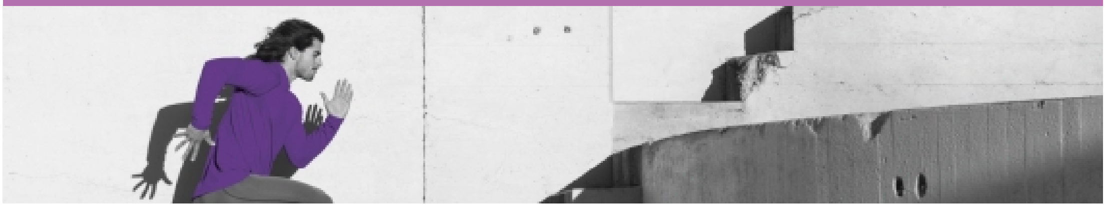

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ELTIF 2.0 – a promising redesign with state-of-the-art features

The EU co-legislators have published the text of a provisional agreement on the review of the Regulation on European long-term investment funds (ELTIFs). This agreement has the potential to access an untapped retail market and strengthen the ELTIF's role as a complementary source of financing for the real economy.

On 19 October 2022, the Council of the EU announced that political agreement (the '**Political Agreement**') had been reached with the EU Parliament on the review of the Regulation on European long-term investment funds (the '**ELTIF Regulation**'). Following additional inter-institutional negotiations aimed at fine-tuning the text of the Political Agreement, the EU co-legislators have now published the draft text of the compromise reached (the '**Provisional Agreement**').

The Provisional Agreement sets out amendments to the ELTIF Regulation that render the ELTIF framework more attractive and easier to invest in, and aims to channel more financing to small and medium-sized enterprises (**SMEs**) and long-term projects. To achieve this, the redesigned ELTIF framework ('**ELTIF 2.0**') significantly broadens the investment universe, removes obstacles to investment by professional investors and makes it easier for retail investors to invest in ELTIFs, while ensuring strong investor protection.

To accelerate the ELTIF's adoption as a 'go-to' fund structure for long-term investments, the EU co-legislators agreed to further increase the flexibility of its design and to enhance its attractiveness by simplifying its distribution.

Product redesign

- **Wider scope of eligible assets.** ELTIF 2.0 will significantly broaden the scope of eligible assets. In addition to what is already possible under the current regime, it will allow for investments in EU AIFs managed by EU AIFMs and invested in ELTIF-eligible assets. Investments in simple, transparent and standardised securitisations will be permitted, as well as investments in green bonds issued in accordance with the proposed Regulation on Green Bonds currently being prepared by the EU policymakers. It also includes a simplified definition of 'real assets' and removes the minimum threshold for real estate strategies, which could boost ELTIFs invested in infrastructure.

  ELTIF 2.0 also provides for additional structuring flexibility by clarifying the option for indirect investments, and by allowing co-investments if the ELTIF has organisational and administrative arrangements in place to handle possible conflicts of interest.

- **Wider scope of qualifying portfolios.** ELTIF 2.0 makes room for investments in recent FinTechs and significantly raises the maximum market capitalisation of qualifying portfolio undertakings from EUR 500,000,000 to EUR 1,500,000,000. It also clarifies that undertakings must not be blacklisted in the

EU.

- **Portfolio composition and diversification.** ELTIF 2.0 modifies the portfolio composition by reducing the ELTIF's pocket for investments in long-term, illiquid assets from 70% to 55% and increasing its pocket for liquid investments (UCITS-eligible assets) from 30% to 45%. These amendments will certainly improve the ELTIF's liquidity profile. The risk diversification requirements for both the illiquid and the liquid investment pockets have also been adapted in line with this increased structuring flexibility.

- **Semi-open-ended ELTIFs.** Although explicit open-ended ELTIFs will not be permitted, ELTIFs will be able to provide liquidity to retail investors by allowing for redemption before the end of the ELTIF's life. In the rules or instruments of incorporation, the ELTIF manager must include the possibility of an optional liquidity window and a matching mechanism ensuring the fair treatment of investors and giving sufficient opportunity for the ELTIF manager to monitor the ELTIF's liquidity risk. To avoid liquidity mismatches, ELTIF managers must use the newly established set of liquidity management tools.

- **Sustainability.** The Provisional Agreement highlights the importance of sustainability for this long-term vehicle by explicitly including EU green bonds as a category of eligible investment assets, clarifying that the ELTIF is subject to SFDR disclosure requirements and including a clause requiring that the ELTIF's contribution to the EU Commission's Green Deal be examined.

Product distribution

ELTIF 2.0 includes rules to make it easier for retail investors to invest in ELTIFs, while ensuring investor protection.

- **Suitability assessment.** The draft amendment text reiterates the ELTIF manager's duty to undertake and document suitability assessment of retail investors and requires that these investors give explicit consent. A welcome amendment is the alignment of the ELTIF suitability test with that of MiFID II. To further strengthen investor protection, a single written alert to retail investors is also required, to the effect that the ELTIF product may not be suitable where the investor is unable to sustain a long-term commitment.

- **Harmonised distribution regime for retail investors.** In line with the alignment to MiFID II, ELTIF 2.0 harmonises the distribution regime for retail investors and removes the minimum investment holding of EUR 10,000 and the 10% exposure cap for retail investors whose financial portfolios are below EUR 500,000. The removal of the previous 'entry ticket' is a welcome amendment as it prevented certain retail investors from having access to ELTIFs.

- **Simplified rules for employee investors.** The draft amendment text provides for a lighter touch regime for an investor who is a member of the senior staff, a portfolio manager, director, officer or an agent or employee of the AIFM or an affiliate of the AIFM of the ELTIF.

Entry into application and transitional rules

The revised ELTIF Regulation is expected to enter into application in Q1 2024. However, it will be possible to opt into the new regime from the date of entry into force of the revised ELTIF Regulation, which is expected to be in April 2023. A transitional period of 5 years after the application date guarantees that ELTIF managers will have sufficient time to adapt to the new regime.

Next steps

It is expected that the EU Parliament will adopt the draft amendment text during the plenary sitting on 13 February 2023 and that the approved text will be published in the Official Journal of the EU in March 2023.

Accelerating the uptake of the ELTIF

Since the original ELTIF framework was adopted in April 2015, 84 ELTIFs have been launched as of January 2023. These authorised ELTIFs are domiciled only in four Member States: Luxembourg (48), France (21), Italy (13) and Spain (2).

The EU Commission published a legislative proposal containing targeted amendments to the ELTIF Regulation on 25 November 2021. Through the proposed amendments, the EU Commission aimed to increase the uptake of ELTIFs across the EU for the benefit of the European economy and investors. The review of the ELTIF framework forms part of a package of four proposals prepared by the EU Commission as part of its CMU 2.0 Action Plan.

For further information, please reach out to your usual contact within the Fund Formation Group_

To access the text of the Provisional Agreement, **click here_**

To access a marked-up version of the ELTIF Regulation showing the amendments introduced by the Provisional Agreement, **click here_**

To access the EU Commission's legislative proposal for amendments to the ELTIF Regulation, **click here_**

To access our newsflash 'Unlocking the potential of the ELTIF', **click here_**

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