European Long-Term Investment Funds

An investor's guide to ELTIFs

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ASSET MANAGEMENT

Broadening access to alternative returns through a regulated fund structure

Alternative assets, such as real assets, real estate, private equity and private credit, can provide an attractive and diversified source of long-term return for investment portfolios. But high barriers to entry – high minimum investments, restrictions on investor eligibility, and a lack of familiarity – have meant these assets have generally been accessible only to large institutional investors and very wealthy individuals.

European Long-Term Investment Funds, or ELTIFs as they are more commonly known, broaden access, enabling previously excluded retail investors[1] – as well as professional investors – to access the potential return, income and diversification benefits of alternative assets, all within a pan-European regulatory framework with investor protection at its heart. The aim is to drive private capital towards the development of projects that can encourage smart, sustainable and inclusive growth within the European Union (EU).

At a glance:

- **Access to long-term investments –** Eligible assets include the equity and debt of unlisted companies, long-term infrastructure projects and real assets.
- **Benefit from illiquidity premia –** ELTIFs allow investors to share in the return potential of long-term assets. While some ELTIFs are semi-liquid, meaning that investments may be redeemed, subject to redemption restrictions disclosed in advance, investors should be prepared to lock up their money.
- **Removes hurdles to investing –** ELTIFs do not have regulatory minimum investment requirements and capital is typically paid in upfront, without capital calls.
- **Regulated distribution framework –** Distribution to retail investors is governed by the Markets in Financial Instruments Directive II (MiFID II) within the European Economic Area (EEA).
- **Transparent risks and objectives –** All ELTIFs publish a detailed prospectus, which must include information on the investment objective, policy and costs, including management and performance fees.

1 For the purposes of this guide, retail investors represent the "Retail Client" category under MiFID II, which is any client who does not fall under the "Professional Client" or "Eligible Counterparty" categories.

What are ELTIFs and how do they work?

The initial ELTIF regulation[3] (ELTIF 1.0) was adopted by the European Parliament and European Council in September 2015, with updated legislation entering into application in January 2024 (ELTIF 2.0).[4] The ELTIF 2.0 regulation aims to make the ELTIF framework more appealing to investors and distributors alike – broadening the scope of eligible assets, allowing allocations to other funds and permitting master-feeder structures. The revised regulation introduces an optional redemption mechanism to allow investors the possibility of redeeming their investment before the end of the ELTIF's life.

As EU regulated funds, ELTIFs provide investors with a framework for investing in long-term assets, covering investment eligibility, liquidity criteria, the distribution of proceeds and accessibility. Crucially, to qualify for a cross-border distribution passport, ELTIFs must meet strict investment rules designed to protect investors.

3 Regulation (EU) 2015/760 of 29 April 2015 on European Long-Term Investment Funds.

4 Information provided according to the "ELTIF 2.0 Regulation": Regulation (EU) 2023/606 of the European Parliament and of the Council of 15 March 2023.

Regulatory framework

The ELTIF regulation lays down uniform rules, which when applied to EU Alternative Investment Funds (AIFs), permit those AIFs to be marketed as ELTIFs – meaning that they can also be marketed across the EEA to retail investors.

Outside the EEA (for example, in the UK and Switzerland), the ELTIF is treated as any other EU AIF, and its marketing is subject to the private placement regime (or equivalent) applicable in each country.

ELTIFs are also subject to a number of other European regulations, including:

- AIFMD: ELTIFs don't operate under the UCITS[5] regime, which means ELTIF managers must be authorised as Alternative Investment Fund Managers (AIFMs) under the 2011 Alternative Investment Fund Managers Directive (AIFMD).
- MiFID II: ELTIFs that are distributed to retail investors within the EEA are also governed by the Markets in Financial Instruments Directive II (MiFID II) regime. ELTIF 1.0 included a double-layered assessment of suitability for retail investors. ELTIF 2.0, however, has removed these requirements and has aligned the suitability assessment with the relevant MiFID II suitability tests, as for other products.
- PRIIPs: The Packaged Retail and Insurance-based Investment Products (PRIIPs) regulation aims to help retail investors understand and compare the key features of different products when they are considering buying an investment product. This information is provided through a standardised Key Information Document (KID), which includes information on the product, the potential risks involved, the performance scenarios, the costs, and information on the holding period and complaints process. The KID can help investors compare similar products and make a better-informed investment decision.
- SFDR: ELTIFs are subject to the provisions of the Sustainable Finance Disclosure Regulation (SFDR). Depending on their sustainability characteristics, ELTIFs can meet the standards of Article 8 ("light green") or Article 9 ("dark green") of the SFDR. In this case, ELTIFs will also be subject to the SFDR regime and the EU Taxonomy Regulation.
- Prospectus Regulation: Although ELTIFs are not required to issue a prospectus compliant with the Prospectus Regulation, the prospectus of an ELTIF must comply with the additional disclosure requirements that apply to closed-ended funds under the Prospectus Regulation.

5 UCITS = undertakings for collective investment in transferable securities.

Accessibility

ELTIFs have been designed to remove barriers to investing in long-term private assets, while ensuring that retail investors have the appropriate protections.

Open to retail and professional investors across Europe: Since ELTIF 2.0 is subject to the AIFMD regulation, ELTIFs benefit from the AIFMD passport regime, under which the manager of an ELTIF can market a fund to professional and retail investors across the EEA subject to a notification procedure. The AIFMD regulation provides both retail investors and professional investors in EEA countries with access to the return and diversification benefits of alternative assets through a regulated fund structure. Outside of the EEA, the ELTIF may be sold, subject to relevant national private placement regimes.

No investment minimum: ELTIF 2.0 does not impose minimum or maximum subscription limits, although individual ELTIF managers may apply limits. The aim is to help retail investors and smaller-sized institutions make their first investment into long-term assets.

Suitability assessment: Distribution to retail investors in the EEA is governed by the MiFID II regulation. Because of the complex nature of the underlying investments, retail investors are subject to a suitability assessment, aligned to the MiFID II suitability test requirements, ensuring that they understand the risks involved prior to subscribing to an ELTIF. Providers must also publish a prospectus detailing the ELTIF's investment objective and key risks, and a Key Information Document (KID) detailing risk exposures, performance scenarios, costs, and information on the holding period and complaints process, must be provided to retail investors.

Cancellation rights: Retail investors have the right to cancel their subscription within two weeks of signing the application form without penalty.

Simplified subscription process: ELTIFs provide the potential for subscriptions to be paid-in up front. There is no need for capital calls; just one payment concurrent with the subscription notification. Retail investors can subscribe via distributor nominee accounts, replicating the experience they are familiar with when buying UCITS funds.

Investment rules

ELTIFs provide access to long-term investment opportunities. They are required to comply with detailed rules regarding portfolio composition, diversification and the investment of portfolio capital.

Eligible assets and portfolio composition: At least 55% of an ELTIF's capital must be invested in eligible assets, which include:

- The equity and debt of unlisted (private) companies.
- The equity and debt of listed (public) companies, provided that their market capitalisation is no more than EUR 1.5 billion at the time of the investment.
- Real assets (such as large infrastructure, transportation and real estate projects).
- Units of certain types of other funds (including EU AIFs and ELTIFs).

Any remainder must be invested into assets that are eligible for UCITS funds, such as equities, bonds, money market instruments and units of other UCITS products.

Retail investor ELTIF limits: ELTIFs marketed to retail investors are subject to several diversification and concentration limits.

The main limits include:

- No more than 20% of an ELTIF's capital can be invested into any single asset.
- While an ELTIF may invest 100% of its capital into other funds, ELTIFs can invest no more than 20% into any single fund, whether another ELTIF, EU AIF or UCITS fund.
- Cash borrowing is limited to no more that 50% of an ELTIF's net asset value.

Geographic diversification: ELTIFs can invest in assets located outside the EU subject to rules regarding the third-party country's money laundering risk and its tax co-operation with the EU. The ELTIF may not invest in funds domiciled outside the EU.

Initial investment (ramp-up) period: An ELTIF must satisfy portfolio composition, diversification and concentration rules within a maximum of five years after the date of authorisation (or half of the term of the ELTIF if shorter).

Investment rules continued

Investment rules at a glance

The table below summarises the investment rules for ELTIFs that are marketed to retail individuals. Certain thresholds and requirements do not apply for ELTIFs that are solely marketed to professional investors.

	ELTIF 2.0 Retail
Minimum aggregate investment in eligible assets	55%
Maximum investment in the equity and debt of a single eligible asset	20%
Maximum aggregate investment into other funds	100%
Maximum investment in single fund	20%
Maximum holding of the units or shares of a fund	30%
Maximum borrowing of cash	50%

Source: J.P. Morgan Asset Management; as of June 2023.

Liquidity

ELTIFs require investors to have long-term investment horizons. ELTIFs aim to provide transparency to investors around redemptions, and around the timing of the disposal of underlying assets and the distribution of proceeds at the end of an ELTIF's life.

Providers must clearly indicate the date of the end of life of an ELTIF, and whether and how that date can be extended.

Under ELTIF 1.0 rules, only closed-ended fund structures were permitted, meaning that investors' capital could only be returned as the ELTIF's assets matured.

ELTIF 2.0 introduced the possibility of redemptions before the end of the ELTIF's fixed term life. ELTIF 2.0 funds can be structured as "de facto" open-ended semi-liquid funds. Redemptions are subject to restrictions, which may include:

- A minimum holding period, during which redemptions are not permitted.
- A minimum notice period, between making a redemption request and the redemption being settled.
- A limited frequency of receiving redemption requests and paying redemptions (for example, quarterly).
- A redemption gate, which means that redemptions may not be paid in full, or they may be paid over a longer period of time, should the volume of redemptions exceed a pre-determined portion of the ELTIF's liquid assets.

Semi-liquid ELTIFs may also have an anti-dilution liquidity management tool. The purpose of this tool is to manage cash coming into the ELTIF through subscriptions and cash going out of the ELTIF through redemptions, to ensure that those cash flows do not disadvantage the existing and remaining investors of the ELTIF or create risks to financial stability.

For example, a large volume of new subscriptions could introduce a large amount of cash into the ELTIF, which may take time to invest, meaning that the investment returns of the ELTIF are reduced. Alternatively, a large volume of redemption requests may mean that the ELTIF is left holding its least liquid assets, or has to sell those least liquid assets at a discount. The types of liquidity management tools that can be used include anti-dilution levies, swing pricing and redemption fees.

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