AMIC DISCUSSION PAPER

Review of the European Long-Term Investment Fund (ELTIF) Regulation

January 2020

Introduction

The ELTIFs regulation, which entered into application on 9 December 2015, aimed at creating a new brand of fund available for both retail and professional investors to invest in long-term assets. Despite a favorable political context (i.e. Investment Plan for Europe and the Capital Markets Union) and the fact that the industry had welcomed this initiative, only a very limited number of ELTIFs were launched so far.

Among AMIC members, who oversee 17 trillion euros worth of assets including assets classes which could be eligible to ELTIFs, only two members have launched respectively one ELTIF fund. Given the slow development of this market, ESMA did not even set up the dedicated fund database initially required by the ELTIF regulation. With the Delegated Regulation only published on 23 March 2018, it can be easily understood why there were no immediate launches. But after nearly two years we have not noticed much progress.

We believe the need for investment into long-term assets has not decreased and that ELTIF should be instrumental for investment into small and medium-sized companies and infrastructures, including sustainability projects which are the priority of the new President of the European Commission. In this context, we believe that the review clause (June 2019) should be used to address perceived shortcomings of the ELTIF model and find possible ways to invigorate this label to the benefit of the European economy.

While remaining respectful of the need to provide the right degree of control to satisfy legitimate concerns, such as investor protection, we recommend considering the following points of improvement to facilitate the take-up of ELTIFs and significantly boost their contribution towards the financing of much needed longer-term investment.

Review clause: article 37 of the ELTIF regulation

1. No later than 9 June 2019, the Commission shall start a review of the application of this Regulation. The review shall analyse, in particular:
(a) the impact of Article 18;
(b) the impact on asset diversification of the application of the minimum threshold of 70 % of eligible investment assets laid down in Article 13(1);
(c) the extent to which ELTIFs are marketed in the Union, including whether AIFMs falling under Article 3(2) of Directive 2011/61/EU might have an interest in marketing ELTIFs;
(d) the extent to which the list of eligible assets and investments should be updated, as well as the diversification rules, portfolio composition and limits regarding the borrowing of cash.

2. Following the review referred to in paragraph 1 of this Article, and after consulting ESMA, the Commission shall submit to the European Parliament and to the Council a report assessing the contribution of this Regulation and of ELTIFs to the completion of the Capital Markets Union and to the achievement of the objectives set out in Article 1(2). The report shall be accompanied, where appropriate, by a legislative proposal.

AMIC's comments

1. **Eligible assets**:

The portfolio rules for ELTIFs state that at least 70% of the ELTIF's capital should be invested in "eligible investment assets" – i.e. long-term assets. Having both a restrictive definition of "eligible investment assets" and a high mandatory threshold certainly helps explain the little success enjoyed by the label so far. We believe the review should be used to explore the possibility to clarify and/or widen the list of "eligible investment assets".

The eligible investments must currently be in equity, debt or loan instruments issued by what are known as "qualifying portfolio undertakings", which include listed companies up to a **capitalisation of €500 million**. Given that the current average market capitalization on the MSCI Europe small cap index is $1.3 billion (€1.18 billion) it might be appropriate to raise this threshold.

Investment in other funds is presently restricted to ELTIFs, or into European Venture Capital Funds (EuVECAs) or European Social Entrepreneurship Funds (EuSEFs), up to 20% of the capital of the fund or up to 25% of the total units in this other fund, provided that they have not themselves invested more than 10% of their capital in ELTIFs. This has been criticised, as it restricts effective fund of funds solutions in these illiquid assets. During the portfolio build-up phase the ability to invest on a broader basis in funds other than ELTIFs, EuVECAs or EuSEFs would allow for a faster deployment of capital. Given the lack of these types of funds it could be relevant to extend the possibility to invest in other collective investment undertakings, like AIFs, that exclusively invest in eligible assets.

Eligible assets also include direct holdings of **"real assets",** so long as they provide a predictable stream of cashflows and have a value of more than €10 million, e.g. infrastructure or property. Real assets such as commercial property and housing are a key asset class in the European and global private fund market, but the subjective and potentially restrictive eligibility requirements in the ELTIF Regulation, combined with the current lack of guidance, may limit the use of ELTIFs for real asset funds. It requires that these real assets "serve the purpose of contributing to smart, sustainable and inclusive growth or to the Union's energy, regional and cohesion policies." We suggest either to withdraw this provision or to establish more objective and measurable objectives.

According to some of our members certain regulators restrict the investment allocation to EU investments which goes against the level 1 (recital 4: "**long term investments (…) in third countries** can also bring capital to ELTIFs and thereby benefit the European economy"). We would hope that this provision regarding the possibility to invest in assets in third countries would be enforced in a more harmonized way across the EU.

2. Encumbrances:

Pursuant to its founding Regulation an ELTIF is allowed to borrow up to 30 % of the value of the capital of the ELTIF. In addition, Article 16 1 (e) states that security granted over the assets of the ELTIF cannot exceed 30% of the value of the capital of the ELTIF. Although, this limit seems to have been set in order to be in line with the 30% limit applied to the borrowing of cash, it is market practice for lenders to require security that exceeds the amount borrowed – in order to better manage credit risk. Therefore, we believe that the 30% limit imposed by Article 16 1 (e) should be increased sufficiently to offset this market practice limitation. This amendment will generate a direct benefit for investors as the cost for the financing will likely decrease.

3. Eligible investors:

Beyond the comments on eligible assets which are essential to boost the supply side, it is also key to look at the demand side to make sure ELTIF realizes its potential both as a retail and a professional investment vehicle.

A **retail investor** whose portfolio composed of cash deposits and financial instruments is smaller than €500,000 is not allowed to invest an aggregate amount exceeding 10% of his portfolio in ELTIFs and provided that the initial amount invested in one or more ELTIFs is no less than €10,000 (although if investing in more than one ELTIF the minimum in any one ELTIF out of the €10,000 is €2,000).

On top of enforcing these investment limits, the fund manager must make sure that retail investors are sufficiently knowledgeable, experienced, and financially resourceful to invest in an ELTIF.

These provisions combined with additional eligibility restrictions and marketing requirements at national levels, the complexity of producing a PRIIPS KID (e.g. transaction costs methodology inappropriate for real assets), and the need to conduct in parallel the MIFID II suitability requirements are hindering the distribution to retail investors. The strict application of target markets' rules under MiFID II largely prevents the distribution to retail investors of ELTIFs, which are considered as complex and non-liquid investment.

Given the diversification rules (article 13) and the retail distribution requirements (article 28) which are already here to protect retail investors, it would not be inappropriate to delete the mandatory minimum entry ticket (this could be decided by the ELTIF manager) and amend the 10% investment limit. It would also be helpful to streamline suitability test requirements and avoid duplications (as currently both MIFID and ELTIF apply).

In the case of **institutional investors** detailed proportion of portfolio composition and diversification rules with strict limits are counterproductive. These investors would rather opt for AIFs or a bespoke portfolio within an individual mandate. We would therefore recommend exempting Professional ELTIFs from the application of some of the provisions of Article 13.2.

4. Tax treatment:

By creating a new harmonised fund structure, the Commission hoped to ensure that ELTIFs display a coherent and stable product profile for investors to invest in; but several national considerations, not least among which is tax, continue to impinge on this. In view of the long-term nature of the investments a favorable tax treatment of ELTIFs (no tax on dividends or capital gains) should be granted across EU jurisdictions. Many of local close-ended/open-ended funds investing in the private equity and/or real assets space and targeting retail offer a tax rebate for retail investors. The “New” ELTIF should benefit at pan-European level of the best preferential tax treatment allowed for local AIFs.

Beyond the issue of national tax treatments for ELTIF investors, there is an added complexity in the treatment of cross-border investments at the fund level. The taxation on dividends and capital gains in some EU jurisdictions, as well as the requirement to appoint a withholding tax agent, make the ELTIF unattractive to retail investors.

At the fund level, we continue to raise concerns with the tax implications of the OECD Base Erosion and Profit Shifting (BEPS) framework for funds that invest cross-border in unlisted investments. While the BEPS framework makes some accommodations for funds which invest in listed securities (called Collective Investment Vehicles, or CIVs), generally speaking, funds which invest in real assets such as infrastructure, unlisted securities or other types of direct investments (“non-CIVs”) on a cross-border (even intra-EU) basis will lose some of their tax-neutrality by losing access to tax treaties. While a comprehensive global solution for non-CIVs has not been found, we believe that an EU-level solution for ELTIFs (at least) would be possible and would make such funds more attractive to end-investors. This framework would enable funds to continue to invest in assets on a cross-border basis, while delivering the necessary transparency and a fair outcome to both investors and tax authorities. At the global level, we believe implementing a ‘TRACE 2.0’ (a technology-focused successor to the OECD Treaty Relief and Compliance Enhancement programme) would give governments transparency and reduce the administrative barriers that currently affect the ability of investors to access the tax treaties to which they are entitled.

AMIC realizes that addressing tax issues, which require a unanimous decision from Member States, could considerably slow down the review which should rather be a quick fix exercise. We therefore suggest prioritizing points 1 to 3 and addressing point 4 once/if new voting rules on taxation allow it.

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