission also shares the view that the role of individuals will be crucial in the coming decades to finance the real economy and support the future of our continent. The ELTIF regulation was just revised to facilitate the distribution of private assets to retail investors. "ELTIF 2.0" is a more flexible platform than its predecessor as most restrictions and additional suitability diligences have been removed. The new regulation also allows open-ended structures to provide more flexibility to meet expectations of individual investors.

Given its flexibility, ELTIF 2.0 structure will facilitate widening the access of PE not only to (U)HNWI or FOs, but also to retail and mass affluent investors.

That being said, legal structures will not be sufficient to properly support the growth of the democratization of PE. All asset managers and servicers will have to upgrade their operation systems (IT systems, digitalization, automation…) and strengthen their teams to be properly handle this higher level of complexity.

The democratization of PE might result in a kind of hybrid industry positioned between the worlds of UCITs and AIFMD. The expertise of the Luxembourg fund microcosm in both areas will be critical to properly support Luxembourg as main financial center for the development of the democratization of PE.

Wider perspectives on the democratization of alternative assets

There are other players within the fund ecosystem that are used to the challenges associated with the democratization of alternative assets.

Private banks were the first within the wider financial industry to interact with individual investors. They have already been exposed to the inherent challenges of the distribution of investments solutions to individual investors: MIFID, AML, digitalization, resources available to exchange with clients and handle complex discussions when necessary. They have also been known to deal with high volumes of transactions with lower values and involving multiple clients, which is generally not as common in the PE industry as raised before. Their role as first point of contact and interaction with individual investors will be critical as well.

Although private and retail banks will be playing a key role, we see more and more disruptive players also trying to directly connect PE investments (funds or direct investments) with retail individuals without using banks as intermediaries. The volume exchanged via these platforms remain modest at this stage and this is certainly due to the complexity of distribution and marketing of these alternative investments solutions to individuals without a banking front office expertise and resources.

Tokenization of the fund's registers of PE vehicles might also bring interesting solutions in the future to bring more simplicity for purchasing and transferring assets, even though it is still a long-term perspective at that stage. Among other things, it could facilitate the creation of a secondary market for alternative investments investors providing more liquidity flexibility.

All those current concrete initiatives or projects to "democratise" private equity are step by step building a bridge between alternative assets and UCITS worlds, providing always more flexibility and liquidity to traditional private assets vehicles. ●

How to the follow the trend:

on June 13, 2022, the LPEA and KPMG organized a conference which shed light on how to "Widen the access of HNWI and FO to Private Equity". Another conference will be organized in June 2023 to follow up how this trend is progressing and impacting Luxembourg. Date of this coming conference and panels composition should be communicated soon.

Follow us on Linkedin or on the LPEA and KPMG websites to stay informed.

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By **Charlotte Lahaije-Hultman,**
Global Sector Head Corporates
at Vistra

Five Steps Every Organisation Should Take when Expanding and Operating Internationally

I've spent much of my career helping organisations expand and operate internationally. There have been many changes during that time, particularly in the last decade. Businesses and investors have had to adapt to the rise of digital commerce, emerging ESG demands, the normalisation of remote work, rising protectionism, inflation and other challenges.

Despite these ongoing shifts, some best practices related to expanding and operating internationally have remained intact. Any growing organisation should understand these practices, or steps, so they can lower risk and promote efficiencies. Private Equity and Venture Capital firms can also benefit by increasing their ability to provide sound guidance to growing portfolio companies.

Keep in mind that expanding and operating internationally in an efficient, compliant way requires expertise in many complex areas. This brief article can only address a few steps at a high level, but they're important ones. And whether you're expanding for the first time or the third, the challenges and risk-mitigation strategies will largely remain the same.

1. Establish an international expansion and operations oversight team

No matter what size the organisation, if it's operating in or considering expanding into a new country, it should establish a team of experts to oversee international activities. The team should have representatives from finance, tax, HR, general counsel and risk management. Most organisations will also want to hire a third-party international expansion provider to obtain ongoing information and advice.

The team should vet any proposed expansion plan to understand: how it aligns with corporate strategy; the nature of the activities; all related compliance obligations and costs; and the target country's culture in relation to the organisation's culture (which shouldn't be underestimated). This kind of thorough research should be conducted well in advance of any expansion.

The team should also regularly review existing international activities in light of changes to corporate strategies, budgets, compliance obligations and other relevant factors. Finally, it should develop and update international expansion and operations policies.

2. Understand and continually address cross-border compliance obligations

In recent years there has been some regulatory cooperation between countries. Many jurisdictions, for example, have implemented the OECD's Common Reporting Standard. But we're a long way from global regulatory convergence. Organisations that operate in only one or a handful of jurisdictions often fail to appreciate the extent to which tax, labour, immigration and other rules vary by country.

To take an example, many organisations underestimate the risks of permanent establishment, or what constitutes a taxable presence. Broadly, if a company generates revenue in a country, or establishes a physical presence over a sustained period, it typically risks triggering a permanent establishment, or PE. PE determination is a grey area, and authorities in different countries interpret and enforce PE laws in their own ways. Unfortunately, the risks of non-compliance are high.

We had a client that approached us because they'd breached PE laws in Sweden. They'd been paying two employees who worked from home and didn't generate significant revenue. After a year, local authorities informed the company that it had triggered a PE, in part because one of the employees had the word "sales" in his title. The situation was complicated, but essentially the organisation should have more formally registered its legal presence in Sweden and paid more employer payroll taxes. In the end, the client had to pay over US$20,000 in taxes and fines.

This is one example of the countless ways non-compliance with local rules can lead to unforeseen costs. Keeping up with new and changing tax, HR, immigration and other obligations in all countries of operation is one of the most difficult, and essential, tasks of any multinational organisation.

> "Keeping up with new and changing tax, HR, immigration and other obligations in all countries of operation is one of the most difficult, and essential, tasks of any multinational organisation."

3. Understand how to pay workers in another country

When an organisation expands into a new jurisdiction, it usually considers hiring contractors. This is a quick solution, but misclassifying workers as contractors rather than employees is a risk. We had a university client that hired local workers as contractors to run a study abroad program. After many years of this arrangement, the contractors sued, claiming they'd been de facto employees all along. They prevailed, and the university had to pay more than US$500,000 in back taxes and damages.

One increasingly popular option for quickly hiring workers in another country is through an employer of record, or EOR. This is a third party with a local legal entity in the target country that can make payrolls and provide benefits while the expanding company directs the workers. It's important to understand that while EOR is a great low-risk option for certain situations — including paying workers after an M&A carve-out deal or to get up and running quickly — it's not intended to be a permanent solution.

The most flexible solution for hiring workers across borders is to establish a local legal entity (such as a subsidiary) and pay local employees through that. Establishing an entity can be expensive and time-consuming, so the organisation should be committed to its target-country activities.

There are other solutions to paying workers abroad, such as paying through a non-resident payroll. Each country has its own set of options with related benefits and risks, so due diligence is essential.

4. Optimise your entire organisation

When I started my career, many clients were primarily interested in our tax services. Over the years, tax has remained critical, but our clients have also demanded more varied services. They need help navigating an increasingly complex global economy that includes cross-border remote work, ESG reporting requirements, disrupted supply chains and other challenges.

To better compete in this volatile environment, companies are now optimising their entire organisations. They're implementing updated corporate governance frameworks, reviewing HR policies and practices to ensure effective and efficient global workforce management, developing robust data protection and IT controls, conducting legal entity rationalisations to optimise their global footprints, and more.

This kind of holistic optimisation creates operational and financial efficiencies while lowering risk. If properly documented, these kinds of steps will appeal to customers and investors and can significantly increase valuations.

5. Know what it takes to wind down operations

One area of planning that's often overlooked is the cost and time it takes to wind down, or dissolve, a legal entity. Here again, rules vary by country, but often include stopping trading, having an external audit performed and not having local tax liabilities. The timelines for winding down also vary, but typically the process takes at least six months.

If an organisation's strategies or circumstances change, it may have to wind down an entity unexpectedly. If it hasn't accounted for the time, costs and requirements of a dissolution, the organisation may face budget shortfalls, compliance risks and other pitfalls.

If there's one overriding truth about international expansion and operations, it's that "you don't know what you don't know." Don't assume that one country's laws and regulations are like another's and seek authoritative information and advice to understand what you're getting into and to keep compliant once you're established. ●

INSIGHTS

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By **Diogo Dias,**
Senior Associate - Attorney
at Law at Loyens & Loeff

The Special Purpose Acquisition Company

Special acquisition companies (SPACs) have received a lot of attention from the media and within the Private Equity industry for the past three years as they suddenly became the most in-demand equity type asset class in the US, the UK and Europe.

Luxembourg has been involved in several SPAC deals in that period with either the SPAC being a Luxembourg company or the foreign SPAC's target company being a Luxembourg company.

While SPACs have hit headlines in recent years, such blank check companies first emerged in the 1980s and had a questionable reputation, being not well regulated and plagued with penny stock fraud. SPACs having characteristics comparable to what we know today have been developed from the 1990s onwards.

Until 2020, SPACs remained a niche market in finance with transactions being limited in size and often only being considered as a last resort strategy when a company could not complete an initial public offering (IPO) or attract interest to be taken over by professional investors.

Their popularity dramatically increased in 2020 and 2021 and the numbers of the so-called "SPAC boom" speak for themselves: the SPACs created in 2020 raised approximately 76 billion USD and the SPACs created in 2021 raised approximately153 billion USD.

However, capital raised through SPACs fell sharply in 2022 to approximately 13 billion USD. This is mainly due to inflation, rising interest rates and the general market slow down.

Does this mean the SPAC party is over?

What exactly is a SPAC and how does it work?

A SPAC, or a blank check company, is a company that is formed by raising capital through an IPO for the purpose of acquiring or merging with an existing operational company. The purpose of a SPAC is to find a target company and complete a business combination with such target.

SPACs provide private companies a unique way to access the public markets. Even though SPACs are usually structured similarly to traditional Private Equity funds, it is generally considered that they should not qualify as alternative investment funds (AIF) within the meaning of Directive 2011/61/EU on alternative investment fund managers (AIFMD) as they (i) pursue a commercial purpose, (ii) do not have a defined investment policy and/or (iii) qualify as a "holding company" in accordance with Article 4(1) (o) of the AIFMD. It is worth noting that the ESMA stressed, within its latest release of its Q&A on the application of the AIFMD on 16 December 2022, "that the structure of SPAC transactions is complex and there are significant variations between the general structuring of relevant vehicles and concrete modalities of their transactions". It is therefore important to assess on a case-by-case basis whether a particular SPAC meets the criteria of the AIF definition as set out in the AIFMD.

When a SPAC is listed through a traditional IPO process the investors in such SPAC are asked to entrust their funds to a company with no real business activity and no track record. In fact, the SPAC is simply a "shell" created to identify and acquire a suitable target company. Usually, a SPAC has between eighteen and twenty-four months to find a suitable target company. As SPAC shares are traded in regulated markets any person or entity having access to such financial markets can invest in a SPAC.

Such investors must have faith that the SPAC will be able to find a suitable target and they must trust the founders of the SPAC – commonly referred to as "sponsors" or "promoters". Anyone able to raise sufficient funds can be a sponsor. From the SPACs established in recent years, sponsors can usually be divided into three groups: (i) former chief executive officers and top executives of leading companies, (ii) a celebrity in any field - actors, singers, athletes or politicians and (iii) Private Equity firms.

The sponsors must meet the expectations of the investors by establishing a business combination (by way of merger or acquisition) with a suitable target company (de-SPAC Transaction). A de-SPAC Transaction can take various forms the most common being a (cross-border) merger. Most SPACs require a de-SPAC Transaction to be completed no later than twenty-four months from the IPO. If a SPAC does not complete a de-SPAC Transaction by the set deadline, then either (i) it requests investors to vote in favor of an extension of the timeframe or (ii) the SPAC is liquidated and the funds are returned to the investors, usually with interest.

> **"SPACs offer investors, targets, and sponsors an alternative to traditional transactions and exits."**

SPACs come to life at the initiative of sponsors, which put their own funds at risk as they cover the formation and initial operational costs of the SPAC. If a Sponsor does not manage to complete a de-SPAC Transaction, it will lose an amount corresponding to these formation and initial operational costs.

However, if the sponsor succeeds in completing a de-SPAC transaction it purchases for a nominal price (often around 25,000 USD) sponsor shares or founder shares. This is how the sponsors get remunerated and is called "the promote". The promote typically represents approximately 20% of the total equity and is only vested upon completion of a de-SPAC Transaction.

The following simple mathematical example helps to illustrate how this works in practice:

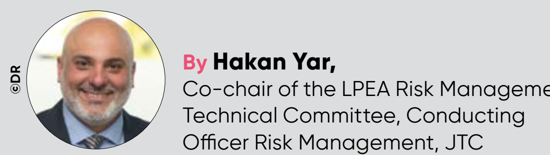
- a sponsor creates a SPAC with a capital raising of 200 million USD;
- the SPAC issues 20 million shares (corresponding to 80% of the total shares) to investors at an issuance price of 10 USD per share;
- the sponsor purchases, for a nominal price (often around 25,000 USD), 20% of the total shares, i.e. 5 million shares;
- the de-SPAC Transaction is completed, and the sponsor shares are vested at 10 USD per share;
- this results in the stake held by the sponsor being worth 50 million USD.

The promote can, clearly, be very lucrative for sponsors. However, this puts the sponsor in a delicate position as it may have to face the choice of pushing a business combination through (even a suboptimal one) or losing the invested risk capital.

Outlook for SPACs

There has, already, been a sharp decrease globally in incorporations of SPACs during 2022. This is not unsurprising given that as a result of the significant popularity of and demand for SPACs in 2020 and 2021, there are currently too many SPACs chasing too few deals. Many SPACs will likely opt to liquidate – some investors like Chamath Palihapitiya and Bill Ackman have already decided to liquidate the SPACs they sponsor.

All that being the case, SPACs are, we expect, still here to stay and have a positive impact for capital markets in general. SPACs offer investors, targets, and sponsors an alternative to traditional transactions and exits and, from the SPAC boom in 2020 and 2021, Luxembourg has proven itself as a well-equipped jurisdiction both for the launch of SPACs and the implementation of de-SPAC transactions. ●



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By **Hakan Yar,**
Co-chair of the LPEA Risk Management Technical Committee, Conducting Officer Risk Management, JTC

Being a Risk Manager in a Private Equity Company

Officially, Risk Management is one of the key pillars in a Private Equity ("PE") Company ("PEC") but not all national regulations are stipulating a distinctive separate risk management role as the Chief Risk Officer ("CRO"). Most of the national regulatory setups require only the role of the Chief Compliance Officer ("CCO") like e.g. in the UK, Canada and USA while the EU regulation requires a distinctive so called "Permanent Risk Management Function" ("PRMF").

The PRMF role can also be taken by the CCO, which is unfortunately quite often the case in the market practice. However, the typical CCO has a Legal background which fits very well for the Compliance function but showing some major restraints for an effective Risk function. Whereas the typical CRO has a (Quantitative) Finance, (Quantitative) Economics, Mathematics, Physics or (Industrial) Engineering background which fits very well with the quantitative requirements of Risk Management (e.g. advanced statistics-based risk measurement).

The Luxembourgish Financial Supervisory, the Commission de Surveillance du Secteur Financier ("CSSF") requires in its latest Circular (18/698) in the context of the Alternative Investment Fund Managers Directive ("AIFMD", an EU regulation) de facto a CRO function separate from the CCO (in Luxembourg, the CRO is officially called "Risk Management Conducting Officer" or PRMF and the CCO is called "Compliance Conducting Officer", in which the title "Conducting Officer" refers to an "Senior Executive" role. Since this title is mainly used in Luxembourg only we will continue to use CRO and CCO in this article instead).

Due to this, all (Fund) Management Companies ("ManCo")/Alternative Fund Investment Managers ("AIFM") are obliged to have de facto a separate CCO and a separate CRO. I use the words "de facto" since the CCO can have also a dedicated Risk Manager who reports to her/him directly without being a CRO/Conducting Officer. However, the market requirements make it necessary that the CCO in this setup needs to understand risk management very well and that this risk manager is required to have very good skills and experiences in risk management which finally makes it necessary to pay higher salaries and this again leads de facto to a CRO role.

Currently, all PECs who are not following the AIFMD do not have a dedicated CRO. This does not mean that there is no risk management in place, but the risk analysis is run by the business operators and is embedded in the business processes. In regulatory terms expressed, only the "first line of defence" for the risk management is in place. That means there is no risk manager who conducts "independent" risk analysis of the PE deals and with this an independent unbiased view on these deals are unavoidably missing, which is in regulatory terms the "second line of defence".

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The fact is that the regulatory requirements, against all resistance by hard Lobby work, are getting stricter (like for the banks) and more demanding (and not only in the AIFMD context within the EU).

And all PECs who are following the AIFMD are obliged to have a CRO. And being a CRO in a financial institution is quite a challenge already but in a PE environment it is another special story as especially quantitative risk management for PECs are still in a "childhood", or in the best will description, in an "adolescence" phase.

The role of the risk manager is defined according the AIFMD in a nutshell as follows: An independent risk manager/controller who defines the risk profile of the active funds and conducts, independently from the business and management, a proper qualitative and quantitative risk analysis.

The essential focus of the risk manager is only showing the potential "downsides" of the fund activities in all risk types (upsides are by definition "risk free"). The risk manager needs to have sufficient experience in risk management activities as establishing a proper risk management department, establishing adequate risk profiles, risk policies and risk procedures, implementing risk models for a proper qualitative and quantitative risk analysis for all relevant risk types, implementing stress test models for all relevant risk types and the compiling of adequate risk reports.

And here we are, since the "focus on the downsides" is where the dilemma of the CRO is starting: Since pointing only to potential downsides could be seen by the business as an "ugly" attempt to deteriorate a deal, to make a great deal look bad, to make the deal guys look foolish. And honestly, this feeling can be understood very well.

The deal guys made a huge effort, checked the company by a thorough due diligence over weeks and months, where they analysed properly and intensively all the potentials and weaknesses of the targeted portfolio company. And these deal guys are the real experts, they have the necessary knowledge, skills and experiences to judge the potential up- und downsides of a potential deal.

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Then comes an "outsider", called "independent risk manager" who runs his/her own "independent" risk analysis and digs only into the "downside" perspective. Yes, this is annoying and totally understandable. It is a natural reflex. Anyone who did a great job does

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not want to hear what s/he allegedly "missed" to do or to see or to consider. But if we are sincere we may all admit, that it is very useful that an "outsider", being not that deep in the process, can bring a fresh and new view on "business downsides" which can help to improve business decision processes.

The allegedly "sad" part is that the "independent risk manager" is only obliged to look on the "downsides". Not to annoy the deal guys, the business makers. That should be never the goal of a good risk manager since her/his salary depends on the success of these deal guys, too! The company's success depends mainly on the success of its business people. Thus, a smart risk manager will never act against the business, rather wants to help to see risks where the business people maybe did not consider them at all or they categorised it just as minor risks. Anyone who is too deep into something can miss to see a broader picture from a vintage point. There is a famous German saying, "Den Wald vor lauter Bäumen nicht sehen", which means „Unable to see the forest because of too many trees". And this is valid for any endeavour, be it business, science or technology.

And unfortunately, all the risks are only "hidden" in the "downsides" of a business, nowhere else. It is the defined role of the "independent risk manager" to look only on this part, to control, measure, qualify and quantify the potential risks of the "downsides" and their impacts.

And this is by far not an easy job. A proper risk manager needs to have a good knowledge on the business, on the business processes, on the micro- and macroeconomy, on finance and investment, on quantitative methods (financial mathematics, mathematical statistics etc.) and alike to be just able to conduct proper full-scope risk analysis. But it does not end here since a proper risk manager needs to have good reporting skills, presentation skills, communication skills (finding the right "language" to report the risks, raise awareness for risks) and negotiation skills (e.g. very important for the communication to the regulator), too.

The "independent risk manager" does only an additional analysis as a support function, who help the business to summarise and to mitigate the risks by his/her analysis. To see concentrations, to show patterns to help to see that some businesses run more successfully than other businesses (because maybe we understand some businesses better than others) and that maybe other business experts are needed for certain business endeavours.

The "independent risk manager" just presents the risk figures and has no decision mandate. The presented figures shall help the business for a proper decision. But the business decision will finally be based on their own professional judgement which can also mean to reject totally or partly the outcome of the risk analysis of the "independent risk manager" due to better expertise and experience on this business. But still, business got an additional analysis which helped them to rethink their views on the business and based on their knowledge and experience they decided to run the deal with the before made assumptions.

If the CRO did a proper job then the business colleagues will find the risk analysis useful and maybe they will rethink the approach to mitigate the risks. And exactly this is the idea to have an "independent risk manager" who runs his/her "independent risk analysis", to broaden the picture, to improve the decision base, and to create new opportunities by proper business risk mitigation.

The "independent risk manager" should not only be regarded as a function required by the financial supervisory (even though this role mainly exist thanks to the regulators), rather it should be seen as a real support opportunity to detect, summarise, discuss and mitigate potential risks as fast as possible. As the "independent risk manager" has a very specific profile, which is very broad, it should be used by the business continuously and in a very early process.

Yes, the risk manager is the "downsides" guy, but this guy is also the one who helps to see the broader picture on these "downsides" and will be the guide for the business to be better prepared in case elements of these "downsides" really come into being.

The most dangerous risk is still the unforeseen risk. And the best risk mitigation is to know most of the potential risks. All the rest can be subsumed just as fate.

Another not lesser important challenge beside the business makers, is the quarterly presenting of the risk reports to the members of the Board of Directors/Managers ("BoD" / "BoM") by the "independent risk manager", the so called CRO, the PRMF.

The BoD is the top of the governance of ManCos/AIFMs and oversees the investment management, administration and marketing and do meet at least quarterly for the Quarterly Reporting but up to eight to ten times or in some cases even more in general.

Hence, the members of the BoD need to cover a broad set of expertise in portfolio/investment management, distribution, risk management, compliance, legal, fund administration/operations and finance, at least in theory. Further, depending on the size and necessary expertise for the ManCo, one to two "Independent Directors" ("ID") need to be member of the BoD according to the CSSF regulations for board compositions. The members of the BoD have been or still are in the function of Managing Director, Conducting Officer, CEO, COO, CFO or in other similar Senior Executive roles or are by profession IDs sitting in several Boards.

Even though the members need to cover in theory a broad skill set, as described above, in reality of course, they will have a higher expertise in one field and lesser in the other. Nevertheless, the BoD members are carrying high legal liability towards the ManCo and even if they don't have the expertise in all fields. That is why the members of the BoD need concise but clear and sufficiently explanatory reports, among others, the quarterly risk reports. For regulatory compliance the reports are the Compliance report including the AML/KYC/CTF reports, and the Risk report including the Investment Compliance report, are essential for the members of the BoD.

Whereas the Compliance/AML/KYC/CTF and the Investment Compliance reports are shown and verified easily, it changes quite fast for the quantitative risk analysis and stress test part of the Risk report.

PE Fund ("PEF") risk reports have certain particularities. In the best case, the valuation and Net Asset Value ("NAV") of the portfolio companies in the PEF are done quarterly, based on the calculated NAV frequency (delivered by the Fund Administration) and financial statements. But there are also cases, where the NAV and valuation are even just once a year.

Here starts the first challenge with the BoD members and especially with the IDs. The IDs are sitting in 10 or even 20 or more boards, and often in UCITS funds (funds with highly liquid assets) where the assets have daily market prices. And now, the CRO is presenting her/his risk analysis, stress tests and Key Risk Indicators ("KRI", Key Performance Indicators for Risk Management based on financial ratios derived from the financial statements) based on e.g. Q2 (as end of June) figures presented end of August or even beginning of September. And the first question very often of an ID or other BoD member who has no profound experience in PEFs is e.g. "we are talking in end of August about

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> **"Very important for the work of the Chief Risk Officer is to raise awareness for the work and burden of the tasks of the CRO and its team."**

risk figures as of end of June, hence we are missing almost two months of information as of today, which the board needs to consider quite a time gap…". This question seems fair and legit at the first glance but inadequate at a second. What these IDs are then missing are that the valuation and the NAV calculation are the real accurate "pricing", the fair value of the portfolio companies in the PEF and if these aren't done quarterly (like semi-annually or even annually) the next available are the quarterly financial statements to derive some KRIs as e.g. (internal or external) credit rating/scoring, debt to equity, EBITDA to debt etc in base, stressed and severe crisis scenarios. There is nothing else between e.g. Q1 and Q2, there are no other validated figures which could have been resilient enough for proper and prudent risk analysis.

Just general market and financial data information cannot be applied and cascaded down to a portfolio company without resilient observable data. Even for an expert judgement approach, applying general market and financial data on portfolio companies of a PEF without any prudent expert opinion would be torn apart by the deal experts in the valuation committee, in the risk management committee and in the executive committee and will harm the reputation of the CRO in the committees and to the general management.

If there is one resilient rational argument which justifies the application of general market and financial data, then and only then these data could be applied with some adjustments if needed. But this is rather very rarely the case. If there is no better data, no better argument, then there is nothing better than the available data of the quarter.

The explanation to the board and the different nature of PEFs to highly liquid UCITS funds with daily market data needs to be carefully and profoundly done, especially for IDs who have no experience or profound knowledge of PEFs. This part is more challenging and happens more often than thought e.g. a lot of so called Super-ManCos which just started to handle PEFs with the same composition of the board as before have members which are still unfamiliar with illiquid funds as PEFs.

Also, very important for the work of the CRO is to raise awareness for the work and burden of the tasks of the CRO and its team. The BoD are seeing an executive summary of the risk report with the annex/appendix of detailed risk reports where they see "only" the calculated risk figures and stress test scenario results and their interpretations. What they don't see is the sophisticated and hard work to design the risk and stress test models which are often non-standardised specialised models adapted at least to the sector and localisation of the portfolio company to reach these results.

If the board members, even rightfully demanded, are asking for additional information and calculation or asking for the adjustment of the presented figures, they are often not aware how much more the workload for the CRO and its team is increasing, since some board members see just few "figures" which should be amended if needed without being aware of its feasibility, model sophistication and needed workload. Hence, making the board aware of this sophistication and workload is essential, also for a better understanding of the presented risk figures and the potential restraints and limitations (e.g. availability of only quarterly data and information).

This board reality will hopefully change but will take time. A way to close the knowledge and experience gap in the boards faster is to setup PE risk management and valuation training sessions for board members and IDs for instance offered by the LPEA Academy. ●

By **Jane Wilkinson,**
Co-chair of iNED

And **Pascal Rapallino,**
Co-chair of iNED

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Independent Non-Executive Directors Club

Our objective is to bring visibility to the wealth of knowledge and experience we have within our iNED group, promote the benefits of appointing an iNED and to provide a dynamic forum for knowledge sharing for our members.

At the origin

In 2021-22 the number of independent non-executive directors (iNED) joining LPEA significantly increased. This triggered the launch of the iNED club in September 2022. The iNED Club brings together a group of highly experienced and knowledgeable individuals, many who have been active within the Luxembourg PE industry and LPEA for the last 25+ years. Members of our group are putting their experience to good use, supporting a number of LPEA GPs as iNEDs on the boards of their funds, SPVs, management companies and portfolio companies.

Who

The iNED club is co-chaired by Jane Wilkinson and Pascal Rapallino, both well-known faces in Luxembourg's PE scene, and both acting as board members on a number of different companies. The club has grown fast in its first few months and now has 25 members, all experts in their respective fields and active as iNEDs or aspiring to become one.

What

The iNED club has set a number of priorities. The first priority is all about raising awareness about the role of iNEDs, the benefits they can bring to the boardroom table, supporting inhouse and service provider teams as well as the extensive bank of NED experience we have within the Luxembourg PE ecosystem. Our members have experience sitting on the boards of all types of private assets funds, the related SPVs, AIFMs as well as portfolio companies. The benefits of having common board members at both the fund level and the portfolio company level, for example can be numerous, including enhanced interaction and knowledge sharing throughout the full structure's value chain. This priority of raising awareness is relevant at different levels in our ecosystem – at the International level as well as here in Luxembourg. The iNED club therefore intends to actively contribute to LPEA's International roadshows, in cooperation with the LPEA Promotion Sounding Board, to organise Luxembourg events, together with other LPEA technical committees, and also to make contributions on the topic of governance through providing content and articles for the Insight/Out magazine and for the LPEA online newsletter and website.

The second priority is around knowledge sharing. Every reader of Insight/Out knows that the world of private assets is far from being straight forward, plain sailing. So, knowledge sharing is at the core of activities of our club. The committee has a programme of technical topics, with a technical deep dive planned for each meeting. Topics might include taxation, legal responsibilities of board members, ESG and many other areas. By bringing together such experienced and active leaders, our members share experiences and learn something new at each meeting.

If you're an (aspiring) iNED and this all sounds good, you're very welcome to join us.

When

The Club meets 4 to 6 times per year. Meetings are generally in person and take place at the LPEA office at the House of Finance.

How to apply

If you are an (aspiring) iNED and interested in joining, you are more than welcome to fill in an application form on the website of the LPEA (https://lpea.lu/membership). ●

"Our first priority is all about raising awareness about the role of iNEDs and the benefits they can bring to the boardroom table."

Allen Foley

Anabela Lourenco

Anke Jager

Anne Canel

Aubry Pierre

Christine Panier

Cornelius Bechtel

Ernst-August Schnieder

Francois Masquelier

Gabriela Nguyen-Groza

Harjeet Singh

Hille-Paul Schut

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Conference *People Due Diligence in PE: People Are Humans, Not Resources*

Laura Zahren (KPMG) and Solenne Niedercorn-Desouches at the PE4W conference *New Year's resolutions: Reset the counters.*

New Year's Party

Stephane Pesch, CEO of LPEA.

Jerome Wittamer (Expon Capital), Pierre Weimerskirch (Apex Group), Alain Rodermann (Expon Capital) and Paul Junck (LPEA).

Teona Khubutia (LBAN), Bert Boerman (Governance.io), Lenka Kopecka (APEX Fund Services), Stephane Pesch (LPEA) and Judith Schleder (Silicon Luembourg).

Patrick Kersten (Statup.lu) and Pierre Thomas (Welnvest Capital Partners).

Claudio Pompei (Spuerkeess), Anastasia Semertzidou (Waystone), Tanya Endshpill (LPEA), Evi Gkini (LPEA), Konstantina Spyropoulou (Waystone) and Marco Cipolla (TMF Group).

LPEA PE&VC Networking Dinner in IPEM.

Priscilla Schnepper (EIF), Billyana Kuncheva (MV Credit), Vincent Lemaitre (Tikehau Capital) and Marie-Laure Mounguia (EY) at the Conference *ESG for Private Debt – Market Players in the Spotlight.*

Stephane Pesch (LPEA) and Patric Gresko (European Investment Fund) at the Luxembourg Private Equity Networking Cocktail in Warsaw.

Justine Henin at the International Women's Day 2023 conference *Game. Set and Match.*

Luxembourg Private Equity Networking Cocktail in Zurich.

Maurice Pedergnana (SECA) and Stephane Pesch (LPEA) at the Luxembourg Private Equity Networking Cocktail in Zurich.

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About LPEA

The Luxembourg Private Equity and Venture Capital Association (LPEA) is the most trusted and relevant representative body of Private Equity and Venture Capital practitioners with a presence in Luxembourg.
Created in 2010 by a leading group of Private Equity and Venture Capital players in Luxembourg, with 429 members today, LPEA plays a leading role locally actively promoting PE and VC in Luxembourg.
LPEA provides a dynamic and interactive platform which helps investors and advisors to navigate through latest trends in the industry. International by nature, the association allows members to network, exchange experience, expand their knowledge and grow professionally attending workshops and trainings held on a regular basis.
If Luxembourg is your location of choice for Private Equity, LPEA is your choice to achieve outstanding results.
LPEA's mission towards its members is to represent and promote the interest of Private Equity and Venture Capital ("PE") players based in Luxembourg and abroad.
LPEA's mission towards Luxembourg is to support government and private initiatives to enhance the attractiveness of Luxembourg as an international hub for carrying out PE business and/or servicing the PE/VC industry in all its dimensions.
In summary, LPEA is the go-to platform where PE practitioners can share knowledge, network and get updated on the latest trends of the industry across the value chain.

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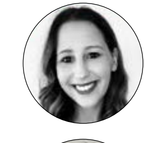
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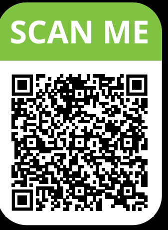

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5th edition May 22-26

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