AN ANALYSIS OF THE REGULATORY FRAMEWORK OF PRIVATE EQUITY IN THE EUROPEAN UNION: LESSONS FOR SLOVAKIA FROM THE GRAND DUCHY OF LUXEMBOURG

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Abstract

Private equity industry plays an important role in promoting the economic growth within the European Union. Although it emerged as an unregulated industry, the 2007 financial crisis and its aftermath stressed the necessity for its regulation. This thesis examines the current regulatory framework related to the private equity in the European Union and selected member states: The Grand Duchy of Luxembourg and Slovakia. The main task of this thesis is, firstly, to analyze the regulatory framework of the private equity on the level of the EU set by the Alternative Investment Fund Managers Directive (AIFMD), which is common for both the Grand Duchy of Luxembourg and Slovakia. And secondly, by comparing the regulatory framework of the Grand Duchy of Luxembourg to Slovakia's find out, whether and if so, Slovakia can benefit from the experience of the Grand Duchy of Luxembourg and improve its regulatory framework in order to make it more attractive for the private equity in the future.

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List of abbreviations

AIF	Alternative investment fund
AIFM	Alternative investment fund manager
AIFMD	Directive 2011/61/EU on Alternative Investment Fund Managers (AIFMD), [2011], OJ L 174
ALFI	Association of the Luxembourg fund industry
CJEU	Court of Justice of European Union
CMU	Capital Market Union
COSME	Competitiveness of Enterprises and Small and Medium-sized Enterprises
CSSF	Commission de Surveillance du Secteur Financier
EC	European Commission
EU	European Union
FCA	Financial Conduct Authority
MiFID	Directive 2004/39/EC on markets in financial instruments (MIFID), [2004], OJ L 145

MiFID II	Directive 2014/65/EU on markets in financial instruments (MIFID II), [2014], OJ L 173
NBS	National Bank of Slovakia (*Národná banka Slovenska)*
Non-UCITS	Collective investment schemes which are not Undertakings for Collective Investment in Transferable Securities
RAIF	Reserved alternative investment funds
SA	Joint stock company (Société anonyme)
SARL	Limited liability company (Société à Responsabilité Limitée)
SCA	Société en commandite par action
SICAF	Investment company with fixed capital (Société d'investissement à Capital Fixe)
SICAR	Investment company in risk capital (Société d'investissement en Capital Risque)
SICAV	Investment company with variable capital
SIF	Specialized Investment Funds
SME	Small and medium enterprises
SOPARFI	Société de Participations Financiéres

UCITS	Undertakings for Collective Investment in Transferable Securities

Introduction

It is no secret that one of the long term goals of the European Union is to establish a capital markets union[1], which would provide 'diversified sources of finance for companies including small and medium-sized enterprises [SMEs].'[2] Moreover, the support for the competitiveness of SMEs in Europe is even backed by special initiatives of the European Commission, such as Competitiveness of Enterprises and Small and Medium-sized Enterprises (hereinafter as 'COSME'), which aims to simplify the access of the SMEs to all source of finance including guarantees, loans and equity capital.[3] The support through the so-called financial instruments promoted by European Commission is deemed to be executed on a commercial basis, which means that the money from the EU budget will be placed on the market via commercial intermediaries, such as banks and also private equity managers, which will share the commercial risk.[4]

Speaking of private equity managers, before 2007 financial crisis they were subject to a controversial political discourse, where due to high profits they were accused of being 'locusts'.[5] This rather populist accusation, steered the debate whether more regulation of the industry is needed[6]. But even though these accusations, the importance of private equity for the

[1] For information look at the webpage of European Commission: https://ec.europa.eu/info/business-economy-euro/growth-and-investment/capital-markets-union/what-capital-markets-union_en. Last visited on: 28.3.2018.

[2] Lachlan Burn, '*Capital Markets Union and regulation of the EU's capital markets',* in Capital Markets Law Journal, Vol. 11, No. 3, p 352.

[3] European commission, Financing programs for SMEs: https://ec.europa.eu/info/business-economy-euro/growth-and-investment/financing-investment/financing-programmes-smes_en. Last visited on 28.3.2018.

[4] The overview of the COSME financial initiative backed by the European Commission: https://ec.europa.eu/growth/access-to-finance/cosme-financial-instruments_en. Last visited on 28.3.2018.

[5] The term 'locusts' were used by German social democrat politician, Franz Müntefering. Luke Harding, *'German industrialist hopping mad at 'locust' accusation'*, 2005, The Guardian. Available online: https://www.theguardian.com/world/2005/may/03/germany.lukeharding. Last visited on 28.3.2018.

[6] *See* Iain Rogers*, 'German workers on private equity 'locusts''*, 29 August 2007, Reuters. Available online: https://www.reuters.com/article/us-germany-privateequity/german-workers-take-on-private-equity-locust-idUSL2244583520070829. Last visited on 28.3.2018.

economy have been still proclaimed as necessary for 'restructuring of industries in the need of consolidation'.[7]

Historically, private equity emerged as an unregulated industry, the main aim of which was to participate in transactions with high level of risk balanced out with potential high profits. Since the emergence of private equity industry, the central controversy surrounding private equity has lied in the lack of transparency and disclosure of information to investors, as well as for their use of aggressive investment techniques and accusation of 'kill[ing] jobs because their priority is to maximize profits and the quickest way to do so is to cut costs through layoffs'[8].

Moreover, the 2007 financial crisis and its aftermath brought up the issue whether private equity firms may cause systemic risk and destabilization of financial markets. This, due to the fact that the industry often relies on leveraged funds and uses lots of external debt, mostly from the banking sector.[9]

But private equity industry should not be seen as something evil. Private equity investments play an increasingly important role in promoting economic growth by investing into the real economy and creating value. According to the available statistics collected by the European private equity venture capital association InvestEurope,[10] as of 2016, as much as €53

[7] *See* Private equity firms strip mine German Firms, 22 December, 2006, Spiegel.Available online: http://www.spiegel.de/international/the-locusts-privaty-equity-firms-strip-mine-german-firms-a-456272.html. Last visited on 28.3.2018.

[8] Shantanu Dutta, Arup Ganguly and Lin Ge, *'Economics of Private equity'* in H. Kent Baker, Greg Filbeck & Halil Kiymaz (ed), *'Private Equity: Opportunities and Risks'* - (Oxford Scholarship, 2015), p. 17.

[9] *See* Christian Rauch, Mark P. Umber, *'Leverage Buyouts'* in H. Kent Baker, Greg Filbeck & Halil Kiymaz (ed), *'Private Equity: Opportunities and Risks'* - (Oxford Scholarship, 2015).

[10] *see* Invest Europe, 2016 European Private Equity Activity: Statistics on fundraising investments & Divestments, 2017. Data available online at: https://www.investeurope.eu/media/651727/invest-europe-2016-european-private-equity-activity-final.pdf. Last visited on 10.2.2018.

bn. were invested into approximately 6000 companies, out of which 83% were invested into small and medium enterprises (hereinafter: SMEs).

The significance of private equity investments lies in the fact that they fill the gaps on the market left out by the banks and underdeveloped capital markets. Due to the desire for higher profits, private equity firms are more willing to invest in risky businesses than other participants in the market, where nobody else wants to invest in, or even if the investee firm has no collateral or other security to offer in order to obtain for instance the loan from the bank. As an example of a successful private equity investment can be mentioned the investment into the company RF Element: a small company based in Humenné, in eastern Slovakia, which specialized in developing innovative wireless networking products. The private equity investment into the company was made by the private equity company Neulogy Ventures in order 'to boost its product development and speed up their time to [reach the] market'[11].

But private equity investments are not only used in relation to providing alternative source of finance for the small and medium companies. Private equity investments are also widely used in complicated structures like project finance or real estate development[12], where it is neither possible, nor wanted to secure the investors rights via traditional securities, such as chattels and mortgages. In these complex transactions, private equity provides securities based upon complex covenants-governed contracts.

As can be seen, the debate about private equity is controversial. While on one side, the private equity investments may steer up the economic growth and create value by supporting

[11] Information about this investment was found on the webpage of the Neulogy ventures, a Slovak private equity firm: http://www.neulogy.vc/rf-elements.

[12] *see* J. Dean Heller, *'Mezzanine Capital and Commercial Real Estate'* in H. Kent Baker, Greg Filbeck & Halil Kiymaz (ed), *'Private Equity: Opportunities and Risks'* - (Oxford Scholarship, 2015).

the real economy, the other part of the debate points out on the potential dark side of the private equity investments and its effects on the whole financial sector.

To minimize these detrimental externalities, two of the largest economies in the world, USA and European Union, adopted special laws to regulate the activities of private equity companies. The approach of the EU, which will be discussed in this thesis, lies in the adoption of the Alternative Investment Fund Managers Directive (AIFMD), the aim of which is to regulate the managers of private equity funds on the EU level, by setting the minimum standards of their activities. The regulation of alternative investment fund managers is also one part of the establishing of the EU's capital markets union.[13]

As can be seen from the abovementioned, private equity is a complex and interdisciplinary topic, which encompasses the notions of law, finance, business management, business development and sometimes it even requires at least partial knowledge of completely different industries (such as, biotechnology, IT, genetics etc.). However, for the purpose of this thesis, it is necessary to ask, what is the role of lawyers in the world of private equity? Indeed, one task of a lawyer is to provide advice in drafting and negotiating the complexities of concrete private equity investments into the targeted companies. The second role of a lawyer is to provide advice in structuring of private equity companies. In order to do so, he must have an in-depth knowledge of corporate law as well as of the relevant regulatory framework. This thesis deals with the lawyer's second role.

i. The Aims and Goals of the Thesis

This thesis provides a comparative analysis of the regulatory framework of private equity companies in the European Union and selected member states. At first, the thesis will

[13] Burn (n 2), p 385.

focus primarily on the regulation of managers of private equity companies, which is due to already mentioned AIFM Directive common for the whole EU. After debate about regulation of managers of private equity on the EU level, this thesis deals with the comparison of the regulatory frameworks of two jurisdictions: The Grand Duchy of Luxembourg (hereinafter also as 'Luxembourg') and Slovakia. The comparison of the selected jurisdictions focuses on the national regulation of private equity companies, with particular attention to the applicable laws and practices, as well as possibilities of the available corporate forms for the structuring private equity companies.

Although both, the Grand Duchy of Luxembourg as well as Slovakia are members of the European Union, the way of the development of the private equity industry differs significantly. This difference may lie in the historical and economic difference, but also in the approach chosen towards the regulation. While the Grand Duchy of Luxembourg is a jurisdiction well-renowned for its business-friendly environment, especially regarding the financial services, Slovakia is still developing its legal framework in this field.

In particular, the Grand Duchy of Luxembourg has been a leading jurisdiction in regulation of alternative investment funds, and private equity for decades. Since the end of the 1980's, the Grand Duchy of Luxembourg enacted numerous laws via which it affected the regulation of the so-called non-UCITS[14] investment funds and investment schemes.[15] Over the years Luxembourg introduced a lot of new innovations and specific legal forms, which were specifically designed to attract private equity companies and private equity investors. This industry-supporting regulation merged with the best practices and supervision of CSSF, made

[14] The term non-UCITS is used as differentiation of the investment funds, which does not fall within the regulation of the Directive on 'Undertakings for collective investments in transferable securities'(UCITS). The distinction will be further discussed in Chapter 2.

[15] The term 'Collective investment schemes' is used in the literature, which will be discussed in this thesis.

the Grand Duchy of Luxembourg the leading centre of alternative investments, and particularly private equity industry in the European Union.[16]

On the other hand, the private equity industry in Slovakia is still underdeveloped. As opposed to Luxembourg, it does not have any specific laws dealing with alternative investment funds and their managers. However, quite recently – inspired by Luxembourg's best practices, introduced a new corporate form specifically for alternative investment schemes – the so-called investment company with variable capital *(investičná spoločnosť s premenlivým kapitálom)*, or SICAV.[17]

Therefore, the main task of this thesis is, firstly, to analyse the regulatory framework of the private equity on the level of the EU, which is common for both Luxembourg and Slovakia; and secondly, by comparing the two jurisdictions find out, whether and if so, how can Slovakia benefit from the experience of the Grand Duchy of Luxembourg - the leading industry for financial services in the European Union.

Before answering this question, it is necessary to say that in this thesis it is impossible to compare the whole regulatory framework dealing with the financial sector of the two jurisdictions, also it is not possible to provide a complete in-depth analysis only of the two regulatory agencies – CSSF (in Luxembourg) and NBS (in Slovakia).

To be as specific as possible, it is necessary to limit the discussions to a comparison of the legal framework, which regulates the private equity industry as a subcategory of alternative investment funds in both jurisdictions. Therefore, the main focus is put on the analysis of the different corporate structures and possibilities of setting up a private equity company. The

[16] The Luxembourg is considered to be the largest centre of investment funds in Europe, second largest in the world after United States.

[17] The introduction of SICAV was exercised by amendment of the law no. 203/2011 on Collective investment Col., and amendment of the law no. 513/1991 col. Commercial code.

comparative part of this thesis is predominantly focused on the legal innovations from the Grand Duchy of Luxembourg, where special laws and special corporate forms, such as SICAR and SICAV, were enacted especially for the purposes of promoting of the private equity industry, and which are also being transposed into the other jurisdictions, Slovakia as well.

ii. Research Problems and Methodology Issues

Before embarking on the discussion, it is necessary to mention the limitations, which are necessary to deal with, while writing of this thesis.

One of the limitations is the lack of sources, especially in regard to the regulatory framework of Slovakia, where private equity is a new issue; the industry is underdeveloped and thus not so much has been written about it. In order to deal with this deficiency and avoid the pure repetition of the provisions of the law, it was necessary to use sources written by the industry itself. Due to the fact that for a long time the Slovak legal order shared the similarities with the legal order of Czech Republic, the analogy and comparison of practices from the Czech regulatory framework (where the issue was more discussed and more written about) is used where relevant, too. However, as the two jurisdictions have not been compared yet, the recommendations for improvement of Slovak legal system lean mostly on the analytical skills of the author of this thesis.

Another issue stems from the fact that private equity is perhaps more a financial or business category, rather than a legal one. Consequently, precise legal definitions are not available, as opposed to established terminology established and used by private equity industry. Therefore, it was necessary to use a vast variety of economic and business literature, in order to understand what private equity is, how it works, and especially where the law or regulation steps or should step in. This is especially seen in the parts where the specific legal

categories, such as ‚funds of qualified investors' are discussed, and which fit the term 'private equity fund 'best.

iii. Structure of the Thesis

Due to the complexity of the problem, this thesis is structured into the following four chapters, which flow from the general parts to the specific.

In **Chapter I,** the introduction and definition of the main concepts and key terms of private equity law are provided. Apart from the definition of the main terms, the chapter provides an overview of the types of the most relevant private equity investments, private equity structures and problem of governance. This chapter however, not only introduces the problematic, but it also provides a general background for the understanding of the complexities of private equity industry, which are essential for the further discussion.

Chapter II places private equity within the regulatory framework of the European Union and discusses the key notions of the Alternative Investment Fund Directive on the private equity industry, which is common for the all member states. The chapter also describes the different regimes of application of the AIFM Directive on the managers of private equity funds. The still ongoing common regulatory debate requires also the juxtaposition of the already regulated UCITS collective investment schemes with the alternative investment funds as defined by the AIFM Directive. This will ensue in this chapter as well.

Chapter III provides an analysis of the regulatory framework of the Grand Duchy of Luxembourg. Here the holistic approach towards the regulation of private equity industry is provided with differentiation between regulated and unregulated types of private equity structures. The special focus is put on the regulated private equity structures and the so-called product laws, the aim of which was to target specifically private equity investment funds. The

analysis of the legal innovations in the tailor-made corporate forms such as SICAR and Specialized investment funds such as SICAV or SICAF are discussed as well.

Finally, **Chapter IV** discusses the current regulatory system affecting the private equity industry in Slovakia. It provides the overview of the relevant provisions of the Slovak Law on Collective Investment, and then analyses the possibilities of structuring private equity companies within the Slovak regulatory framework. The last subchapter of Chapter IV compares the Slovak regulatory framework with the Luxembourg one, and provides conclusions and recommendations.

Chapter 1 - Overview of the Private Equity Industry

1.1. Characteristic Features of Private Equity

There are many definitions of the term private equity, but perhaps the most viable one defines the term as 'an asset class consisting of equity securities and debt in companies not quoted on a public exchange.'[18] This definition is however, not complete as there also exist investments into the companies quoted on stock exchanges, but traditionally, private equity investments have been mostly attributed to the non-listed companies.

Private equity investments are usually being made via private equity funds, which may be defined as 'collective investment scheme[s] used for making investments in various securities according to one of the investment strategies associated with private equity.'[19] Private equity fund is thus a 'financial intermediary between investors and target companies,'[20] which 'pools capital from its investors and negotiates an equity capital participation in the target companies'[21]. On behalf of the investors, a private equity fund also takes an active role in managing the portfolio companies[22]. Depending on the structure, private equity fund may take an active role in the managing the investments itself, if it is internally managed. In that case, we are talking about a private equity investment company[23]. However, a private equity fund may be also managed by an appointed external manager, who is a separate legal entity from the fund. For the purposes of this thesis, the terms private equity company, firm, private

[18] H. Kent Baker, Greg Filbeck & Halil Kiymaz (ed), *'Private Equity: Opportunities and Risks'* - (Oxford Scholarship, 2015), p. 4.

[19] Issabelle Lebbe and Philippe-Emmanuel Partsch (2012). Chapter 11 Luxembourg. In: Eddy Wymeersch, ed., Alternative investment fund regulation. (Kluwers International, 2012), p. 256.

[20] Axel Buchner and Markus Kuffner *'Diversification Benefits of Private Equity Funds-of-Funds'* in H. Kent Baker, Greg Filbeck & Halil Kiymaz (ed), *'Private Equity: Opportunities and Risks'* - (Oxford Scholarship, 2015), p 465.

[21] Ibid.

[22] Ibid.

[23] The investment companies such as SICAR and SICAV known in the Luxembourg law will be discussed in the Chapter III.

equity funds or private equity structures are used as equivalents, however, when necessary the difference will be pointed out.

Private equity funds, or perhaps more generally, private investment funds[24], have to be distinguished from the public investment funds. The distinction between the two lies in the way how are the investors protected[25]. The public investment funds are more regulated because they are widely marketed to the retail investors, which are not considered to be professional and therefore they require strengthen regulatory protection.[26] On the other hand, private investment funds are marketed only on a limited basis to the sophisticated[27] investors, who are professional, or well-informed in doing business on the financial market.

Private nature is thus one of the main characteristics of the private equity investments. It refers to the relation between the investor, who is considered to be a professional, and private equity fund, and therefore their mutual relation is being governed by the contractual agreement[28]. This contractual agreement is sometimes referred to as private placement memorandum[29]. Private placement memorandum is 'an offer of transferable securities to a specified group of investors, which does not involve an offer of securities to the public, requiring approval by a regulator.'[30] This means that by accepting a private placement memorandum, an investor will receive a transferable security or a share, which will prove his right as an investor in the private equity fund. Private placement memorandum also contains a

[24] Apart from the term private investment funds, also term alternative investment funds is used and encompasses private equity funds, hedge funds, real estate funds and other.

[25] Timothy Spangler *'The Law of Private Investment Funds'* (Third edition, Oxford University Press, 2018), p. 3.

[26] Ibid.

[27] The term 'sophisticated' is just one of many other terms, which refer to the notion of 'professional', 'well-informed' or sometimes 'institutional' investors.

[28] *See* Douglas Cumming and Sofia A. Johan *'Venture Capital and Private equity contracting; an international perspective* (Amsterdam; Boston; Academic Press/Elsevier, c2009).

[29] Raj Panasar & Philip Boeckman (eds.),'*European Securities Law'* (2nd edition, Oxford University Press, 2014), p 217.

[30] Ibid. p 203.

specified investment strategy, according to which the manager of the private equity fund will invest the investor's money and take the active role of their management.[31]

Another essential characteristic of private equity is illiquidity of investment.[32] The nature of illiquidity stems from the fact that private equity investments are usually[33] being made in to privately held companies, not-listed on the stock exchanges[34]. This means that, once invested, the private investor cannot easily sell the shares of the privately held company simply by tapping the capital markets. Rather, a sale of its shares usually presumes direct negotiations with the potential buyer. The problem of illiquidity lies in the defining of the value and the price of the investee company. Therefore, in order to sell the shares in the investee company it is necessary to undergo a complicated procedure of company evaluation.

While private nature is the dominant characteristic of the relation between private equity fund and the investor, illiquidity is predominant characteristic of the relation between private equity fund and the targeted investment. What connects these two sides is the time in which the whole private equity investment takes place. Private equity investment is a time-restricted investment, which usually last usually up to 10 years[35]. This time span correlates with the notion of so-called investment life. Private equity funds are therefore usually structured as closed-end type of funds[36], which means that they issue a fixed number of shares only once usually at their inception, which are not redeemable from the fund. Therefore, the

[31] Baker, Filbeck and Kiymaz (eds.) (n 8), p 22.

[32] Jennifer Payne, *'Private Equity and Its Regulation in Europe'* in 12 European Business Organization Law Review, 2011, p. 564.

[33] The term 'usually' is there on purpose, as in recent years also private investments into public equity (PIPE) emerged. For more information *see* Na Dai, *'Private equity in Public Equity'* in H. Kent Baker, Greg Filbeck & Halil Kiymaz (ed), *'Private Equity: Opportunities and Risks'* - (Oxford Scholarship, 2015).

[34] This stems from the most common definition of the private equity used by many scholars and already quoted above.

[35] Payne (n 32), p. 562.

[36] Baker, Filbeck and Kiymaz (eds.) (n 18), p 1.

investor has no right to get back his investment for the duration of the fund's existence. Time restriction also affects the investment from the private equity fund to the investee company, as the investment is also time-limited, after is passes the private equity investor tends to exit the investee company by selling its share.

Finally, the last characteristic of private equity investment is that it can be also seen as an alternative source of finance[37], especially for the Small and Medium Enterprises (hereinafter: SMEs), which due to the fact that they are not listed on the stock exchange cannot get funding directly from the capital markets and due to lack of liquidity they cannot obtain a loan from the bank. Such investment is inherently connected with the high level of risk[38], therefore to counterbalance; private equity investor usually actively participates in the management of the company. Due to the combination of financing and managerial support, private equity investment is usually being referred to as smart money[39].

1.2. Types of Private Equity Transactions

The term private equity is a broad term, and it encompasses a variety of different transactions.[40] The unifying theme of all private equity transactions is that 'the capital has been raised privately and will be deployed either by investing in private companies or by investing

[37] *See* Baker, Filbeck and Kiymaz (ed.) (n 18).

[38] Ibid.

[39] *See* PWC, *'Bringing in the Smart Money',* Special feature delivered by the PWC, originally published by the Business Times on 12 January 2017. https://www.pwc.com/sg/en/deals/assets/strategy-in-action/strategy-in-action-7.pdf. Last visited on 11 March 2018.

[40] Baker, Filbeck and Kiymaz (ed.) (n 18), p. 3.

in the publicly traded securities where the target is immediately taken private.'[41] The two major types[42] of private equity investments are venture capital and leveraged buyouts[43].

The term venture capital is sometimes, mistakenly, being used as a synonym of private equity. In accordance with many scholars[44], it is necessary to point out that venture capital is only one type of many private equity transactions. Venture capital is a type of equity investment which is being made into 'typically less mature companies for the launch of a seed or start-up company, early stage development, or expansion of a business.'[45] One of the specific notions of venture capital is that it is usually an investment into the innovative idea or a cutting-edge technology, which is connected with the high risk.

On the other hand, the leverage buyout represents the largest category, as of total investment volume of private equity investment[46]. Leverage buyout (LBO) is a specific form of transaction as the equity capital from a private equity fund is used to get high amount of debt capital in order to acquire 'private or public company by the private equity investor'[47]. The characteristic notion of leverage buyout is its use of 'leverage effect to increase equity returns'[48]. The effect of leverage on the equity investment is twofold: at first interest expenses on debt are tax-deductible; second is so called mortgage effect – meaning that the LBO

[41] Payne (n 32), p. 562.

[42] There are of course many different types of private equity investments, which differ from each other especially as they use different investment techniques. As examples can be mentioned: (1) mezzanine transactions, which refer to '*subordinated debt or preferred equity securities that often represent the most junior portion of a company's capital structure that is senior to the company's common equity'; (2) distressed debt transactions which 'refer to investments in equity or debt securities of financially stressed companies.'; and many more. For further information look:* Baker, Filbeck and Kiymaz (n 8).

[43] Alexandros Seretakis '*Private Equity in United States and Europe Market'* in H. Kent Baker, Greg Filbeck & Halil Kiymaz (ed), 'Private Equity: Opportunities and Risks' - (Oxford Scholarship, 2015), p. 33.

[44] Payne (n 32), p. 562.

[45] Baker, Filbeck and Kiymaz (n 18), p.3.

[46] Baker, Filbeck and Kiymaz (n 9), p. 66.

[47] Ibid. p. 66.

[48] Ibid. p. 66-67.

investment consists of 'the small fraction of equity and large fraction of external debt to purchase all outstanding equity and debt securities of the target company[49].'

The difference between venture capital funds and leverage buyout funds is not only in the amount of monies managed in their portfolio but also in the use of different investment techniques. These nuances are very specific and have effect on the structuring and governance of private equity fund and also play role in the relevant regulatory approaches.

1.3. Governance of Private Equity Funds

Private equity fund is just one particle not only in a complex relation between investors and the investees, but also between investors and fund managers. The governance of the private equity fund is thus essential especially in 'establishing a long-term relationship based upon trust and pre-agreed economic parameters, between an investment manager and a potentially disparate group of investors in a regulatory compliant and fiscally efficient manner.'[50] The governance itself is however, challenge, as it exists on the 'boundary between the fund participant's rights and fund manager's obligations.'[51]

The problem of governance is especially actual in the situation of private equity funds which are not managed internally – the sole fund does not have any directorial means; but they are managed externally, or to be more precise 'they are established and operated by the individuals and firms whose financial interest, and primary duties of loyalties, lie outside of, and apart from, the legal entity they have just formed.'[52] This external management give a rise to the question of ownership and control. While investors do have an ownership share in the

[49] Ibid. p. 67.

[50] Spangler (n 25), p. 20.

[51] Ibid. p. 4.

[52] Ibid. p. 3.

fund itself, they have only very limited ability to influence the decision-making process of the private equity fund. On the other hand, it is the manager of the fund who usually does not necessarily have an ownership in the fund but on the other hand has more control to influence the decision-making process of the fund. The problem between investor and fund manager thus lies in the information asymmetry, as the fund manager has much more information about the investment activities of the fund[53]. Due to the lack of regulatory protection of the investors in the private equity funds, the participants have to rely on their own ability to negotiate an adequate level of protection in the contract that will govern the management of the fund and mutual rights between investors and fund manager, especially the rules on monitoring and reporting[54].

Apart from the contractual form of investor's protection, other form of protection lies in the way of selecting the appropriate type of fund vehicle. One of the most traditional ways of structuring the private equity fund, especially in the Anglo-American legal framework, is in a form of limited partnerships or limited liability company[55]. In the partnerships, the manager of the private equity fund acts as a general partner, while the particular investors act as limited partners[56]. The problem of governance in the limited partnerships, however centres 'primarily on the restrictions imposed on the limited partners with regards to involvement in the management of the partnership business.'[57]

On the other hand, the governance problem in the fund structured as an limited liability company, stems from the fact, that limited liability company has its own corporate bodies – such as board of directors, which are normally responsible for the management of the company,

[53] Ibid. p. 9.

[54] Ibid. p. 7.

[55] *See* Harry Cendrowski *'Private equity: History, governance and operations'* (Hoboken, N.J. : Wiley, c2012).

[56] *See* Ibid.

[57] Spangler (n 25), p. 7.

but 'delegate the bulk of that responsibility to the external fund manager, retaining only limited role of monitoring and evaluation.' [58]

Setting up a proper governance structure is challenging and therefore some jurisdictions in order to attract more investors, enacted special corporate forms and legal entities, which are tailored for the purposes of private equity investment schemes, and which are mentioned in the subsequent chapters dealing with the regulatory approach of the Grand Duchy of Luxembourg and Slovakia.

Although selecting a right corporate form might mitigate the governance problems, the incorporation of the principles of corporate governance is also essential in setting up a transparent and accountable internal management of the company[59]. Good corporate governance should encompass clear rules and procedures[60] by which the company is directed and governed, and which are accepted by all parties – directors and investors as well.

The problem of governance and mutual rights and obligations between fund manager and the investors is even more acute in more complicated private equity structures, where multiple vehicles or funds are involved. As an example of such vehicles, the so-called 'fund of funds' schemes can be mentioned[61]. These structures are typically double-layered, meaning that one fund can be structured into one or more specific sub-funds. Fund-of-funds are externally managed investment vehicles. One of the main advantages of such structure is that investors are allowed to decide whether they want to invest into whole fund-of-funds or into the specific compartment (sub-fund) of the Fund of Funds. Therefore, added value of such

[58] Ibid. p. 7

[59] Ibid. p. 8.

[60] Ibid.

[61] *See* Baker, Filbeck and Kiymaz (n 20).

structure lies in the diversification of different investments[62]. Each sub-fund represents a separate proprietary entity, which is different from the main fund-of-funds structure, which in case of default will not affect the existence of the fund-of-funds[63].

Certain specific issues may arise in the quite novel private equity structures, which are product of legal and financial innovations. These novelties diverge from the traditional perception of 'private equity' as being private companies not-listed on a stock exchange. As an example of such new structures can be mentioned the publicly traded private equity (or listed private equity)[64].

Publicly traded private equity can be defined as an 'asset class comprised of vehicles that offer investors an opportunity to take part in private equity investment.'[65] As opposed to non-listed private equity funds, the main advantage of listed private equity is the access of the liquidity directly from the regulated market, while in the other hand investors have right to easily sell their shares. Another advantage of listed private equity is that they are not close end funds with fixed life, and thus they may provide permanent capital, 'with the proceeds from the sales of investments being recycled into new transactions rather than returned to the investor.'[66]

Due to fact that the listed private equity is marketed on a stock exchange and investors have a right to sell their share in LPE at any time, and they are not bound by the fixed period, the problem of governance and the mutual relation between fund manager and investor is not

[62] *See* Baker, Filbeck and Kiymaz (n 20).

[63] *See* Claude Kremer and Isabelle Lebbe, *'Collective Investment Schemes in Luxembourg: Law and Practice'* (Oxford University Press, Second edition, 2014).

[64] *See* Mathias Huss and Hanz Zimmermann *'Listed Private equity: A genuine Alternative for an Alternative Asset Class'* in Douglas Cumming (ed.), *'The Oxford Handbook of Private Equity'* (Oxford University Press, 2012).

[65] Henry Lahr *'Publicly traded private equity'* in H. Kent Baker, Greg Filbeck & Halil Kiymaz (ed), *'Private Equity: Opportunities and Risks'* - (Oxford Scholarship, 2015), p. 483.

[66] Christopher Brown and Roman Kraeussl *'Risk and Return Characteristics of Listed Private Equity'* in Douglas Cumming (ed.), *'The Oxford Handbook of Private Equity'* (Oxford University Press, 2012), p. 553.

as acute, as in traditional private equity structures. This also stems from the fact that trading on a stock exchange is being done under transparent rules[67].

As it can be seen from the abovementioned, the governance of the private equity firms is still an on-going debate. While a lot depends on the way how is private equity fund structured and also what corporate form is selected, the governance of private equity firms is also affected by the current regulation of the whole industry. The increased regulatory requirements also put a pressure on the structure of the internal governance of the private equity companies. For instance, Alternative Investment Fund Managers Directive set the conditions on the various internal governance of procedures of private equity managers[68]. These requirements together with the national regulation of specific corporate forms, thus inherently affects the internal governance of the private equity structures.

In the next chapter, we will discuss the regulatory approach towards the private equity industry of the European Union, which is based on regulating the managers of alternative investment funds common for the all EU member states. The subsequent chapters will then deal with the regulatory approaches towards the regulating private equity funds on the level of national states: The Grand Duchy of Luxembourg and Slovakia.

[67] Panasar and Boeckman (n. 29), p. 67.

[68] And managers of alternative investment funds in general. As examples we may mention requirements for the internal documentation dealing with the remuneration, conflicts of interests, risk management, liquidity management and so on.

Chapter 2 - Private Equity within the Regulatory Framework of the European Union

2.1. Private Equity: An Unregulated Territory?

Private equity has been for a long time an unregulated industry[69]. The reason this situation has been persisting is due to fact that private equity investments have been predominantly an area for professional investors, who are considered to be well-aware of the complexities of private equity transactions and are thus capable of protecting themselves.[70] The arguments that private equity is a domain of professionals are still one of the reasons why the industry should have been left out of the eye of the regulator.[71]

The 2008 financial crisis and its aftermath have, however, brought up the legitimacy of the debate on the regulation of private equity industry. One category of the arguments was vouching for the regulation raised by the policy makers due to the accusations that private equity industry represents a systemic risk, because of their use of high amount of leveraged funds, which may destabilize the whole financial market.[72] The other type of pro-regulation arguments put forward the issues relating to transparency and disclosure requirements[73]. It might be argued that the second category of arguments is much more relevant in relation to the regulation of private equity industry, as it points to the problem of information asymmetry between managers of private equity funds and investors of the private equity fund, and to the governance challenge.

Despite the previous lack of common EU regulation of the private equity industry, some member states have enacted specific regulations, which recognized the existence of the industry

[69] *See* Cendrowski (n 55).

[70] Spangler (n 25), p. 3.

[71] Ibid., p. 22.

[72] Some commentators are however saying that these arguments were more emotional that rational and later proved groundless. *See* Payne (n 32).

[73] Payne (n 32) p. 561.

as such. This has been done in juxtaposition to the traditionally at EU level regulated 'undertakings for collective investments in transferable securities' (UCITS)[74]. By regulation of UCITS schemes, a separate category of so-called non-UCITS schemes, which does not meet requirements for the UCITS regulation emerged.

While the UCITS schemes were subject to the common regulation at the EU level, the regulation of non-UCITS collective investment schemes, including 'investment funds offered to public in only one-member state […] has been left to the member state's national initiative.'[75] The regulation of non-UCITS funds was, however, treated differently in different member states, and in some jurisdictions managing collective investment schemes other than UCITS funds has not been subjected to regulation so far at all.[76]

This non-unified regulatory approach resulted in a variety of regulatory frameworks among the member states, ranging from the liberal systems – 'which seem to regulate only investment fund that are offered to the public, thus leaving certain qualified investors free to invest in unregulated investment funds – to the conservative – which prohibit the offering of any unregulated investment funds in any circumstances.'[77]

In accordance with the abovementioned, the authorized and thus regulated, non-UCITS investment funds might be divided into two categories. The first category is so-called non-UCITS retail scheme, which are allowed to pool the funds from the general public[78]. The second category of non-UCITS funds was restricted only to qualified/professional investors;

[74] Directive 2009/65/EC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) [2009] OJ L 302.

[75] Lodewijk D. van Setten and Danny Busch *'1 The Alternative Investment Fund Managers Directive'* in Lodewijk D. van Setten and Danny Busch (eds.), *'Alternative Investment Funds in Europe: Law and Practice'* (Oxford University Press, 2014), p. 3.

[76] Ibid. p. 3.

[77] Ibid. p. 3.

[78] Ibid. p. 3.

therefore, they are sometimes being referred to as qualified investor schemes[79], or specialist funds[80].

The reason why is this mentioned is that private equity investments are also forms of collective investment[81], especially in situations when more than one investor is willing to invest its money into the private equity fund. Due to the regulatory restrictions related to the marketing, private equity funds are usually being marketed only to the qualified investors, and thus are not subject to the application of UCITS directive but national regulation.

This is necessary to mention because while the national states have the means to regulate the private equity industry on the level of fund, European Union chose an approach that the common level of harmonization should be on the level of manager of private equity fund.[82] Therefore, the EU enacted the Directive 2011/61/EU on Alternative Investment Fund Managers (AIFMD), which set the minimum regulatory standards for the whole EU[83]. This chapter deals with the regulation of private equity industry on the level of manager of private equity fund and in the context of common EU framework. Therefore, at first the means and goals and regulation of the AIFMD will be described in the following three subchapters. The last subchapter will take a look on the relevant case law of the Court of Justice of the European Union. After conclusion of the debate about the regulation on the EU level, the next two chapters will deal with the regulation on the national level.

[79] Many jurisdiction in the EU (e.g. Slovakia, Czech republic) use the term 'funds of qualified investors' as a special category of the collective investment funds marketed only to the professional investors.

[80] Eddy Wymeersch, '*Chapter 1 The regulation of private equity, Hedge funds and state funds'*, in Eddy Wymeersch, ed., Alternative investment fund regulation. (Kluwers International, 2012), p. 15.

[81] Spangler (n 25), p. 4.

[82] Thomas M. J. Mollers, Andreas Harrer, Thomas C. Kruger, *'The AIFM Directive and Its Regulation of Hedge Funds and Private Equity*', in 30 J.L. & Com. 87, 106 (2012), p. 89.

[83] Ibid. p. 103.

2.2. Alternative Investment Fund Managers Directive: An Umbrella Approach

AIFMD was a major attempt to harmonize the regulation of the entire alternative investment industry by setting the minimum regulatory requirements for managers of alternative investment funds and thus 'promote an internal market for their activities.'[84] The underlying reason for regulating the industry by regulation of managers of alternative investment funds was determined by balancing two goals relating to protection of investors and 'functional protection of the capital market.'[85]

Although the directive does not regulate the funds themselves, it provides a broad definition of what the AIF is. According to that definition, AIF is: 'collective investment undertakings, including investment compartments thereof, which: (i) raise capital from a number of investors, with a view to investing it in accordance with a defined investment policy for the benefit of those investors; and (2) do not require authorisation pursuant to Article 5 of Directive 2009/65/EC [UCITS].'[86] Such broad definition thus encompasses variety of different alternative investment schemes, such as managing of hedge funds, real estate funds and private equity funds[87].

Such approach is chosen for two reasons. The first reason is that it is impossible to regulate the broad range of different types of alternative investment funds in a single act. The second reason is that by the regulation of the activities of managers of alternative investment

[84] Alexandros Seretakis, *'A Comparative Examination of Private Equity in the United States and Europe: Accounting for the Past and Predicting the Future of European Private Equity'* in Fordham Journal of Corporate Law and Financial Law, Vol XIII, 2013, p. 656.

[85] Mollers, Harrer, Kruger (n 82) p. 89.

[86] Article 4 of AIFMD.

[87] Tom C. Hodge *'The Alternative Investment fund Managers Directive: The European Union Gives Private Equity Managers the Social Market Economy Treatment'* in North Carolina Banking Institute, Vol. 18, 2014, p. 321.

funds, implicitly also the indirect regulation of vast variety of alternative investment funds occurs[88].

Some commentators[89] say that by defining the term alternative investment fund, the European legislator unified the distinction of the collective investment schemes from the dichotomy of UCITS v. non-UCITS, to UCITS v. AIF. By juxtaposing the UCITS and AIF, we are facing the complex regulation of collective investment schemes in European Union. On one hand, there are UCITS which regulate 'the schemes [that] are subject to very strict limits in investing and in borrowing given that they have been created to be sold to retail investors.'[90] And on the other hand, there are AIF, which 'are all the schemes which do not comply with the limits in investing and borrowing according to the UCITSD. Just for this reason they cannot be considered as UCITSs and they are necessarily AIFs. '[91]

Even though that this distinction seems logical, there are still jurisdictions, which are using all three terms, to wit UCITS, AIF, and non-UCITS. It might be presumed that the reason for this might be an uncertainty and lack of applicable practice, whether all non-UCITS funds are AIFs, as well as customs of national legislation.

At this point it is necessary to provide a terminological distinction of various types of alternative investment fund managers, which can be classified in accordance with the exemption set out in the AIFM Directive[92], and which might also affect the perception of the still usance of both terms non-UCITS and AIFs. The exemptions set out in the Directive helps to classify the AIFMs into the following categories:

[88] Recital (10) of AIFMD.

[89] *See* Marco Bodellini, *'Does it Still Make Sens from the EU perspective, to distinguish between UCITS and non-UCITS schemes?'* in 11 Capital Markets Law Journal 528-539 (2016).

[90] Ibid. p. 11.

[91] Ibid. p. 11.

[92] Article 3 of the AIFMD.

1. The first category consists of AIFMs, who are exempted from the application of the AIFM Directive 'in so far as they manage one or more AIFs whose only investors are the AIFM or the parent undertakings or the subsidiaries of the AIFM or other subsidiaries of those parent undertakings, provided that none of those investors is itself an AIF. '[93] This category is excluded as it obviously is not a collective investment scheme, but rather a structure of the group of companies with the interlinked economic interest.
2. The second category consists of AIFMs, who do not meet the requirements set out in the Article 3 (2) and who do not opt-in for the application of the AIFM directive.[94] These AIFM are however subject to the minimum requirements set out in the directive and are regulated at the national level.
3. The third category consists of AIFMs, who meet the requirement set out in the Article 3 (2) or the AIFMs who voluntarily opt-in for the application of this directive.

Out of this regulatory division, it is clear that the AIFM directive will be fully applicable only to the third category of fund managers. These are the ones who will have to undergo the full authorisation procedure in front of relevant national bodies and will also fully benefit from the application of AIFMD.

On the other hand, the second category might also opt for the application of the AIFMD and undergo the full authorisation procedure. If the manager does not opt for the full application of the AIFMD, it might be regulated by the laws of national states. In this situation, however, the directive requires at least registration with the competent authorities[95].

[93] Article 3 (1) of the AIFMD.

[94] In accordance with the possibility set out in the Article 3 (4).

[95] Article 3 (3) of the AIFMD

The Directive takes into the account that not every private equity fund has to be managed by an external manager, but some investment funds having a legal personality and adequate corporate governance structure are allowed to be managed internally[96]. Therefore, in this situation we may distinguish between the internally managed AIF and AIF managed by the external AIFM[97]. The internally managed AIF must however meet stricter requirements for the basic capital[98].

Although AIFMD is an umbrella Directive, which aims to cover all alternative investments, it also particularly refers to the aim of regulation private equity investments in its Recitals and especially in the investments strategies targeted on investing into the non-listed companies.[99] The specific nature of such investments are therefore mirrored in the requirement to provide the competent authorities an information on the financing of the acquisition, respectively acquiring control over a non-listed company[100] and in relation to the issues of acquiring control over the 'issuer whose shares are admitted to trading on a regulated market.'[101]

2.2.1. Selected Requirements for the Managers of Private Equity Funds

It is no secret that one of the long-term goals of the European Union is to create a capital market union, which would encompass also harmonization of alternative investments.[102] In

[96] van Setten, Busch (eds.) (n 75), p. 21.

[97] Ibid. p. 21

[98] Internally managed AIF has to have minimum capital 300 000€, while external AIFM is required to have at least 125 000€. *See* Ibid. p 21-22.

[99] Recital (34) of AIFMD

[100] Recital (56) of AIFMD.

[101] Recital (53) of AIFMD.

[102] *See* European Commission, *'What is the capital markets union? General information on the objectives of the capital markets union*', available online: https://ec.europa.eu/info/business-economy-euro/growth-and-investment/capital-markets-union/what-capital-markets-union_en. Last visited 28.3.2018.

order to create a harmonized market for alternative investments, AIFMD draws on similar rules like the UCITS Directive, for instance 'common European authorization, a management company's minimum capital requirements and introduction of depository.' [103] The compliance with these rules will be necessary for the managers of private equity funds willing to operate within the whole European market and it will affect their internal governance structure.

The regulatory requirements targeting the internal management structure of private equity fund managers are drawing on those established by the UCITS and MifiD directives[104]. The concept of common EU authorization means that a manager authorized in one EU state, by one regulatory agency will be able to set up and market its funds in any other EU member state, on condition that it notifies the local regulatory agency. In its filing for authorization, manager of private equity funds may also request for authorization for providing other services, such as portfolio management and investment services, such as investment advice, safekeeping of the shares or units of collective investments, and reception and transmission of orders relating to the financial instruments[105], however, its core authorization must not be limited only to these activities.[106] The authorization for these services were previously granted in accordance with the MIFID Directive[107], however, the new MIFID II Directive[108] expressly excluded its application on AIFM, making an AIFMD only Directive applicable to AIFMD.[109]

One of the mandatory requirements is that the AIFM must operate in an effective organizational environment that would effectively take all the reasonable steps to prevent the

[103] Mollers, Harrer, Kruger (n 82), p. 89-90.

[104] Ibid. p. 89.

[105] Article (6) (4) of AIFMD.

[106] Article (6) (5) of AIFMD.

[107] Directive 2004/39/EC markets in financial instruments (MIFID) [2004] OJ L 145.

[108] Directive 2014/65/EU markets in financial instruments (MIFID II) [2014] OJ L 173.

[109] *See* Kitty Lieverse *'The Scope of MiFID II' in* Danny Busch, Guido Ferrarini *'Regulation of the EU Financial Markets: MiFID II and MiFIR'*, Oxford University Press, 2017.

emergence of conflict of interests that might adversely affect the managed fund and its investors.[110] The AIFMD recognize a various types of conflict of interests and requires the AIFM to prepare and implement adequate policies for its preclusion.[111] Such policies should incorporate the segregation of tasks and responsibilities, monitoring and subsequent disclosure of potential conflicts of interest to the investors.[112]

Due to the fact that most of the AIFM will operate in transactions dealing with the higher risk, AIFM is obliged to establish appropriate systems for monitoring 'all risks relevant to each AIF investment strategy to which each AIF is or may be exposed.'[113]

Perhaps the most talked about requirement for the AIFM is to appoint a separate depository for each AIF under management. The role of depositary lies in the three main functions monitoring of the cash; safekeeping of an AIF's assets and oversight of the certain operational functions.[114] Generally, depositary should be financial institution located in the EU[115], however managers of private equity funds may also appoint the public notaries, registrars and law firms, who are licensed to act as depositaries, as well.[116]

As it was already mentioned, private equity companies were widely criticized for the lack of transparency and lack of disclosure of information to the investors.[117] The AIFMD thus introduced a requirement for disclosing the essential information relating to the fund and its internal organization to the prospective investors at the initial stage of investment, as well as

[110] Van Setten, Busch (eds.) (n 75), p. 56.

[111] Ibid. p. 56.

[112] Ibid. p. 58.

[113] Ibid. p. 59.

[114] Ibid. p. 78.

[115] Eddy Wymeersch *'Chapter 18 The European Alternative Investment Fund Management Directve'* in Eddy Wymeersch, ed., Alternative investment fund regulation. (Kluwers International, 2012), p 460.

[116] Ibid.

[117] Payne (n 32), p. 561.

subsequent regular disclosures.[118] Apart from disclosing information to the investors, AIFMs are required to provide reporting, mainly on the risk management issues and liquidity, to the national supervisors.[119]

However, the most complex regulatory means, from which might the managers of private equity managers benefit is the regulation of marketing. Due to its complexity, it will be described in the following subchapter.

2.2.2. Marketing of Private Equity Funds

When we talk about marketing in relation to the investment funds, we mean the way how the funds are being advertised to the investors. Traditionally, a distinction between marketing to retail and professional investors existed.[120] As far as the means of marketing goes, there has been a difference between marketing via public offer and marketing via private placement.[121] The aim of AIFM Directive was to provide a harmonized way of marketing of alternative investment funds, with focus on the marketing to the professional investors.[122]

The AIFM Directive sets the conditions for the managers of alternative investment funds authorized in the EU in relation to the marketing of the EU-AIF they manage in their home member state. The main advantage of an authorized manager of alternative investment fund is that the manager is given a so-called passporting right, which means that he is allowed to market units or shares of European Union AIF that it manages to professional investors in member states other than the home member state of the AIFM as soon as certain conditions are

[118] Wymeersch (n 115), p 469.

[119] Ibid.

[120] Spangler (n 25), p. 36.

[121] *See* Panasar and Boeckman (n. 29).

[122] Van Setten, Busch (eds.) (n 75), p. 11.

met[123]. The marketing passport is therefore the most important harmonization targeting the unified fund market.[124]

When we talk about marketing of private equity funds, we usually mean marketing to professional investors. The concept of professional investor is a term of European law, which can be found in the Directive 2004/39/EC (MiFiD Directive), as well as in the new Directive 2014/65/EU (MiFiD II Directive) – and it refers to the investor that 'possesses the experience, knowledge and expertise to make its own investment decisions and properly assess the risks that it incurs.'[125] The term is sometimes being used interchangeably with the terms 'institutional investors' or 'qualified investors' or 'well-informed investors'. The examples of who is considered to be a professional investor (or a client) are stated in the Annex II of the MiFiD II Directive. As a non-exhaustive list of such professional investors, we can mention credit institutions, investment firms, authorized or regulated financial institutions, insurance companies, collective investment schemes and management companies of such collective investment schemes, pension funds and management companies of the pension funds and others. According to the directive as a professional investor are also considered large undertakings, public and regional governments and so on. Apart from the entities who are automatically considered to be professional investors, the directive also sets requirements for clients who may be treated as professionals on their own request[126] – therefore, rich individuals, if the meet conditions may be considered as professional investors, and thus allowed to invest into the private equity funds.

[123] The conditions for marketing outside of the home member state are set out in the Article 32 of the AIFMD.

[124] Van Setten, Busch (eds.) (n 75), p. 4.

[125] Kremer, Lebbe (n 63), p. 41.

[126] Annex I to Directive 2004/39/EC.

Even though the private equity funds are usually attracting professional investors, according to AIFMD, member states may allow the managers of private equity funds to market in their territory units or shares of such funds also to retail investors. In such case, however, member states may impose stricter requirements,[127] in order to protect less-knowledgeable retail investors as oppose to well-informed, professional investors.

Apart from the harmonized regulation of marketing for the authorized managers of the alternative investment funds, in accordance with the AIFM Directive, there is also a national private placement regime (NPPR). This NPPR allows alternative investment fund managers (AIFMs) to market alternative investment funds (AIFs) that 'otherwise cannot be marketed under the AIFMD domestic marketing or passporting regimes.'[128] This applies to the marketing by a non-EU AIFM or marketing of a non-EU AIF, but also to the marketing of small sub-threshold alternative investment funds, which did not opt in for the application of AIFM directive. Although the requirements for the national private placement marketing regime differs from jurisdiction to jurisdiction, the similarities can be found within the concept of private placement memorandum or a private offer, which is usually being addressed to the concrete private investors without involvement of public.

Marketing of managers of private equity funds to certain extent depends also on the size of the fund and the purpose of the investing. Therefore, some managers do not market their funds at all. What they do is that they are waiting for the investors to approach them with the requirement to invest either into the private equity fund or portfolio of companies managed by

[127] Article 43 (1) of AIFMD

[128] The explanation for this is for instance provided by the British regulatory agency, Financial conduct authority, National private placement regime (NPPR), updated 12.4.2017 Available online: https://www.fca.org.uk/firms/nppr .

private equity company.[129] This form of investing is therefore referred to as 'reversed solicitation'[130], which means that investors are looking for the private equity funds to invest on their own initiative. This way of investing is left out of the regulation set out in the AIFMD[131].

Setting-up a private equity fund and its manager is still governed by the laws of the national state, however AIFMD harmonized the industry very significantly. The internal structure of the private equity firms will thus depend on whether the manager will opt-in for the AIFMD harmonization or not. Due to the fact that the AIFMD targets predominantly managers managing large amounts of assets[132] most of the large private equity companies will have to comply with the AIFMD requirements. The other factor that affects the internal governance of the private equity companies is the regulatory approach towards marketing, especially via EU passport, which is conditioned by the full authorization of the manager.

2.3. Private Equity in the Context of the Case Law of Court of Justice of the European Union

As it was already explained, before enactment of the AIFM Directive, private equity funds were regulated only on the level of some national states, as a so called non-UCITS investment schemes. Although most of the case law dealt with the issues related to the UCITS directive, there are also some cases that dealt with the issues of non-UCITS schemes. To

[129] *See* Trevor Dolan, Daragh O'Malley, *'Reverse Solicitation',* May 12, 2015, Lexology. Available online: https://www.lexology.com/library/detail.aspx?g=abdbb29b-2a35-4f29-a4da-686aef7dd17e. Last visited on: 28.3.2018.

[130] *See* Danny Busch and Deborah A. DeMott, *'Introduction'* in Danny Busch and Deborah A. DeMott (eds.), *'Liability of Asset Managers'* (Oxford University Press, 2012).

[131] Recital (70) of AIFMD.

[132] Due to the conditions set in article 3 of AIFMD which sets out the exceptions for small AIFs.

provide some hints about the approach of the Court of Justice of the European Union, some of them are discussed below.

In *Abbey National*[133] the court dealt with the issue of whether 'management special investment funds' is exempted from the application of VAT. The court's analysis dealt with the distinction of management of UCITS funds, which were exempted from the application of VAT as they were defined in the EU law. On the other hand, the definition of special investment funds was conferred on the particular member states.[134] The court says that the concept of 'management' has its own independent meaning in the EU law, which may not be alter by the member states. In conclusion the court says that 'management of special investment funds' refers to the services provided by the third-party manger if they are specific and essential for the management of those funds. The court however excluded that the functions of depositary are covered by the concept of management of special investment funds.[135] The same approach was later enacted in the AIFMD.[136]

The next case worth mentioning is the *Aberdeen case*[137]. In this case, the court also dealt with the tax issues. Particularly, the court had to decide whether the dividends, paid from the subsidiary company operating in Finland to the parent company in Luxembourg, are exempted from the withholding tax. The parent company in Luxembourg, was an investment fund, formed in the corporate form of SICAV. The issue was whether the Luxembourg' SICAV can benefit from the more favourable tax treatment set out in the parent-subsidiary Directive[138],

[133] Case C-169/04 Abbey National plc and Inscape Investment Fund v Commissioners of Customs & Excise [2006] I-04027.

[134] Id. para 39.

[135] Id. para 74.

[136] Van Setten, Busch (eds.) (n 75), p. 78.

[137] Case C-303/07 Aberdeen Property Fininvest Alpha Oy [2009] I-05145.

[138] Directive 90/435/EEC on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States [1990] OJ L 225.

if, the corporate form of SICAV is not enlisted in this Directive, and according to Luxembourg law, the investment funds are exempted from the corporate tax.[139] The court analysis was twofold. At first it analysed, whether the company SICAV is similar to some other corporate structures in Finland. The court concluded that due to the fact that the form SICAV is not enlisted in the parent subsidiary Directive, it does not benefit from its application. However, court stated that the Luxembourg SICAV is similar to the Finish investment fund and company limited by shares. Due to the fact that these corporate forms are excluded from the taxation in Finland, the same treatment shall be granted to also to the Luxembourg SICAV.[140]

The above-mentioned cases give some insights into the operation of the investment funds within the common EU market. The Abbey National case pointed out to the concept of management, and its distinction from the providing depositary services. As some commentators, points out the separation of these functions were in the subsequent adoption of AIFMD kept also due to the Madoff Affair.[141]

On the other hand, the part of the Aberdeen case points to the problem of comparing the qualitative attributes company forms, which are common in one jurisdiction, but by analogy may be compared to the company forms of another jurisdiction. The corporate structure of Luxembourg SICAV is discussed in the next chapter, and due to its popularity, it has been also transposed to another jurisdiction.

Finally, as the AIFMD aims at creating the common market for the managers of alternative equity funds, including private equity managers, it might be expected that the further harmonization of the industry will be impacted also by the decision making of the Court of

[139] António Calisto Pato, Priscilla Goes Seize, '*EC Law and Investment funds: The Aberdeen Case',* in EC Tax Review 2009/3, p. 115.

[140] Case C-303/07 Aberdeen Property Fininvest Alpha Oy [2009] I-05145.

[141] Van Setten, Busch (eds.) (n 75), p. 78.

Justice of European Union. This chapter dealt with regulation of the managers of alternative investment funds, which is common for the all member states. The subsequent two chapters discuss the two different approaches of the regulation of private equity industry on the national level and juxtapose the leading regulatory framework of Luxembourg with the emerging regulatory framework of Slovakia.

Chapter 3 - The Grand Duchy of Luxembourg: Leading Private Equity Industry in Europe

3.1. Overview of the Regulatory Framework

For years, the Grand Duchy of Luxembourg has provided a favourable environment for the private equity industry.[142] The main advantages of Luxembourg lie not only in stable political and economic environment[143] and favourable tax regimes[144], but also in a business-friendly regulatory framework with corporate structures tailored especially for the needs of private equity industry[145].

The aim of Luxembourg to be the leading regulatory framework[146] in the private equity industry has materialized in enactment of four laws, which target the regulation of alternative investment funds and private equity. These are:

1. Law of 15 June 2004 relating to the Investment Company in Risk (SICAR);
2. Law of 13 February 2007 relating to the Special Investment Funds (SIF);
3. Law of 12 July 2013 on Alternative Investment Fund Managers (AIFM);
4. Law of 23 July 2016 on Reserved Alternative Investment Funds (RAIF).

[142] Luxembourg has been considered as a leading jurisdiction of investment funds in Europe. For more information see: https://www.lpea.lu/private-equity-in-luxembourg/.

[143] Due to the insecurities connected with the Brexit some of the biggest private equity firms are looking for Luxembourg as an access to single EU market. *see* Javier Espinoza and Patrick Jenkins: *'Private equity looks to Luxembourg for access to single market',* Financial Times, 27 January 2017. online at: https://www.ft.com/content/72a98d1e-e240-11e6-9645-c9357a75844a . Last visited on 20.3.2018.

[144] *See* Mariia Domina Repiquet, *'Report from Luxembourg: New Alternative Investment fund Regulation in Luxembourg – Basis for an Attractive Domicile in the Post-Brexit Era?',* in European Company Law Journal 15, No. 1 (Kluwer Law International, 2018).

[145] *See* Global Custodian *'Is Luxembourg structurally favorable for private equity funds?'* Asset International 2010.

[146] According to statistics Luxembourg is the leading private equity industry in Europe and second largest global leader for domiciled funds after US. *see* Alexandrine Armstrong-Cerfontaine, *'Private equity in Luxembourg: market and regulatory overview',* Thomson Reuters, 2017. Online at: https://uk.practicallaw.thomsonreuters.com/5-500-8319?transitionType=Default&contextData=(sc.Default)&firstPage=true. Last visited on 28.3.2018.

Luxembourg's legal framework offers variety of possibilities of structuring private equity companies, including both regulated and unregulated vehicles[147].

The main difference between regulated and non-regulated PE vehicles lies in the fact, whether they are authorized and supervised of Luxembourg regulatory agency – CSSF (Commission de Surveillance du Secteur Financier) or not[148]. The regulated structures are therefore mostly investment companies, which are subject to one of the above-mentioned laws.

In addition to the national regulatory framework, it is necessary to take into consideration requirements of the AIFM Directive, which applies to both regulated and unregulated private equity structures. Therefore, even an unregulated SOPARFI structure, if qualified as AIF, is required to be managed by the authorized AIFM, and thus is subject to the 'full impact of the indirect product rules contained in the AIFM law, such as need to appoint depositary and transparency obligations.'[149]

On the other hand, it is necessary to take into consideration the impact of the AIFM on the regulated private equity structures such as SICAR and SIF, too, as they also need to fulfil the requirements of the Directive. Implementation of AIFMD thus introduced the following differentiation within the SIF and SICAR product laws[150]:

1. SIFs and SICARs qualifying as AIFs and managed by a duly authorized AIFM;
2. SIFs and SICARs not qualifying as AIFs and therefore subject to the original legal framework of the product laws;

[147] *see* Luxembourg Private Equity and Venture Capital Association, *Private equity in Luxembourg*, 2016, available online at: https://www.lpea.lu/wp-content/uploads/2016/12/pe-in-luxembourg-brochure-2016.pdf.

[148] Gilles Dusemon, Victorien Hémery, Myriam Moulla, *'Chapter 7 Luxembourg*' in Lodewijk D. van Setten and Danny Busch (eds.), *'Alternative Investment Funds in Europe: Law and Practice'* (Oxford University Press, 2014), p. 318.

[149] Ibid.

[150] Ibid. p. 328.

3. SIFs and SICARs managed by a sub-threshold AIFM not opted for authorization as an AIFM.

The abovementioned differentiation is, however, mostly theoretical because due to the broad definition of the AIF most SIFs and SICARs will qualify as AIFs and thus will require to be managed either by authorized or sub-threshold AIFM. It is also necessary to state that while AIFM Directive aims to regulate only the managers of alternative investment funds, it is the national laws that regulate the private equity structures. As it is explained in the subsequent paragraphs, both SICARs and in this thesis described SIFs are investment firms created as separate legal entities. Therefore, if managed internally, they may be authorized as alternative fund managers themselves, or in case of external management, the manager has to be an authorized alternative fund manager.

Eligible investors

Private equity has been always domain of sophisticated investors. This is because private equity investments are connected with high level of risk, which needs to be 'understood and accepted by the investors.'[151] Luxembourg law is using the term well-informed investors, which apart from institutional and professional investors, contain also 'any another investor who, […] gives assurances demonstrating his understanding of the increased risk.'[152] This detailed distinction of investors thus allows making investments also for the rich individuals, if some conditions are met[153].

Despite the restriction of private equity funds to the well-informed investors, the issue of marketing is still actual and complex. As it was already described in Chapter II, AIFMD to

[151] Kremer, Lebbe (n 63), p. 680.

[152] Ibid.

[153] For instance, the law on SICAR as well as the law on SIF, sets the threshold for minimum investment 125 000€, or require that the investor has been certified by some third parties.

large extent harmonized marketing of EU alternative investment funds. However, these funds which don't meet the requirements of AIFMD are subject to the national marketing regulations.

Traditionally two forms of marketing emerged: 1.) the marketing via public offering – which is regulated by the Luxembourg law on prospectuses[154]; and 2.) marketing via private placement/private offer – which is not regulated at all.[155]

3.2. Unregulated Private Equity Structures

3.2.1. SOPARFI (Société de Participations Financiéres)

Although the abovementioned laws represent the ambition of regulating the private equity industry, however, still[156], most of the private equity firms in Luxembourg are set-up in the form of unregulated SOPARFI (*Société de participations financiéres*) vehicles. The term itself does not represent a specific legal concept, but rather a term of convenience, which can be translated as 'Financial holding company'[157]. The SOPARFI, as opposed to regulated forms of private equity structures, represents a normal commercial company, the activities of which resemble those of a traditional holding company. The SOPARFI may be structured into one of the five legal forms[158], while the two major ones are: 'Société anonyme' ('SA') and 'Société à responsabilité limitée' ('Sàrl'). The internal governance of SOPARFI, thus depends on the relevant corporate form.

[154] The prospectuses are regulated by the Act of 10 July of 2005 on prospectuses for securities.

[155] Kremer, Lebbe (n 63), p. 499.

[156] *See* Armstrong-Cerfontaine (n 146).

[157] The content is taken from the brochure of public-private agency for the development of the financial centre 'Luxembourg for Finance'. *Luxembourg for Finance, SOPARFI, April 2012.* Online at: http://www.luxembourgforfinance.com/sites/luxembourgforfinance/files/lff-brochure-soparfi.pdf .

[158] The corporate forms are regulated in the law of 10 August 1915 on Commercial companies. The predominant use of the Sarl and SA forms are mentioned by the Luxembourg for Finance brochure cited above.

The setting-up a SOPARFI is no different from setting up a regular commercial company. Due to the fact that they are not regulated, they are not subject to any 'risk-spreading requirements and in principle may invest in any asset class.'[159] However, the SOPARFIs are not an investment company, but their purpose is rather 'to hold and manage assets in other undertakings.'[160] Due to the fact that SOPARFI resembles much more traditional commercial company, they are not subject to any restrictions on investors or subject to authorization of CSSF[161]. However, in situation where SOPARFI qualify as an alternative investment fund, it is required that it is managed by the registered or authorized alternative investment fund manager.[162]

3.2.2. Reserved Alternative Investment Funds

Reserved alternative investment funds ('RAIFs') represent a new innovation of the Luxembourg's regulatory framework, which main aim is to introduce a new type of vehicle, which is reserved to 'Luxembourg alternative investment funds managed by an external alternative investment fund manager ('AIFM') within the meaning of Directive 2011/61/EU of 8 June 2011 on alternative investment fund managers ('AIFMD').'[163]

RAIFs represent a hybrid combination of regulated and unregulated funds structures, especially because the fund entities do not fall within the supervisory scope of the CSSF and

[159] Association of the Luxembourg fund industry, Luxembourg private equity and venture capital, November 2017, available online at: http://www.alfi.lu/sites/alfi.lu/files/ALFI-Private-Equity-and-Venture-Capital-brochure.pdf

[160] van Setten, Busch (eds.) (n 148), p. 319.

[161] Wymeersch (ed.) (n 19), p. 266.

[162] van Setten, Busch (eds.) (n 148), p. 318.

[163] *See* Luxembourg Private equity and venture capital association, *Private equity in Luxembourg*, 2016, available online at: https://www.lpea.lu/wp-content/uploads/2016/12/pe-in-luxembourg-brochure-2016.pdf.

the approval from CSSF is not required[164]. However, it is necessary to mention that RAIFs have to be managed by an authorised alternative investment fund manager. In conclusion RAIFs are thus supervised only indirectly – by supervising the activities of the manager of the RAIF, who has to be authorized alternative investment fund manager[165].

RAIF regulation has been lauded by the practitioners as it combines the advantages of regulated and flexibility of unregulated structures[166]. The main advantage of this regulation is the flexibility and speed of setting up the RAIF. According to the law, 'the formation of the RAIF shall be witnessed by a Luxembourg notary public within 5 days of its formation.' Due to the management of the authorized alternative investment fund manager, RAIF can easily benefit from EU marketing passport, and it 'is not restricted to make investments in any asset class and using any investment policy or strategy.'[167]

It might be presumed that the overall decision whether to structure fund as RAIF or choose one of the regulated form will thus depend on the manager, investment activities and preferences of the investors.

[164] *See* Luxembourg Private equity and venture capital association, *Private equity in Luxembourg,* 2016, available online at: https://www.lpea.lu/wp-content/uploads/2016/12/pe-in-luxembourg-brochure-2016.pdf.

[165] *See* Association of the Luxembourg fund industry, *'Luxembourg's Reserved Alternative Investment Fund vehicle approved*', press release, 14.7.2016. Available online: http://www.alfi.lu/node/3289.

[166] *See* Johan Terblanche, *Luxembourg Set to Introduce a European Game Changer: The Reserved Alternative Investment Fund (RAIF),* Investment Lawyer, Vol. 23, No. 4, April 2016.

[167] *See* Arendt & Medernach, *Reserved alternative investment funds (RAIF) for EU and third-country AIFMs,* Luxembourg, 2017, available online:

http://www.arendt.com/publications/documents/brochures/2017.03%20-%20raif.pdf

3.3. Regulated Private Equity Structures

3.3.1. SICAR (Société d'investissement en Capital Risque)

Law of 15 June 2004 relating to the investment company in risk (SICAR) was specifically designed in order to fulfil the needs of the private equity industry[168]. The aim of the law was to fill the gaps and 'create the vehicle not as strictly regulated as traditional undertakings for collective investments, but at the same time more flexible than commercial company.'[169]

SICAR Law however does not create specific legal form, but rather it may take one of the existing legal forms of commercial company or partnership[170]. As its name already says, the SICAR is an investment company, therefore its main purpose is to provide investment activities[171], and not just holding activities, which are common in unregulated SOPARFI structures, and it cannot restrict itself to just holding activities. Due to similarities, the difference between holding and investment activities are sometimes blurred, as private equity fund or investment company are also undergoing holding activities. The main difference is however in holding period and the purpose of holding activities.[172] The holding period in case of private equity funds and investment companies are time restricted, which means that after passing the time, the private equity fund is obliged to sell its shares and distribute the profit to the investors.[173]

[168] Wymeersch (ed.) (n 19) p 265.

[169] Mario Starita, *'The SICAR: A new Luxembourg Vehicle for Private Equity and Venture Capital Investments'* in 34 Intertax, Issue 8/9, pp. 418–422(Kluwers International 2006), p 418.

[170] Some commentators mention that the most common forms are S.C.A. (corporate partnership limited by shares), S.A. (public limited company) and Sarl (private limited company). For more info look at Note 65 in Wymeersch (ed.) (n 19) p 266.

[171] Kremer, Lebbe (n 63), p. 672

[172] Ibid.

[173] Ibid.

In order to provide the investment activities, SICAR has to be authorized by the Luxembourg regulatory agency - CSSF, in order to launch its activities. According to statistics, which are generated daily by CSSF, currently there are 284 Investment companies in risk[174]. As it was already mentioned, most of the SICARs will qualify as AIFs, and therefore will have to be managed by an AIFM. In this case the supervision of the CSSF will be twofold; on the level of the AIFM, and on the level of the SICAR.

One of the main characteristics of SICARs is that it must 'invest its assets in securities representing risk capital in order to provide its investors with the benefit of the result of the management of its assets in consideration for the risk which they incur'[175]. The precondition of high risk is supplemented by the intention to develop the investee company[176]. The concept of development should be however understood in the broad sense, as value creation on the level of portfolio company, which may take many different forms[177].

The high risk which is associated with the investments made by the SICAR, restricts the access only to the investors, who are aware of the risk incurred. Therefore, investment in SICAR is allowed only to the professional/well-informed investors. This is especially so, as SICAR law does not impose any rules of diversification of the risk, which means that SICAR is allowed to make investment only to one single company.[178] As oppose to other entities, SICAR is allowed to invest only into the risk capital.[179] This requirement of investment into

[174] Statistics are available online on the webpage of Luxembourg regulatory agency CSSF. Data used in this thesis were dated as of 20th March 2018. For more information look:

https://supervisedentities.apps.cssf.lu/index.html?language=en&type=AIF#ResultResearch.

[175] Circular CSSF 06/241 – Concept of risk capital under the Law of 15 June 2004 relating to the investment company in risk capital (SICAR).

[176] Circular CSSF 06/241 – Concept of risk capital under the Law of 15 June 2004 relating to the investment company in risk capital (SICAR).

[177] Circular CSSF 06/241 – Concept of risk capital under the Law of 15 June 2004 relating to the investment company in risk capital (SICAR).

[178] Kremer, Lebbe (n 63), p. 670.

[179] Ibid.

risk capital, together with the no obligation for risk spreading sets the main distinction between SICAR and other regulated undertakings for collective investments in Luxembourg. On the other hand, due to the private equity nature of the SICAR law, the investments into the hedge funds, derivatives and listed securities are not eligible[180].

Selecting a proper legal form of the SICAR depends on the various factors, and some of them arise from the preference of the investors, or are limited by the provisions of Act on Commercial companies.[181] As some commentators point out, 'SICARs are often created on behalf of a limited number of investors who wish to retain maximum control over their structure.'[182] Therefore, the best legal form to achieve this is société en commandite, as it combines the unlimited liability of general partner, who can exercise its management powers, while the investors are limited partners with 'more passive role'[183].

The minimum requirement for the subscribed share capital together with issue premium of SICAR is one million EUR, which has to be reached within the twelve months of the authorization of the company[184]. With respect of the minimum subscribed share capital, SICAR is also allowed to stipulate in its articles of association that its capital will be variable.

SICAR is also allowed to be structured into the multi-layered investment vehicles, such as fund of funds (or funds of private equity funds)[185]. This possibility is simplified, as the law allows the SICAR to be composed of multiple compartments, 'each compartment corresponding to a distinct part of SICAR's assets and liabilities.'[186] The so-called umbrella

[180] Wymeersch (ed.) (n 19) p 266.

[181] These limitations may consist for instance, from the number of maximum available investors (up to 40) in Sarl company, which however might be preferred by the small group of investors.

[182] Kremer, Lebbe (n 63), p. 684

[183] Ibid.

[184] Article 4 (1) Law of 15 June 2004 relating to the investment company in risk capital (SICAR).

[185] Wymeersch (ed.) (n 19) p 266.

[186] Article 3 (2) of the Law of 15 June 2004 relating to the investment company in risk capital (SICAR).

SICARs would therefore allow investors to decide whether to invest on the level of the fund of funds, or into the particular compartment.

Depending on the legal form, SICAR is allowed to issue different kind of securities 'based on its own needs and those of its investors'[187]. The advantage of SICAR lies in the fact that as oppose to other regulated undertakings for collective investments, securities issued by SICAR doesn't have to be issued on the net asset value.[188]

3.3.2. Specialized Investment Funds

As opposed to the regulation of SICARs, SIF law represents the wider framework for regulating the alternative investment funds, which does not concern solely on the private equity funds but may encompass also hedge funds and other types of funds[189]. SIFs encompass all alternative investment class and they are not subject to 'any eligibility requirements in terms of their investments'[190]. As opposed to SICARs, they are subject to the requirement for diversification of their investments, and must invest into diversified portfolio of assets.[191] Specialized investment funds, may not invest more than '30 of its assets or commitments to subscribed securities of the same type issued by the same issuer.'[192]As some commentators

[187] Kremer, Lebbe (n 63), p. 686.

[188] Ibid.

[189] Wymeersch (ed.) (n 19) p 264.

[190] Association of the Luxembourg fund industry, *'Luxembourg private equity and venture capital'*, November 2017, available online at: http://www.alfi.lu/sites/alfi.lu/files/ALFI-Private-Equity-and-Venture-Capital-brochure.pdf.

[191] *See* Association of the Luxembourg fund industry, *'Luxembourg private equity and venture capital*', November 2017, available online at: http://www.alfi.lu/sites/alfi.lu/files/ALFI-Private-Equity-and-Venture-Capital-brochure.pdf.

[192] CSSF Circular note 07/309 on risk spreading in the context of specialized investment funds.

points out, SIFs can be an 'appropriate vehicle for private equity investment when the pure private equity or risk capital component of the fund is not so obvious.'[193]

Specialized investment funds may be structured into the three available forms[194]:(1) contractual funds (FCP)[195]; (2) investment company with variable capital (SICAV); (3) investment company with fixed capital. According to statistics, which are generated daily by the CSSF[196], there are 1561 specialized investment funds, which fall within the scope of the law of 13 February 2007. Out of these numbers the most, 1160, were incorporated in the form of SICAV.

Similarly, as SICAR, specialized investment funds are under supervision of CSSF and require a prior authorization of the CSSF in order to launch their operations.[197] In the authorization procedure, CSSF approves the constitutional documents and also the directors of the Specialized investment funds.

Law on specialized investment funds offers flexibility and wide possibilities of structuring of private equity funds, including the possibility of structuring the fund in an umbrella vehicle.[198] The following subchapter provide the overview of the most common forms of structuring SIFs in relation to private equity – SICAV and SICAF.

[193] Wymeersch (ed.) (n 19) p 263.

[194] Ibid. p 264.

[195] The contractual fund does not have a legal personality and it has to be managed by the separate fund management company, therefore it is not a way in which are the private equity funds structured.

[196] Statistics are available online on the webpage of Luxembourg regulatory agency CSSF. Data used in this thesis were dated as of 20th March 2018. For more information look:

https://supervisedentities.apps.cssf.lu/index.html?language=en&type=AIF#Extraction.

[197] Article 42 of the law of 13 February 2007 related to the specialized investment funds.

[198] Wymeersch (ed.) (n 19)) p. 266.

3.3.2.1. SICAV (Société d'investissement à Capital Variable)

SICAV, as an investment company with variable capital, allows a wide variety of structuring the private equity fund. Similarly, as SICAR, it can be structured in one of the available forms for the commercial companies[199]. The governance of SICAV therefore strongly depends on the selected corporate form. Some commentators[200] mention that for the bigger specialized investment funds, the best option to structure SICAV is in the form of SCA (société en commandite par action) or SA (société anonyme).

SCA is characterized by the structure consisting of two types of partners – general partner(s) and limited partner(s).[201] General partner or partners have unlimited liability and are responsible for the management of the SICAV. Due to unlimited liability for its activities, it is common that the general partner(s) will transfer their 'unlimited liability to a company with limited liability SA or Sarl'[202]. On the other hand, the limited partners will be the investors – limited solely just to the amount of their investment.

The structure and governance of SA is different as the control and competences of the board of directors is not as wide as competences and control of the general partners, who commit their own funds and thus are personally committed to the management of SICAV.

With some restriction, for some specialized investment funds, and even for the private equity funds, the structuring in the form of Sarl (limited liability company) might be preferable. The advantages of Sarl structure may lie in a less stringent regulation, which might be

[199] Article 25 of the Law of 13 February relating to the specialized investment funds states that the SICAV may be incorporated in one of the following legal forms: public limited company (*société anonyme*), a partnership limited by shares (*société en commandite par action*), a limited partnership (*société en commandite simple*), a special limited partnership (*société en commandite spéciale*), a limited company (*société à responsabilité limitée*) or a cooperative in the form of a public limited company (*société coopérative organisée sous forme de société anonym*).

[200] Kremer, Lebbe (n 63), p. 54.

[201] Article 16 and following of the Luxembourg law of 10th August 1915 on commercial companies.

[202] Kremer, Lebbe (n 63), p. 54

preferable for the smaller private equity funds, which investors are limited up to the number 40[203]. On the other hand, the disadvantage of Sarl structure might be in its legal nature, as the Sarl cannot offer its shares in the public offer.

The problem of governance of SICAV occurs, in situation when SICAV will be an alternative investment fund, and therefore it will be subject to the application of AIFM Directive. As it was already mentioned, in this case it will be therefore crucial to appoint the authorized alternative investment fund manager. Solving this problem depends on the structure of the SICAV. In case of structuring the SICAV as an SCA there are three possibilities: '(1) the general partner will be authorized AIFM, in; or (2) the whole SCA and its general partner will be considered as an AIFM; or (3) the external AIFM will be appointed'[204]. In case of structuring SICAV in other corporate form than SCA there are only two possibilities, consisting of either appointment of external AIFM or, the whole SICAV will be internally managed AIFM. SICAV has a separate legal personality, with its own board of directors and other corporate bodies. Therefore, in case of delegation of the management of the SICAV to the external AIFM, the question of the competences of the bodies of SICAV arises. Due to the fact that AIFM is the one who is responsible for the governance and management of the fund, the competences of the corporate bodies of the SICAV will be highly restricted.

As the name suggests, SICAV is a company, which capital constantly vary but at all times it should be 'equal to the net asset value of the company – the value after deduction of its liabilities'[205]. Due to the capital variation, SICAV is an open-ended collective investment vehicle. According to the law, the minimum subscription capital should be no less than 1.25 mil. €, 'which should be reached within the period of twelve months after authorization of the

[203] Ibid.

[204] Ibid. p. 55.

[205] Ibid. p. 52.

SICAV.'[206] The shares[207] issued by SICAV shall have no par value and their issuance and redemption is governed by the articles of incorporation. The share 'shall specify the minimum amount of capital and give no indication regarding its par value or the portion of the capital, which it represents.'[208]

3.3.2.2. SICAF (Société d'investissement à Capital Fixe)

SICAFs, represent the category of specialized investment funds, which have not been constituted as a common funds or SICAVs. The term SICAF refers to the investment company with fixed capital (société d'investissement à capital fixe).[209] Although a not precise legal term used by the law, many practitioners use it as distinction to the investment companies with variable capital (SICAV).

In its substance, SICAF resemble more traditional companies, whose 'capital is equal to the amount of contributions received.'[210] Therefore, as opposed to SICAV, the capital cannot be change simply as a result of investment decision, but only in compliance with the 'decision of the general meeting of shareholders'.[211]

Similarly, as in SICAV the whole governance structure will depend on the selected corporate form of the SICAF investment company, as well as its relation to the AIFM. The possibilities of having an external authorized/registered AIFM or the scenario when the SICAF itself will be authorized AIFM resemble the problems described in SICAV. The most common

[206] Article 27 of the Law of 13 February relating to the specialized investment funds.

[207] Due to the various possibilities of structuring the SICAV, the law is using the term 'securities and partnership interests' in order to cover all possibilities.

[208] Article 28 (8) of the Law of 13 February relating to the specialized investment funds.

[209] Wymeersch (ed.) (n 19) p 264.

[210] Kremer, Lebbe (n 63), p. 55.

[211] Ibid.

corporate forms, in which SICAF might be incorporated seems to be SA and SCA, especially as 'their shares are easily transferable'[212].

As can be seen, the Grand Duchy of Luxembourg offers wide possibilities of structuring the private equity funds, either in the regulated or unregulated form. However, due to implementation of AIFM Directive, most of the private equity funds will have to be managed by the authorized or registered AIFM. It might be argued that it will be on the decision of investors, whether they will opt for fully regulated national vehicles such as SICAR or SIF, which, however will be managed by the authorized AIFM in case of marketing their shares in the EU. In this situation, these structures will be regulated and supervised both on the level of AIFM and on the level of fund.

In the next chapter, the variety and complexity of the Luxembourg law will be juxtaposed with the still emerging new member of the EU: Slovakia.

[212] Ibid. p. 56.

Chapter 4 - Slovakia: A Private Equity Newcomer

4.1. Overview of the Slovak Private Equity Industry

Even though Slovakia has been a member state of the European Union since 2004, private equity industry in Slovakia is still considered to be rather underdeveloped. The reasons for this situation can be found not only in underdeveloped capital markets, but also in the lack of awareness of the possibilities of private equity financing. In recent years, however, EU-backed initiatives, such as JEREMIE[213] emerged, the main aim of which was to improve access to finance for the SMEs in the EU[214]. Apart from the state-owned and EU-backed initiatives there are also 'few established domestic private equity groups, as well as regionally focussed private equity investors.'[215]

Due to the underdeveloped industry and lack of data, not so much has been written about private equity and structuring of private equity funds in Slovakia. But mainly due to the tax reasons the commentators point out that 'Slovak fund structures for private equity funds are uncommon.'[216] Most of the private equity funds operating in Slovakia are, however, incorporated in the other member states[217] or operates in unregulated structures, similar to Luxembourg' SOPARFI. However, despite this fact, and especially due to implementation of AIFM Directive and amendments of the Slovak Law no. 203/2011 Col. on Collective Investment (hereinafter as 'Slovak Law') some changes might be expected.

[213] Abbreviation of the 'Joint European Resources for Micro to Medium Enterprises', a joint initiative launched by the European Commission. In Slovakia it has been implemented via *Slovenský záručný a rozvojový fond, s.r.o.* For more information look: http://www.szrf.sk/en/home-page.

[214] More information can be found in the leaflets and documents dealing with the JEREMIE initiative: http://www.szrf.sk/_img/Contents/JEREMIE_leaflet_EN.pdf.

[215] Adam Hodoň, Martin Vojtko, *'Slovakia'* in Charles Martin, Simon Perry (ed.), *'Private equity: Jurisdictional comparisons*', (London:Sweet & Maxwell, 2nd ed. 2014), p. 383.

[216] Ibid. p. 384.

[217] Ibid.

In order to understand the problem of private equity industry in Slovakia, it is necessary to provide a description of the Slovak law on Collective Investment and its amendments. Even though uncommon, the subsequent subchapters will describe the possibilities of structuring the private equity funds in Slovakia and compare the current regulation with the one described in the previous chapter. Finally, the author's suggestions for improvement will be provided.

4.2. The Slovak Law on Collective Investments

As opposed to the Grand Duchy of Luxembourg, where collective investment schemes are complexly regulated by more laws and by accepting the distinction between traditional UCITS funds and non-UCITS – alternative investment funds, Slovak Law no. 203/2011 Col. on Collective Investment (hereinafter as 'Slovak Law') does not clearly follow the distinction between alternative investment funds and undertakings in transferable securities. Neither it follows the distinction between classical UCITS fund and qualified investors or non-UCITS funds, as it is followed by the Czech Republic[218]. The Slovak law on collective investment is still much more a classical law for asset management companies[219], while other types of funds – qualified investors funds and alternative investment funds, are being regulated only partially.

In order to discuss the potential regulation and structuring of private equity companies, it is necessary to place them within the context of the Slovak law. Therefore, it is necessary to analyse the three key terms: (1) local subject of collective investment (*tuzemský subjekt*

[218] The reference to the law of Czech Republic is provided due to the traditionally close relations between these two jurisdictions. The Czech law no. 240/2013 Col. on investment companies and investment funds, provides much more complex regulation of so-called funds of qualified investors in the separate part of the law.

[219] *See* Christel M. Grundmann-van de Krol *'The Markets in Financial Instruments Directive and Asset Management'* in Danny Busch and Deborah A. DeMott (eds.), *'Liability of Asset Managers'* (Oxford University Press, 2012), p. 25-26.

kolektvneho investovania)[220]; (2) funds of qualified investors (*fondy kvalifikovaných investorov)*[221]; and (3) alternative investment fund (*alternatívny investičný fond)*[222].

The local subjects of collective investment may be divided into three categories: 'a) share fund *(podielový fond);* b) investment fund with variable capital *(investičný fond s premenlivým kapitálom);* c) other local subject of collective investment with legal personality, which is business corporation or cooperative with the registered seat in Slovak republic, which collects the money from more investors with the purpose of their investment in accordance with the defined investment policy on behalf of those investors (*iný tuzemský subjekt kolektívneho investovania s právnou subjektivitou, ktorým je obchodná spoločnosť alebo družstvo so sídlom na území Slovenskej republiky, ktoré zhromažďujú peňažné prostriedky od viacerých investorov s cieľom investovať ich v súlade s vymedzenou investičnou politikou v prospech týchto investorov). '*[223] While the share fund is a subject without legal personality[224], the investment fund with variable capital and other local subjects of collective investments do have legal personalities and are subject to the law no. 513/1991 Col. Commercial code.

The term fund of qualified investors[225] is defined as special fund of qualified investors and local subject of collective investment according to §4 (2) (c) – as defined above.

Finally, the term alternative investment fund[226] only enumerates the two types of AIF, which are public special funds and funds of qualified investors. This enumeration clearly considers funds of qualified investors as alternative investment funds.

[220] § 4 (2) of the Law no. 203/2011 Col. on Collective Investment.

[221] § 4 (4) of the Law no. 203/2011 Col. on Collective Investment.

[222] § 4 (12) of the Law no. 203/2011 Col. on Collective Investment.

[223] § 4 (2) of the Law no. 203/2011 Col. on Collective Investment.

[224] § 5 (2) of Slovak Law no. 203/2011 Col. on collective investment.

[225] § 4 (4) of Slovak Law no. 203/2011 Col. on collective investment.

[226] § 4 (12) of Slovak Law no. 203/2011 Col. on collective investment.

Slovak law requires that the alternative investment funds, and thus funds of qualified investors, will be managed by the manager who is authorized in accordance with the AIFM Directive. However, the managers who do not meet threshold conditions for the amount of money under management, are not required for the authorization, but rather they are required to be registered into the registry of the managers of alternative investment funds[227] held by the National Bank of Slovakia. This exception, however does not apply to the managers of public special funds and special funds of qualified investors, which need to be authorized. This distinction thus follows the difference between below and above threshold AIFM set by the AIFM Directive[228].

Irrespective that the registration of managers of alternative investment funds is a simple procedure, conditioned only by the payment of a small fee, very few of subjects have become registered as AIF managers[229].

While Slovak law does not provide a comprehensive regulation of funds of qualified investors, it provides a regulation of special investment funds[230]. Special investment funds are type of alternative investment funds, and Slovak law specifically regulates public special investment funds and special funds of qualified investors. Both types of funds can be managed only by the manager who is fully authorized in accordance with the AIFM directive, as the exception for below threshold managers is not applicable. It is necessary to mention that due to lack of regulation, or even practice commentaries it is not certain where lies the difference between 'funds of qualified investors' and 'special funds of qualified investors'. One may however argue that due to lack of regulation 'funds of qualified investors' are left unregulated.

[227] § 31a of Slovak Law no. 203/2011 Col. on collective investment

[228] van Setten, Busch (ed.) (n 75), p. 21.

[229] As of 26th March 2018, only 7 subjects were registered as alternative investment fund managers. For more information: https://regfap.nbs.sk/regsaif/zoznam.

[230] § 136 of the Law no. 203/2011 Col. on collective investment

As some commentators argue, the private equity funds in Slovakia, 'would likely take the form of alternative investment funds; in particular, the special qualified investors fund managed by the alternative fund manager.'[231] It can be argued that the implementation of AIFMD[232] into the Slovak law introduced the possibilities of structuring the private equity companies. Moreover, the amendment of Slovak law on collective investment introduced the Luxembourg-inspired transposition of SICAV (*akciová spoločnosť s premenlivým kapitálom),* which can be also used in structuring alternative investment funds and private equity[233].

4.3. The Possibilities of Structuring Private Equity in Slovakia

Implementation of Alternative Investment Fund Managers Directive into Slovak regulatory framework introduced the possibilities of structuring of alternative investment funds, and in conclusion also private equity funds in two ways, as: 1) alternative investment funds managed by above-threshold authorized AIFM;[234] and 2) alternative investment funds managed by subthreshold registered AIFM.[235] These two different possibilities however set different requirement for the authorized and registered manager.

[231] Martin, Perry (ed.) (n 215), p. 384.

[232] Ministry of Finance of Slovak republic, National Bank of Slovakia, *'Consultancy material to implementation of AIFM Directive'*. Available online: https://www.nbs.sk/_img/Documents/_Dohlad/ORM/RegulaciaTrhov/Konzultacny_material_MFSR_a_NBS_k_implmentacii_AIFMD.pdf

[233] § 26d of the law 203/2011 col. on collective investment.

[234] § 28a of the law 203/2011 col. on collective investment.

[235] § 31a of the law 203/2011 col. on Collective Investment.

4.3.1. Private Equity Managed by the Registered AIFM

Setting up a private equity company managed by the registered AIFM follows the exception from the application of AIFMD for so-called below threshold managers[236]. In case of external management, the law follows the distinction between alternative investment fund manager, who might be set up as a commercial company in one of the available corporate forms according to law 513/1991 Col. Commercial code, and alternative investment fund, which might be set up in accordance with the Commercial code and Law on Collective investment also as a commercial company[237].

According to registry held by the National Bank of Slovakia[238], most of the managers and funds are set up either in form of limited liability company (*spoločnosť s ručením obmedzeným)* or joint stock company (*akciová spoločnosť).*

Apart from externally managed funds, law allows also internally managed (self-managed) alternative investment funds. According to the registrar[239] of National Bank of Slovakia, there are currently four internally managed alternative investment funds, while two are being set in the form of joint stock company with variable capital (*akciová spoločnosť s premenlivým kapitálom*).

[236] van Setten, Busch (ed.) (n 75), p. 21.

[237] Registered alternative investment fund manager however, cannot manage the joint stock company with variable capital, which implies from the § 31b of the law 203/2011 col. on Collective investment.

[238] *See* Registrar of managers of alternative investment funds held by the National Bank of Slovakia: https://regfap.nbs.sk/regsaif/zoznam.

[239] *See* Registrar of managers of alternative investment funds held by the National Bank of Slovakia: https://regfap.nbs.sk/regsaif/zoznam.

4.3.2. Private Equity Managed by the Authorized AIFM and the Management of Special Funds of Qualified Investors

According to Law, an authorized AIFM can be only set up in a form of joint-stock company, with minimum capital 125 000€[240]. In case of internally managed authorized AIFM, the minimum capital has to be 300 000€.[241] In comparison with the Luxembourg law, and also with the registered AIFM in Slovakia, this can be seen as a certain limitation in selecting the corporate form. However, one may argue that the rationale beyond this requirement are stricter regulation of governance of joint stock companies, than for instance limited liability companies.

After authorization process is done by the National Bank of Slovakia, the AIFM can fully benefit from the EU marketing passport and thus market its funds not only in Slovakia but also in other Member states of the EU.

As it was already mentioned, the one of the possible ways of structuring private equity companies is by setting up special funds of qualified investors[242], which are regulated by law on Collective investment and a special approval of National Bank of Slovakia is necessary[243]. The special funds of qualified investors are limited only to the professional investors, and investors who invests at least 50 000€.[244]

The marketing of these funds is allowed only by the private offer. Public offering of the funds is forbidden with exception for the investment company with variable capital.

[240] § 47 of the law 203/2011 col. on Collective Investments.

[241] § 26c of the law 203/2011 col. on Collective Investments.

[242] Martin, Perry (ed.) (n 215), p. 384.

[243] § 137 of Slovak Law no. 203/2011 Col. on Collective Investments.

[244] § 136 of Slovak Law no. 203/2011 Col. on Collective Investments.

4.3.3. Investment Fund with Variable Capital

Investment fund with variable capital is in Slovak law regulated in two laws, however with different name pointing out to the same thing. At first the general regulatory framework is set in the Commercial Code, where it is regulated as a specific form of joint stock company named joint stock company with variable capital (*akciová spoločnosť s premenlivým kapitálom*). The commercial code however, explicitly says that joint stock company with variable capital can be set up only for the purposes of collective investment. Secondly, the specific regulation is provided in the law on collective investment, where it is named differently as investment fund with variable capital (*investičný fond s premenlivým kapitálom*), or notoriously, SICAV[245].

According to the explanatory note to the amendment of the Law the introduction of SICAV should develop the potential of collective investment similarly as in other EU states[246]. As opposed to Luxembourg, where SICAV can be set up in various corporate forms, according to Slovak Law it can be set up only in a form of joint stock company[247].

When set up as an investment fund managed by an external AIFMD, SICAV has to be set up with the minimum capital of 125 000€, which is entered into the business registrar. On the other hand, the internally managed SICAV has to be incorporated with the minimum capital 300 000€. The minimum capital is being referenced to as a 'written basic capital' (*zapisované základné imanie).* The articles of incorporation set out the maximum basic capital, which also set the limit of highest number of shares the SICAV can issue. Above this written basic capital,

[245] The term SICAV is being notoriously used in the public debate, even explanatory note to the amendment of the law used the term SICAV, therefore it is used here as well.

[246] Apart from Luxembourg, SICAV has been used in Czech republic, Germany, France

[247] 26d of law no. 203/2011 col. on Collective Investments.

SICAV may issue shares only in accordance with the public offer[248]. SICAV thus represent an open-end collective investment vehicle.

Apart from regular activities of subject of the collective investment, main advantage of SICAV is that it can be structured into different compartments (sub-funds). Similarly, as for Luxembourg' SICAV, each compartment represents a separated accounting of its assets and liabilities[249], which has to differ from each other by certain criteria[250]. It is expected that this legal possibility will allow creating the umbrella structure, which will consist of the different compartments in accordance with different investment strategies, or different investment goals.

Due to inflexibility of Slovak corporate law, the problem with governance of SICAV, in case when managed by the external AIFM, is even more acute than in Luxembourg. This is due to the fact that the Slovak SICAV has to be structured in accordance provisions of Commercial code on joint stock company. As oppose to some other jurisdictions, Slovak law does not distinguish between monist and dualist form of joint stock company[251], only know the later. That means that the mutual relations of the manager and the fund will be affected by the decisions of mandatory corporate bodies of both manager and the SICAV. Therefore, even due to the fact that the relation between manager and the SICAV (as a fund) will be governed by the contract set out in the law on collective investment, it is likely that due to the lack of case law and best practices of industry, the confusion of what should corporate bodies of the SICAV do, will arise.

[248] §220c of law no. 513/1991 Col. Commercial code.

[249] § 26e of law no. 203/2011 col. on Collective investments.

[250] § 26e of law no. 203/2011 Col. on Collective investments.

[251] The distinction between monist and dualist joint stock company was enacted in to the Czech law on Commercial companies, with the aim to simplify the internal governance of the joint stock company. While the dualist system has usually two obligatory bodies (board of Directors and Supervisory board), the monist system is characteristic with one executive body. *see 'Explanatory Note to the Adoption of Czech Law on Commercial Companies'*, available online: http://obcanskyzakonik.justice.cz/images/pdf/Duvodova-zprava-k-ZOK.pdf.

Having said that, one may argue that the SICAV was a good move for improvement of the collective investment industry, however *pro futuro* more complex reform of the company law might be useful.

4.4. Comparison with the Grand Duchy Luxembourg: What can Slovakia Learn?

The discussions above on the impact and necessity of the alternative investment fund managers vary among the commentators.[252] While some say that AIFMD represents a big step towards harmonized regulation,[253] other claim that it was unnecessary.[254] However, it might be argued that in the context of emerging capital markets, the implementation of the AIFMD was a good incentive to steer the regulation of private equity industry, also in the countries like Slovakia.

The Grand Duchy of Luxembourg has a long tradition of regulation of the alternative investment funds, including private equity, which has preceded the adoption of the EU AIFM Directive[255]. This tradition can be particularly seen in its complex regulatory framework, which development was also driven by the present private equity industry. Therefore, it can be noticed that the Luxembourg regulatory framework not only distinguishes between traditional UCITS and non-UCITS (alternative investment funds) schemes, but moreover, it offers specific laws, which aim is to fulfil the desires of private equity industry.

On the other hand, Slovakia does not have a tradition of regulating the alternative investment funds, including private equity. This is especially because Slovakia has for more than forty years been a socialist command economy, and during subsequent transition to market

[252] *See* Seretakis (n 84).

[253] *See* Payne (n 32).

[254] *See* Seretakis (n 84).

[255] *See* Kremer, Lebbe (n 63).

economy, thinking about complex regulation of alternative investment funds was not a primary issue. However, with the progressing transition and accession to the EU, Slovakia consecutively adopted its law on Collective Investments and after implementation of UCITS Directive, subsequent implementation of AIFM Directive occurred as well.

From this short historical exposure, it can be seen that while Luxembourg enacted its laws relating to the collective investment schemes and alternative investment funds by its own initiative and by the demands of the industry, with certain exaggeration it can be said that Slovakia did it because it had to transpose the EU Directives.

Therefore, despite the implementation of the AIFM Directive in its laws, Slovakia still can improve its regulatory framework relating to private equity industry and inspiration by the regulatory framework of Luxembourg might serve this purpose. The juxtaposition of the regulatory frameworks described in Chapter III and currently in Chapter IV hints that improvement of Slovak legal framework might occur in both laws relating to the regulation of private equity: law on Collective Investments, as well as Commercial code dealing with the company laws.

As far as the improvement of the law on Collective Investments goes, certainly the better distinction and differentiation between traditional UCITS schemes and alternative investment funds might be beneficial for the industry. As it was already mentioned, Slovak law on Collective Investments is rather amended traditional UCITS law, with predominant focus on asset management companies. Moreover, certain specifics of alternative investment funds, especially in relation to private equity are not present.

This improvement might occur in two ways. Either by enacting separate law which would deal solely with the alternative investment funds and its managers, or by enacting new law on collective investments, which would take into consideration the differences between the

two types of the investment funds and perhaps deal with them in the separate chapters. As can be seen from the Luxembourg, alternative investment funds are regulated in two separate laws (AIFM and RAIF), while its presence can be seen also in the specific laws such as SIF and SICAR. The approach of regulation both UCITS and AIF in one law can be seen, for instance in the Law on investment companies and investment funds in Czech Republic.

Regulation of private equity investments is inherently connected with the available corporate forms, in a particular, legal framework. In this context, the flexibility of structuring private equity funds in accordance Luxembourg law might be hailed. The best example for this can be the comparison of the both forms of SICAV. While in Luxembourg the SICAV is not limited by the certain corporate form[256], in Slovakia the incorporation is restricted solely to the joint stock company[257]. *Pro futuro* it would be more beneficial if the structuring of the SICAV was also possible in the corporate form similar to Luxembourg (SCA) *société commandite par actions.* The reason for this recommendation is that the SICAV in the form of SCA can be formed by authorized/registered manager, who will be the general partner of the SCA and investors who would be limited partners. Structuring of PE fund in the form of SCA would create a clearer governance organization as the rights of general partner and limited partners are regulated by separate statutes, usually law on Commercial companies.

Another thing that the potential new legislation should definitely contain, is not only the increased flexibility of structuring of private equity schemes, but also more flexibility in structuring the management of private equity funds. As a deficiency of the current Slovak law can be considered the fact that the authorized manager of alternative investment fund can be only incorporated in the form of joint stock company. This shows that the legislator did not

[256] Article 25 of the law of 13 February 2007 on Specialized Investment Funds.

[257] According to §26d of law no. 203/2011 col. on Collective Investments and §220b of the law 513/1991 col. Commercial code.

think about the differences between traditional UCITS and AIFs and did not allow more flexibility. As most of the registered subthreshold managers of alternative investment funds are incorporated in the form of limited liability company, this change might be welcome also for authorized managers.

Finally, the Grand Duchy of Luxembourg is well-known, well-established legal environment for the investors. This perception stems not only from the business-friendly attitude of the national regulator, but also in favourable tax incentives for the investment funds, and overall policy approach towards regulation of investment funds. Therefore, if Slovakia wants to improve its regulatory framework of the alternative investment fund, in order to attract more investors, it should also think about the regulation more holistically. Earning a trust takes years and sometimes even decades and enactment of the new laws might not be enough, however it might be a good precondition from the benefiting of private equity industry in the future.

Conclusion

The main aim of this thesis was to analyse the regulatory framework of private equity in the European Union by comparing the jurisdictions of Luxembourg and Slovakia. After introduction to the functioning of the private equity industry in Chapter I and describing the common regulatory framework of the EU set by the AIFMD in Chapter II, the complex legal environment of the Luxembourg (in Chapter III) was described and subsequently juxtaposed with the regulatory framework of Slovakia (Chapter IV). The outcome of this comparison showed not only the lacunas of Slovak legal framework, but also inspiration for further development. In particular, better distinction between regulation of alternative investment funds and traditional UCITS schemes, increasing the flexibility of structuring private equity vehicles, including the reform of the company law have the potential to help Slovakia to improve its legal framework and increase its attractiveness for the private equity industry.

The analysis of the EU approach shows the existence of the two-tier level of regulation of private equity. While on the EU level, AIFMD set the minimum requirements for the managers of private equity, it is still the member states who have the competence to adopt laws, which would specifically target the structuring of private equity companies.

Apart from these legal nuances, private equity has to be put in a broader context. This is because private equity forms an inherent part of the promoting of the economic growth in the free trade economies. The positive effect of private equity investments was noticed also by European Commission, which introduced the policies and initiatives for promoting the competitiveness of SMEs by venture capital and private equity. This shows that the industry, which was at first the domain of the private investors and private sector finds its importance also in the public sector, as well.

Moreover, the economic importance of private equity together with the harmonization of the common regulatory framework on the EU level can be perceived as necessary preconditions, which will enhance the creation of the common Capital Market Union.[258]

Despite the attempt to provide as complete analysis of the regulation of the private equity, as possible, the amount of the materia was way beyond the possibilities of this thesis. This conclusion, however, points out to some issues for further research.

Firstly, the regulation concerning private equity on the EU level is much broader than it was possible to describe. Apart from AIFM Directive, which set to harmonize minimum requirements for alternative investment fund managers, three more regulations were adopted concerning the subthreshold AIFs:

1. The regulation 343/2013 on European Venture capital funds (EUVECA)[259];
2. The regulation 345/2013 on European social entrepreneur's funds (EuSEF)[260];
3. The regulation 760/2015 on European long-term investment funds (ELTIF)[261].

All these three regulations provide a simplified access to the common European market for the subthreshold alternative investment funds. Due to their direct effect it will be interesting to observe how these regulations will actually work in practice and how will the member states cope with them.

Based on the findings of this thesis, it is clear that the second issue that is worth of the further research is the soon-to-be created capital market union, where alternative investment funds, including private equity, will play a major role in promoting the economic growth.

[258] Burn (n 2), p. 385.

[259] Regulation 343/2013 on European Venture Capital Funds (EUVECA) [2013] OJ L 115.

[260] Regulation 345/2013 on European Social Entrepreneur's Funds (EUSEF) [2013] OJ L 115.

[261] Regulation 760/2015 on European Long-term Investment Funds (ELTIF) [2015] OJ L 123

In addition to that it will be interesting to see, how will the new and perhaps still emerging countries like Slovakia adopt to these changing circumstances. While the Luxembourg will probably keep its position as a stable and business friendly regulatory framework for the private equity industry, it is up to Slovakia how it will develop and adjust in the future. Hopefully, recommendations of this thesis have the potential to improve its regulatory framework and increase the attractiveness of the private equity industry.

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4. Invest Europe, 2016 European Private equity Activity : Statistics on fundraising investments & Divestments, 2017. Data available online at: https://www.investeurope.eu/media/651727/invest-europe-2016-european-private-equity-activity-final.pdf .

5. Information about this investment was found on the webpage of the Neulogy ventures, a Slovak private equity firm: http://www.neulogy.vc/rf-elements.

6. *'Explanatory Note to the Adoption of Czech Law on Commercial Companies'*, available online: http://obcanskyzakonik.justice.cz/images/pdf/Duvodova-zprava-k-ZOK.pdf.

7. Ministry of Finance of Slovak republic, National Bank of Slovakia, *'Consultancy material to implementation of AIFM Directive'*. Available online: https://www.nbs.sk/_img/Documents/_Dohlad/ORM/RegulaciaTrhov/Konzultacny_material_MFSR_a_NBS_k_implmentacii_AIFMD.pdf

8. 'Joint European Resources for Micro to Medium Enterprises', a joint initiative launched by the European Commission. In Slovakia it has been implemented via *Slovenský záručný a rozvojový fond, s.r.o.* For more information look: http://www.szrf.sk/en/home-page.