

## **The European Long-Term Investment Fund ("ELTIF") Regulation in a nutshell**

On 20 April 2015, the Council formally approved a new regulation which was published in the Official Journal of the European Union on 19 May 2015 (the "[Regulation](#)") aiming at increasing the pool of capital available for long-term financing in the European real economy by creating a new European investment fund vehicle appealing to investors such as insurance companies or pension funds which need steady income streams or long-term capital growth. The ELTIF project was announced by the EU Commission back in October 2012 in the Single Market Act II communication and in the Green Paper on Long-Term Financing of the European Economy. The main features of ELTIFs are described below:

### **A European Label:**

An ELTIF is a "hybrid" concept lying somewhere between the AIFM and the UCITS worlds as it can invest in illiquid assets but also offers to AIFMs an EU passport for marketing to retail investors.

Only EU managers authorised as AIFMs under the AIFMD<sup>1</sup> may manage and market ELTIFs. Similarly, only EU AIFs can qualify for the ELTIF label. Therefore an ELTIF and its AIFM will need to comply with the AIFMD requirements (such as the appointment of a depositary).

An ELTIF must be authorised by the national competent authorities and its AIFM must also be specifically authorised to manage ELTIFs. ELTIFs are also conceived as investment vehicles through which the European Investment Bank (EIB) Group can channel its European infrastructure or SME financing.

### **ELTIF Eligible Assets: Alternative Long-Term Assets:**

At least 70% of the ELTIF's capital has to be invested in "eligible investment assets" although ELTIFs will have up to five years after their authorisation as ELTIF to reach this target or half the life of the ELTIF, whichever is the earlier.

The following are eligible investment assets:

- equity/quasi-equity instruments, debt instruments issued by a qualifying portfolio undertakings.<sup>2</sup>

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<sup>1</sup> The Directive 2011/61/EU on Alternative Investment Fund Manager

<sup>2</sup> A qualifying portfolio undertaking must fulfil certain criteria; among others (i) it must not be a financial institution (ii) it must not be admitted to trading on a regulated market or on a multilateral trading facility except if at the same time it has a market capitalisation of less than EUR 500 million (iii) it is established in a Member State or in a third country which is not a high-risk and non-cooperative jurisdiction identified by the financial task force and it has signed an agreement with the home Member State of the AIFM of the ELTIF and in Member States where the units or shares (hereafter referred to as "units") of the ELTIF are intended to be marketed to ensure that this third country fully complies with the standards of Article 26 of the OECD Model Tax Convention on Income and on Capital and ensures an effective exchange of information.

- loans granted to qualifying portfolio undertakings not exceeding the life of the ELTIF under certain restrictive conditions;
- direct or indirect holdings of real assets with a value of at least EUR 10 million that generate an economic and social benefit. These assets include (i) infrastructure (ii) intellectual property (iii) vessels and aircraft, (iv) equipment and machinery and (v) others such as rolling stock or immovable property meeting certain criteria.
- units of ELTIFs, EUSEFs<sup>3</sup> and EUVECAs<sup>4</sup> which do not themselves invest more than 10% of their capital in ELTIFs.

The assets do not necessarily have to be European as originally foreseen in the draft Regulation. ELTIF investments are subject to strict risk diversification rules.

### **"Ancillary" UCITS Eligible Liquid Assets:**

Up to 30% of the capital of the ELTIF can be held in assets that would be eligible investments for a UCITS (with the exception of financial derivatives which can only be used for hedging purposes). These assets are also subject to strict risk diversification principles.

### **Prohibited Investments and restriction on leverage:**

To limit speculative activities, ELTIFs are prohibited from using various types of investment techniques, in particular those creating leverage. Hence, they cannot (i) enter into short selling, (ii) take direct and indirect exposure to commodities, (iii) enter into financial techniques and instruments (such as securities lending, securities borrowing or repurchase transactions) if they affect more than 10% of the ELTIF's assets and (iv) use financial derivatives that do not serve the purpose of hedging risks inherent in other investments of the ELTIF.

Borrowing of cash above 30% of the value of the capital of the ELTIF is also prohibited.

### **Legal Form:**

They may have any legal form available in their home jurisdiction.

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<sup>3</sup> According to Regulation (EU) No 346/2013 of the European Parliament and of the Council of 17 April 2013 on European social entrepreneurship funds

<sup>4</sup> According to Regulation (EU) No 345/2013 of the European Parliament and of the Council of 17 April 2013 on European venture capital funds

### **Redemption Policy:**

The ELTIFs constitutive documents must specify a date for the end of the life of the ELTIF. Its life must be consistent with the long-term nature of the ELTIF and should be sufficient in length to cover the life-cycle of each individual asset in its portfolio<sup>5</sup>. Therefore, the ELTIF would run for a specified period of time, during which investors will not in principle, have the right to redeem their holding. However, by way of derogation redemptions may be allowed before the end of the life of the ELTIF to the extent that the liquidity of the assets of the portfolio (i) is in line with the redemption policy and (ii) is adequately managed.

The liquidity of ELTIFs may also be ensured by the trading of their units on a regulated market or multilateral trading facility.

### **Distribution of proceeds and capital:**

ELTIFs may regularly distribute to their investors the proceeds generated by the assets contained in their portfolio which comprise proceeds that assets are regularly producing and capital appreciation realised after the disposal of assets.

### **Transparency:**

A prospectus which shall include all information necessary to enable investors to make an informed assessment regarding the proposed investment and the risks attached thereto must be published by ELTIFs before they can market their units. This prospectus must contain minimum listed information and in particular the information which must be disclosed by closed-ended funds in accordance with the Prospectus Directive<sup>6</sup> and the information which must be disclosed under Article 23 of the AIFMD (if not already covered under the Prospectus Directive). In addition, ELTIFs must publish annual reports.

### **Passport:**

ELTIFs may be marketed in the European Union to professional investors but also, and this is a revolutionary concept in the AIFMD environment, to retail investors in compliance with Articles 31 and 32 of the AIFMD.

If the financial instrument portfolio (as defined in the Regulation) of a potential retail investor does not exceed EUR 500,000 the AIFM or any distributor shall ensure that this investor does not invest an aggregate amount exceeding 10% of that investor's financial instrument portfolio in ELTIFs and that the initial minimum amount invested in one or more ELTIFs is EUR 10,000. Retail investors are responsible for providing accurate information on their patrimonial situations.

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<sup>5</sup> ESMA will develop draft regulatory technical standards, which shall be submitted to the European Commission by 9 September 2015, specifying the circumstances in which the life of an ELTIF is considered sufficient to cover the life-cycle of each of its individual assets.

<sup>6</sup> The Directive 2003/71/EC on the prospectus to be published when securities are offered to the public or admitted to trading and amending Directive 2001/34/EC.

### **Specific provisions concerning ELTIFs marketed to retail investors:**

ELTIFs marketed to retail investors will benefit from additional protection features and additional conditions are applicable to the AIFM and the depositaries which, amongst others, are the following:

- the **AIFM** shall put in place facilities available to investors for making subscriptions, repurchasing or redeeming units of the ELTIF and providing them with relevant information;
- the AIFM may directly offer or place units of the ELTIF to retail investors only if it is authorised to provide discretionary management services (i.e. it has the so-called MIFID extension licence) in accordance with Article 6.4 of the AIFMD.
- retail investors are provided with appropriate investment advice from the AIFM (provided it has the extension licence mentioned above) or the distributor.
- the AIFM shall have performed a suitability test for each retail investor in accordance with the Regulation;
- a **depositary** compliant with Article 23.2. of UCITS Directive<sup>7</sup> (as it will be amended by the so-called UCITS V Directive<sup>8</sup>) must be appointed;
- no right to re-use the ELTIF assets (e.g. transfer, pledge, sale or lending of assets) must be granted unless it is for the account and benefit of the ELTIF;
- the depositaries will have no right to discharge or limit their liability in the event of a loss of financial instruments held in custody by a third party or for all other losses in the event of negligent or intentional failure to fulfil their obligations;
- the **legal form** of ELTIFs should not lead to any further liability for the investors or require any additional commitments on behalf of such investors apart from the original capital commitment;
- retail investors benefit from a **cancellation right** during the subscription period and at least two weeks after the date of their subscription, without penalty;
- additional information will need to be given to retail investors and preferential treatment or specific economic benefits granted to investors or groups of investors are prohibited;
- AIFMs of ELTIFs must implement a complaint handling policy;
- a PRIIPs<sup>9</sup>-compliant KID will need to be issued.

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<sup>7</sup> The Directive 2009/65/EC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) as regards depositary functions, remuneration policies and sanctions.

<sup>8</sup> The Directive 2014/91/EU amending UCITS Directive

<sup>9</sup> Packaged Retail Investment Product in accordance with EU Regulation 1286/2014

**Next steps:**

The Regulation will enter into force on the 20<sup>th</sup> day following its publication in the EU Official Journal, i.e. on 9 June 2015 and will be applicable 6 months thereafter, i.e. on 9 December 2015. As a regulation, the text will be directly applicable in all the Member States without the need for any implementing provisions. No gold-plating is allowed, Member States cannot add or remove any requirement in the Regulation.

ESMA will need to develop technical standards on several aspects of the Regulation such as (i) use of financial derivatives for hedging purposes, (ii) redemption policy and life of ELTIFs, (iii) disposal of assets, (iv) cost disclosure and (v) facilities available to investors. Further developments may also stem from the Capital Market Union Green Paper published by the EU Commission on 18 February 2015 and the consultation on the Prospectus Directive published the same day, in which the EU Commission encourages measures to boost the development of ELTIFs and to assess the relevance of the information to be published in their prospectuses.

**Luxembourg initiatives:**

In Luxembourg there are currently discussions on whether a law, decree, regulation or other type of publication should be put in place to position this new type of vehicle in the existing legal and regulatory UCI, AIFM and AIF framework.