ELTIF 2.0: TOWARDS THE DEMOCRATIZATION OF ELTIFS IN FRANCE AND EUROPE?

ELTIFs or "European long-term investment funds" are a variety of Alternative Investment Funds (AIFs), designed to raise capital for financing long-term projects, whose regime was inaugurated by the European Regulation 2015/760 (hereinafter "**ELTIF 1.0**").

Nearly 10 years later, in 2023, the European Council and Parliament drew conclusions from the limited enthusiasm generated by the initial Regulation, with 84 ELTIFs identified in Europe in 2023. It is with a dual objective of modernization and improvement of the attractiveness of ELTIF AIF that Regulation (EU) 2023/606 was published on March 20, 2023 (hereinafter "**ELTIF 2.0**"). Coming into force on April 9, 2023, this second regulation has been applicable since January 10, 2024 ***(Article 2 of ELTIF 2.0 regulation).***

SO, WHAT ARE THE CHANGES MADE BY THE NEW REGULATION?

Alignment of the professional regime with that of retail investors

In the first regulation, the rules applicable to professional investors were more favorable than those provided for retail investors.

ELTIF 2.0 has proceeded with a quasi-alignment of the two regimes, Notably and non-exclusively:

- regarding the rules relating to the use of leverage; and
- concerning asset diversification ***(considering 21 ELTIF 2.0).***

In 2015, investment in an ELTIF could not exceed 10% of a retail investor's financial portfolio and could not be less than €10,000.

The ceiling and the floor have been removed by the 2023 regulation. It is now possible for a retail investor to invest from the first euro ***(modification of Article 30 by ELTIF 2.0).***

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<u>**Modification of the material scope**</u>:

<u>Eligible enterprises</u>

In 2015, investments in equity or quasi-equity instruments were only possible in subsidiaries majority-owned by the ELTIF. The eligible asset base has been expanded with the possibility of investments through a stake in intermediate entities ***(modification of Article 10 by ELTIF 2.0)***.

In 2015, it was prohibited for an ELTIF to invest in an investment firm, insurance company, or other financial companies. The 2023 Regulation allows it provided that the target has been registered or authorized less than 5 years before the date of the ELTIF's initial investment ***(modification of Article 11 by ELTIF 2.0)***.

While ELTIF 1.0 clearly stipulated that "third-country AIFs should not be eligible to be marketed as ELTIFs", ELTIF 2.0 opens the way for investment, even majority, of ELTIFs in economies and infrastructures of third countries to the EU ***(modification of Article 11 by ELTIF 2.0)***.

Companies were eligible for investment when their market capitalization was less than €500 million. This threshold has now tripled to €1.5 billion. The direct consequence is the wider choice of investments that ELTIFs will have, leading to better diversification ***(modification of Article 11 by ELTIF 2.0)***.

<u>The assets concerned</u>

The requirement for a minimum value of €10 million for a physical investment asset has been removed. They are eligible for investment regardless of their value ***(modification of Article 10 by ELTIF 2.0).***

Since the first regulation, ELTIFs have not been obliged to invest all their capital in eligible assets.

By modifying the threshold of eligible assets from 70% to 55% ***(modification of Article 13 by ELTIF 2.0)***, ELTIF 2.0 allows funds to better manage their liquidity, honor their redemption requests, execute their investment strategy more freely, etc.

<u>**Introduction of new mechanisms**</u>:

<u>An easing of the general ELTIF regime</u>

The first regulation imposed a heavy administrative burden on ELTIFs, requiring them to provide a detailed program for the orderly disposal of assets at the end of the fund's life ***(Article 21 ELTIF 1.0)***.

The new regime only requires ELTIFs to inform the competent authorities of the disposal of their assets for investor reimbursement.

Management companies will only have to provide a detailed program at the express request of the competent authority ***(modification of Article 21 by ELTIF 2.0)***.

Possible withdrawal during the life of the ELTIF

The possibility for investors to request the liquidation of an ELTIF when it was unable to meet their redemption request contributed to the fragility of these investment funds ***(Article 18 ELTIF 1.0)*** and their low attractiveness. This faculty, deemed disproportionate, has been removed by the reform ***(modification of Article 18 by ELTIF 2.0)***.

Under certain conditions, they may now repurchase their units or shares during the life of the ELTIF ***(modification of Article 18 by ELTIF 2.0)***.

With the lowering of the threshold for the purchase of eligible assets in the composition of an ELTIF to 55% of the portfolio ***(modification of Article 13 by ELTIF 2.0)***, it will benefit from better liquidity allowing the realization of the faculty left to investors to obtain a reimbursement during the life of the ELTIF.

This reimbursement request is framed and may only cover a portion of the investments in the absence of sufficient liquidity.

The regulatory technical standards (RTS) projects of the European Securities Market Authority (ESMA) dated May 23, 2023, provide useful clarifications on the operation of the new ELTIF 2.0 regime:

Firstly, ESMA warns that the minimum duration before obtaining a reimbursement may vary from one ELTIF to another.

To assist management companies, it proposes 9 criteria to determine this minimum duration:

1) The long-term nature and investment strategy of the ELTIF, the underlying asset class(es) of the ELTIF, and their liquidity profile/position in their lifecycle, investment policy, and, for private equity ELTIF, how the ELTIF intends to engage in their investments.

2) The investment base of the ELTIF, in particular whether the ELTIF can be marketed to retail investors and if so, the overall concentration of retail investors, or if the ELTIF can only be marketed to professional investors, and if so, information on the concentration of these professional investors in the ELTIF.

3) The liquidity profile of the ELTIF.

4) The valuation of the ELTIF's assets and the time required to produce a reliable, sound, and up-to-date valuation of investments.

5) The extent to which the ELTIF lends or borrows cash, grants loans, and enters into securities lending, securities borrowing, repurchase operations, or any other agreement having an equivalent economic effect and presenting similar risks.

6) The composition of the portfolio and the diversification of the ELTIF.

7) The average life of the assets of the ELTIF.

8) The duration, frequency, and characteristics of the lifecycle and redemption policy of the ELTIF.

9) The timetable for the investment phase of the ELTIF's strategy, particularly with regard to the assets listed in Article 9 §1 of the 2015 regulation.

Additionally, the management company should consider the following points when setting the minimum holding period:

- that the minimum holding period covers the initial investment phase of the ELTIF or the period necessary to invest the total capital contributions unless justified by the management company by a particular circumstance;
- that the minimum holding period chosen is proportionate and consistent with the time needed to realize the investment of the capital contributions of the ELTIF; and
- that the period is carried out in accordance with the valuation and redemption policy of the ELTIF.

Finally, ESMA is in favor of a minimum investment holding period that would be common to all ELTIFs, during which it would be impossible for an investor to request a reimbursement.

Such a common standard would offer a double advantage:

- standardize ELTIFs; and
- ensure that investors understand that it is not an investment in a classic AIF but rather a long-term investment.

Contrary to the European Commission, which considers that setting a minimum holding period is only an option, ESMA has maintained in the proposal for a second draft of the technical standards that this is one of the key aspects of the redemption policy and that, consequently, all open-ended ELTIFs must set such a minimum holding period.

In a delegated regulation not yet published in the Official Journal but the text of which was revealed on July 19, 2024 (accessible here), the European Commission has set the following minimum holding periods and notice periods:

Minimum percentage of liquid assets	Minimum redemption request frequency	Percentage
10%	*Every 12 months or less often*	*Up to 100%*
15%	*Every 6 months*	Up to 67%
20%	*Every 3 months*	Up to 50%
25%	*Every month or more often*	Up to 20%

Minimum notice period / Minimum redemption request frequency	No minimum notice period	2 weeks notice period	One month notice period	3 months notice period	6 months notice period	9 months notice period	12 months notice period
Evry 12 months	100%	100%	100%	100%	100%	100%	100%
Evry 6 months	50%	52,2%	54,5%	66,7%	100%	100%	100%
Evry 3 months	25%	26,1%	27,3%	33,3%	50%	100%	100%
Evry 2 months	16,7%	17,4%	18,2%	22,2%	33,3%	66,7%	100%
monthly	8,3%	8,7%	9,1%	11,1%	16,7%	33,3%	100%
Once every 2 weeks	4,2%	4,3%	4,5%	5,6%	8,3%	16,7%	100%
Once a week	1,9%	2%	2,1%	2,6%	3,8%	7,7%	100%

For example, the investor may redeem 67% of the funds invested provided that:

1. ELTIF holds at least 15% of liquid assets,
2. the investor waits at least 6 months before requesting redemption, and
3. the investor gives 6 months' notice,

It should be noted that the precise notice period, the redemption frequency and the percentage holding are determined by the ELTIF manager, who implements its redemption policy in compliance with the minimums imposed on the basis of the criteria provided (e.g. liquidity profile, life cycle of the ELTIF's assets, etc.).

The new master - feeder structure

A new investment structure between ELTIFs has been added by the 2023 regulation. Following the logic of fund of funds, ELTIFs can alternatively be master or feeder ***(modification of Article 2 by ELTIF 2.0)***.

To be a feeder ELTIF, it must have been authorized by the AMF to invest at least 85% of its assets in units or shares of another ELTIF.

Conversely, the master ELTIF must have an investment compartment in which another ELTIF invests at least 85% of its assets in units or shares.

In the event that the depositaries of the structures are different, an information exchange agreement between them must be put in place.

The feeder has a prospectus containing information on the master fund and conditions for exchanging information between them. If an investor requests it, the information exchange agreement must be communicated to him.

This master-feeder fund mechanism is therefore a take-up of the well-known fund of funds system offering more selective and diversified investment.

A major criticism of the master fund - feeder fund relationship lies in the opacity that can result from the dilution of accessibility to information by investors.

This opacity is here avoided by the obligation for the feeder ELTIF to communicate the information it holds about the master ELTIF, at the request of the investor ***(modification of Article 29 by ELTIF 2.0)***.

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Who is concerned?

To manage an ELTIF fund, the management company does not need to obtain additional approval.

It should be noted that the application for ELTIF approval can be made simultaneously with that of AIFs with the AMF. ELTIF approval can only be granted once AIF approval has been obtained.

How?

We assist managers in preparing and submitting the ELTIF approval file to the AMF, which includes the following elements:

a. the ELTIF approval application form;

b. the statutes or constitutive documents of the fund, for example the prospectus with, where applicable, a request for amendment to incorporate into the prospectus the specific constraints of the regulation;

c. information on the identity of the proposed manager of the ELTIF, his current and past experience in fund management and his background;

d. information on the identity of the depositary;

e. a description of the information to be made available to investors, including a description of the complaints handling mechanism for retail investors; and

f. the compliance analysis grid for the regulation.

From the date of receipt of the complete file, the AMF has a period of two (2) months to examine the application.