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MANCO GROWTH REAFFIRMS LUXEMBOURG'S POSITION AS A FUND DOMICILE

Investment managers have seen their regulatory and compliance burden inch upwards for years. The use of management companies (ManCos) in jurisdictions like Luxembourg has sought to ease this load. Investment managers are welcoming the additional support provided by a third-party ManCo, allowing them to concentrate on their core capabilities of managing money.

Luxembourg regulation dictates that all regulated investment vehicles must appoint a ManCo or be self-managed. Even Reserved Alternative Investment Funds (RAIFs) need to appoint an external Alternative Investment Fund Management company.

The 2022 Management Companies Observatory Barometer by PwC revealed that, despite the industry challenges, ManCos "demonstrated an incredible ability to adapt by developing their business models and transforming regulatory evolution into business opportunities. 2021 ended again with a series of records".

According to the report, these entities in Luxembourg managing €5.3 billion, which represents an increase of 22% year on year. Further, both traditional Ucits and

alternative assets reported double digit increases, 16% for UCITS but even more impressive for AIFs with 41% YOY.

Luxembourg has a strong track record for delivering quality in this space, offering a broad ecosystem, which operators can benefit from when selecting a firm to represent them. The growth in the ManCo arena is proof that the Grand Duchy has continued finding ways of delivering value-add to fund managers seeking professionals to support the expansion of their business.

Bertrand Jaboulay, Partner, Management Company Leader, PwC Luxembourg says: "The increase of alternative assets has been mainly driven by the continuous success of unregulated assets since 2016 with the modernisation of the products offering by creating an unregulated AIF regime - the RAIF - in 2016 and creating the Limited Partnership regime in 2017. Those structures are by far the most successful products used by AIFMs. The dynamism of alternative investments has been characterised by a wide range of investment strategies deployed in 2021, mainly Private Equity, Real Estate, Fund of Funds and Private Debt."

MANAGERS AND INVESTORS DEMANDING MORE FLEXIBILITY

Investors are demonstrating a keen appetite for alternative investments. However, they are simultaneously showing a need for a certain level of liquidity. This is leading to a growing demand for semi-open-ended alternative funds being launched in European fund domiciles.

Alain Delobbe, head of management company Luxembourg, Alter Domus, details the shift he has observed: "Our clients are telling us that there is more and more demand from institutional investors for alternative funds to be semi-open-ended alternative funds.

This fund structure enables investors to get in and out of the fund easily under certain specified conditions. In Delobbe's view, the trend is driven by investors' need for liquidity, balanced against their desire for alternative sources of yield.

"The documentation of these funds makes the distinction clear. It does not come across like a Ucits fund which would allow frequent subscriptions and redemption. However, a classic PE fund would have a holding period of around seven to eight years. These semi-open-ended structures provide some flexibility and the potential, though no guarantee, of partial liquidity," he says.

In Ireland, the focus has been on promoting its newly reformed partnership structure as a key alternative in Europe. Ireland has been somewhat slower in terms of building its AuM in private markets. "A lot of work has been done in Ireland on the reform of the ILP to create a partnership regime comparable to partnerships regimes seen in the UK, Luxembourg, Delaware and Cayman," says Conor O'Callaghan, senior manager AIFM, Alter Domus.

With a number of leading managers having launched ILPs into the market over the past year, early evidence suggests it will continue to gain traction and momentum in 2023. This, in O'Callaghan's view, will give the opportunity for Ireland to take advantage of new and more niche structures being seen in Luxembourg, such as the semi-open-ended funds.

Though Ireland's alternative industry is not exactly in its infancy, it is at an inflection point which should see the assets in this area grow considerably.

Strong governance

From a ManCo provider perspective, adding liquidity does not largely impact the Alter Domus modus operandi. "The firms usually use us as the AIFM in these situations and, ultimately, we need to make sure the valuations are accurate. This function doesn't change whether the fund is closed-ended or semi-open-ended," Delobbe explains.

He notes that if a fund allows investors to subscribe and redeem then the AIFM's key responsibility in terms of valuation kicks in: "We need to ensure fair treatment of investors, and this is where we need to be particularly cautious."

An efficient and effective ManCo setup hinges on strong governance. There needs to be full visibility of policies, procedures and expertise, to be presented to the regulator. In Luxembourg, the CSSF demands are mounting and several regulations have been introduced, with more coming down the pipe.

"A key part of our job is to give managers that comfort in terms of governance," Delobbe stresses.

O'Callaghan also notes managers should take time optimisation into account when setting up their ManCo arrangements: "If a manager chooses to outsource a core function, then it is incredibly important for that setup not to monopolise the manager's time. This is why ManCo providers must have strong product and structuring knowledge. If the product knowledge isn't there within the third-party provider, projects will be at

risk of delay and will require significant time input from managers."

From its perspective, Alter Domus has intentionally positioned itself in the alternative assets space and built a team of experts who are skilled at providing core services in these asset classes.

Delobbe adds to the point about expertise, saying how over the years, Alter Domus has attracted alternative asset managers from other service providers seeking a better fit in terms of knowledge in alternative asset classes.

"Our clients found that some of the third parties they worked with didn't understand the distinction or the nuances of alternative assets as they differ from those of financial assets such as listed equities and fixed income securities. The market has now moved in the right direction and has evolved with operators fully recognising the different approach needed within alternatives."

Pre-marketing strategies

Ireland and Luxembourg have witnessed an influx of US managers setting up funds in their jurisdictions and making use of third party ManCos. According to O'Callaghan, this trend is primarily driven by new rules and guidance related to the way funds are marketed: "US

managers are increasingly reluctant to rely on reverse solicitation to attract investors into their funds. This has given rise to growing demand for our fund structuring services. We've worked with a number of US clients who have chosen to go down the path of setting up their EU vehicle to facilitate non-US and EU investors into their fund."

Delobbe says this is being echoed in Luxembourg as well, not only related to US managers, but also managers from Asia and the UK are expressing this preference. "Reverse solicitation still works but more and more investors do not want to play this risk game anymore. The practice is under scrutiny by ESMA and other regulators so now the concept of pre-marketing is coming into play."

Defined as "provision of information or communication, direct or indirect, on investment strategies or investment ideas by an EU AIFM or on its behalf, to potential professional investors," pre-marketing is exercised through the AIFM passport and a notification filed directly with the regulator. "It means the client can start pre-marketing at a low cost and it's a safe way of testing the waters," Delobbe notes.

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Conor O'Callaghan
Senior Manager AIFM

Conor O'Callaghan is Senior Manager AIFM at Alter Domus in Ireland. He is an experienced operations manager with deep understanding of operational risk and building trade support and operating models in a front office environment across several asset types.



Alain Delobbe
Head of Management Company Luxembourg

Alain Delobbe is Head of Management Company Luxembourg, Conducting Officer, and Board Member. Alain joined Alter Domus in December 2017 with over 25 years of industry experience.

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