FINANCE - MARKETS

SPECIAL PURPOSE ENTITIES

FDI declines in Luxembourg as SPEs withdraw investments

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Multinational companies are moving away from using Luxembourg special purpose entities (SPEs), leading to a decline in the country's contribution to euro area FDI assets and liabilities, data from the European Central Banks shows. Photo: Shutterstock

Over the past four years, Luxembourg has experienced a notable decline in the value of SPE-related external assets and liabilities, indicating a shift in multinational investment strategies.

Luxembourg's financial sector is witnessing significant changes as special purpose entitiy-related foreign direct investments move out. Q4 2023 saw the largest withdrawals, according to data from the European Central Bank, reflecting broader adjustments in multinational operational strategies.

Understanding SPEs

In technical terms, SPEs are legal entities established in a country where they conduct minimal to no business activities. They often lack substantial employment, physical presence or production capacity. Multinational enterprises frequently create SPEs to take advantage of specific benefits offered by the host country, such as channelling investments, managing risks and optimising tax structures. Even companies with a substantial presence in the country could create an SPE for investment management or tax reasons.

Destination Luxembourg

Luxembourg, in particular, boasts a favourable environment for financial services, including asset management, banking and investment activities, which cements its status as a global financial hub. Historically, SPEs in Luxembourg have played a significant role in the country's financial sector.

As of the end of 2023, SPEs accounted for 22% of Luxembourg's external assets and liabilities, according to data from the ECB. This figure is twice the euro area average of around 11%, but notably lower than Malta's 86% and Cyprus's 72%. In Ireland, SPEs represent almost 10% of external assets and liabilities. However, despite their past prominence, there has been a gradual decline in the activities of SPEs in the grand duchy over the past years.

Foreign direct investments

SPEs, often established by multinational companies, significantly impact foreign direct investment data, reflecting multinational cross-border financial linkages such as equity investments in foreign subsidiaries or intragroup loans. By the end of 2023, SPEs represented over one-quarter of both euro area FDI assets and liabilities.

In Luxembourg, SPEs were responsible for almost 54% of FDI assets and liabilities, second only to Cyprus at about 80%, and followed by the Netherlands at about 32%. In contrast, in Ireland, SPEs play a minor role in FDI due to the presence of foreign multinationals that establish entities with some level of employment and production in the host economy, thus not accounted under the SPE definition.

Despite not directly contributing to employment or physical production, SPEs indirectly support jobs in ancillary sectors such as finance, legal services and consulting. This highlights the broader economic impact of financial activities facilitated by SPEs, for example in Luxembourg.

However, over the past four years, there has been a noticeable decrease in the value of external assets and liabilities held by SPEs in the euro area, including Luxembourg.

Negative transactions in FDI in Luxembourg, totalling over €700bn in assets and liabilities between 2020 and 2023, such as foreign investors withdrawing equity or repaying loans, have contributed to this trend. Q4 2023 alone saw a decrease of €163.44bn in asset value and €141.79bn in liabilities, marking the largest decline in the last 16 quarters for which data is available. This suggests that multinationals are adjusting their global operations, particularly by reducing their use of SPEs in euro area countries.

In contrast, some member states, such as Malta and Ireland, have benefited from positive movements.

Overall, multinationals and foreign investors are reducing their use of SPEs in euro area countries, with Luxembourg seemingly experiencing a larger impact.

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