

Asset Management & Investment Funds Update

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ELTIF Enhancements En Route

The regulation on the European Long-Term Investment Fund (ELTIF) of the European Union (EU) entered into force in 2015. A long-term investment fund is a fund that invests in the real economy (such as financing for SMEs) and real assets (such as infrastructure projects and real estate). While having the advantage of a harmonised alternative investment fund (AIF) product with a retail passport, the ELTIF nonetheless has had only limited take-up to date. The original ELTIF regulation had a range of shortcomings and portfolio constraints that resulted in the product being of limited appeal and utility for fund sponsors.

Following a Commission review, a number of important enhancements have been made to the ELTIF regulation. These reforms, to take effect in January/February 2024, herald a brighter future for the ETIF.

The principal strands of reform include:

- Expansion of the range of eligible assets
- Relaxation of portfolio composition and diversification restrictions
- Removal of barriers to retail investor access

Expansion of eligible assets

An ELTIF will be permitted to invest in:

- a global investment universe as the reforms will permit investment in assets located in non-EU countries
- financial products that have (taxonomy-aligned) sustainable investments as their objective in accordance with Article 9 of the SFDR
- fintech companies dealing with digital financial services
- green bonds
- securitised assets with an “STS-label” under Regulation (EU) 2017/2402, e.g. mortgage-backed securities
- EU AIFs and other ELTIFs

- eligible publicly listed qualifying companies with a market capitalisation of up to €2 billion (previously the market capitalisation limit was up to €500 million).

In addition, the definition of “real asset” has been simplified and it will no longer be necessary for real assets to be held directly or via a qualifying portfolio company. These changes will make it easier for an ELTIF to pursue a strategy of investing in real assets such as infrastructure and real estate.

Relaxation of portfolio composition and diversification requirements

The reforms will give ELTIF managers more flexibility when constructing an ELTIF's portfolio of assets:

- The minimum percentage of capital that an ELTIF must invest in eligible assets will be reduced to 55% while the cap on investment in an individual eligible asset will be increased to 20% of the ELTIF's capital. In addition, the minimum permitted investment in real assets has been reduced from €10 million to €1 million. The limit that applies to investment in debt instruments issued by, or loans granted to, a single qualifying entity has been raised to 20%.
- Many of the ELTIF portfolio composition, diversification and concentration rules (save for the 55% minimum investment in eligible assets) will no longer apply to ELTIFs marketed solely to professional investors.
- An ELTIF will have the ability to co-invest with other funds and/or accounts managed by the same investment manager and will also be able to pursue fund-of-funds investment strategies and be established as a feeder fund feeding into an ELTIF master fund. The ability to set up ELTIF fund-of-funds will mean that retail investors may be granted indirect exposure to EU AIFs.
- Previously a leverage limit of 30% of an ELTIF's capital applied. Under the reform of the ELTIF, new leverage limits will be introduced being 50% of the capital of an ELTIF marketed to retail investors, and 100% of the capital of an ELTIF marketed to professional investors only. ELTIFs will also be allowed to use leverage to finance loans.

Removal of barriers to retail investor access to ELTIFs

The ELTIF may be marketed to retail investors in Europe under a specific marketing passport regime. A key emphasis of the reforms is therefore to enhance the accessibility of ELTIFs for retail investors. Notable changes here include:

- Currently, retail investors in an ELTIF are required to have liquid investments worth at least €100,000 and are also subject to a minimum initial investment requirement of €10,000 in a single ELTIF. Both of these requirements will be removed.
- Distribution of the ELTIF to retail investors will be less cumbersome as: (a) AIFMs directly marketing ELTIFs to retail investors will no longer need have a top-up MiFID "investment advice" authorisation (b) the ELTIF product governance and suitability rules will be aligned with MiFID II; and (c) it will no longer be necessary to have local facilities in each Member State where the ELTIF is marketed to retail investors. As such, it will be possible for an ELTIF and its AIFM to be domiciled in different Member States.

Next Steps

It is widely anticipated that the reform of the ELTIF will provide a much more flexible and attractive long-term investing AIF vehicle for retail distribution. It is likely to support the trend of retailisation of private markets that has emerged in recent years.

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