Luxembourg private equity asset servicing market survey

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This article presents the results of a recent private equity survey of Luxembourg's PE service providers, which mainly include fund administrators and depositary[1] banks.

Scope

Private equity had been touted as one of the key frontiers for the continued expansion of Luxembourg's fund industry. With the market anticipating a very positive growth trajectory in this asset class, we deemed it opportune to conduct this survey of Luxembourg's PE asset servicers in order to gain a broader view of their PE businesses and operations. Our questions focused on three main areas, namely:

- The PE organisation, clients and services
- The operational challenges and concerns of PE service providers
- The market growth and outlook in the PE business in the near and long term

Our survey respondents include a mix of traditional fund administrators and custodians and those handling only alternative funds. Their aggregate net assets under administration or custody cover a significant tranche of the Luxembourg PE market. Based on our analysis of the most recent data published, our respondents represent 87% of Luxembourg's estimated €48 billion in total net assets of regulated PE structures.

Luxembourg's PE fund providers are conscious of the fact that competition is intensifying

The range of core central administration (fund accounting, reporting and transfer agency) and custody services (transaction processing, asset monitoring and reconciliations) offered is generally uniform across all our respondents. With more demanding GPs and investors, competition is now shifting towards specialised, value-added services, a global service offering spanning international target investment areas, fees and overall service quality.

While core functions are generally performed in-house, most respondents revealed that they prefer to outsource certain large or repetitive tasks to central operating hubs or third parties. For fund administration services, 25% and 13% of respondents outsource fund accounting and reporting respectively; while for depositary services, 42% and 33% outsource reconciliations and transaction processing respectively.

1 *References to 'custody' or 'custodian' in this article refers to the 'depositary' for a PE fund*

Figure 1: Estimated contribution of PE in the organisation's revenues

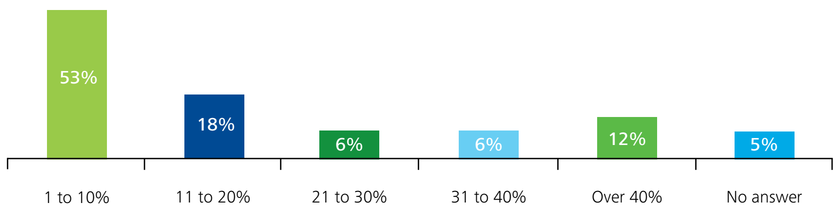
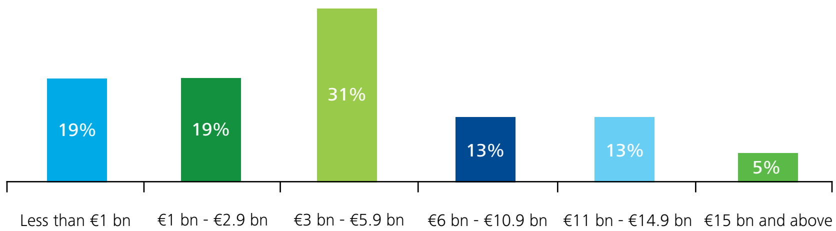


Figure 2: Net assets under administration



The majority of our respondents recognise PE as a strategic activity for their organisation

Most of them have established dedicated teams focused on PE back-office services. For 53% of respondents, the revenue contribution of PE operations accounts for up to just 10% of firm revenues, testament to the fact that the Luxembourg PE market is split across mainstream and pure alternative fund providers *(fig. 1)*. Our respondents acknowledge the need for a robust business development plan and an effective marketing approach to boost the current PE business. In order to accommodate the projected growth in PE, to handle increasing competition in service offering and fees, and ultimately to increase margins, it is essential to invest in comprehensive service solutions tailored to PE clients and ensure that the proper tools and systems are available.

The volume of assets serviced varies among the respondents and depends on whether an asset provider focuses on traditional or purely alternative services

31% of respondents catering mostly to PE clients (niche players) have higher-than-average levels of net assets under administration *(fig. 2)*. Although the majority came under the average category, there are still a number of fund providers whose individual total assets serviced fall below the average net assets range. Additionally, the majority of sub-funds handled have less than €1 billion in net assets.

A detailed upfront analysis of any client is paramount

An even more essential criterion than AUM when entering into a relationship with a PE client is the complexity of the case (i.e. type and location of the target investment, structure of the investment scheme). GPs are now involved much earlier in the fund creation process and are much more heavily involved with their asset services in order to establish a partnership that goes beyond what is normally required for a traditional fund. Information, transparency and document collection are crucial to ensuring that asset servicers will be in a position to deliver their services properly, with appropriate pricing and the utmost quality.

Our survey respondents request an increasing amount of documentation upfront and tend to review and understand the fund set-up and its complexity in greater detail prior to accepting a fund or giving GPs a fee quotation. However, it is fair to say that the depth of the requested documentation highly depends on the services requested (custody vs. fund administration) and the experience of the asset provider.

Even though we see an important convergence of operating model and services offered by asset servicers, the fee quotation mechanism is no longer purely based on basis points and is starting to differ from one provider to the next. Asset servicers are trying to model their fee quotes based on the profile and specifics of a fund while at the same time ensuring that a minimum cap is set to accommodate running costs.

Our survey respondents include a mix of traditional fund administrators and custodians and those handling only alternative funds

A focus on two key elements for GPs

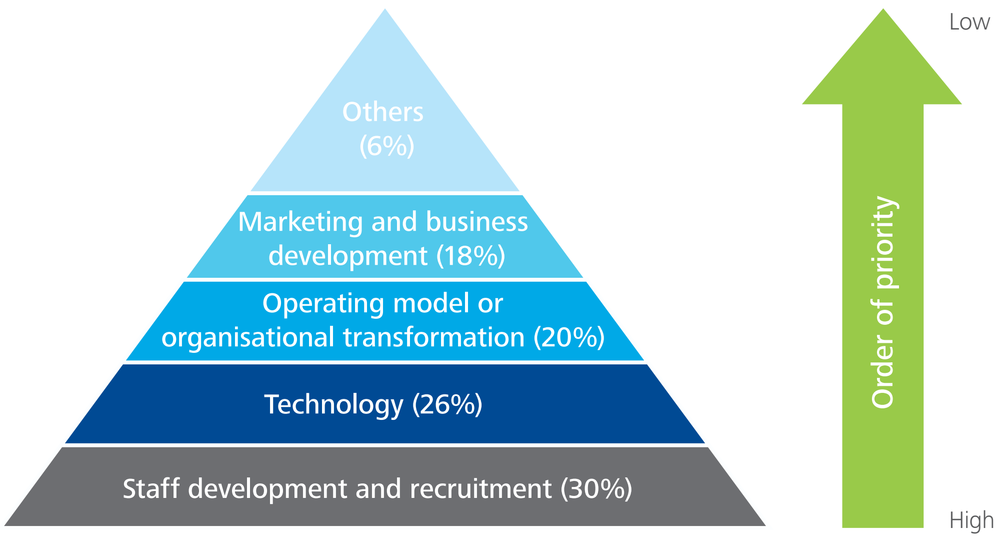
Asset valuation, even with AIFMD just around the corner, is not a request PE houses have transferred to their asset servicers. One comment frequently made by survey participants is that even though their clients may have requested valuation services, they do not anticipate offering this service. It is a much too complex and risky activity for a fund administrator.

Information, transparency and document collection are crucial to ensuring that asset servicers will be in a position to deliver their services properly, with appropriate pricing and the utmost quality

The other key and specific factor relates to reporting to investors. This exercise is performed on a largely bespoke basis in the PE industry, as opposed to in the UCITS world for instance. However, the PE industry increasingly uses international standards, such as IPEV and ILPA, for investor reporting. Moving towards automation and standardisation is still considered to be a solution for the future, as investors still have specific needs and fund administration systems are not yet ready to store and structure data in the way required for investor reporting.

Generally, survey respondents are quite satisfied with their current PE systems; however, 65% still plan on changing or upgrading it. Indeed, it would not be sustainable to continue using multiple, isolated systems as business volumes increase. At least 65% of respondents are currently using multiple (at least two) PE systems, which implies that there is no single vendor solution in the market that is able to support the end-to-end processes in PE.

Figure 3: Organisation's future investments in PE activities



Expected sustainable and long-term growth in the PE asset class

All respondents foresee both investment and market growth in Luxembourg. However, the range of respondents' growth expectations remains rather broad. In terms of workforce size, growth expected in five years' time ranges from 5% to 30%, with 41% of respondents being in the upper category.

When talking about market growth, more optimistic respondents expect growth exceeding 50% within the next two years and continued growth of over 30% within the next five years. The expected rise in market size will mainly be driven by new PE firms coming to Luxembourg (either in regulated or unregulated conditions) and the organic growth of the current client base. We can also highlight a positive trend in the development of new products for PE asset servicing firms, mainly driven by value-added services offerings.

Some key takeaways from the survey

PE is a significant asset class and growth driver for each respondent. Competition is fierce among asset servicers and past differentiators in terms of offering and operational set-up have become market practice nowadays and are no longer considered competitive advantages. Moreover, the needs of GPs are constantly changing, with some requiring more streamlined middle-to-back office, bridge financing and a single point of contact for a cross-border and multi-jurisdictional service offering. The PE servicing industry seems to be moving towards operating models that include competence centres set up worldwide—much like where UCITS fund servicers started decades ago.

To the **point**:

- PE is considered by Luxembourg service providers as a strategic activity for their organisation, with further growth anticipated in this asset class
- Competition is fierce in PE and is now shifting focus towards specialised, value-added services, a global service offering, fees and overall service quality
- The cross-border and multi-jurisdictional service offering required by GPs prompted asset services to set up operating models that include competence centres across the globe
- During onboarding, a detailed upfront analysis of any client is crucial, primarily to the assessment of the complexity of PE operations
- GPs are more hands-on in the fund creation process and aim for a more collaborative partnership with asset servicers

Our respondents acknowledge the need for a robust business development plan and an effective marketing approach to boost the current PE business