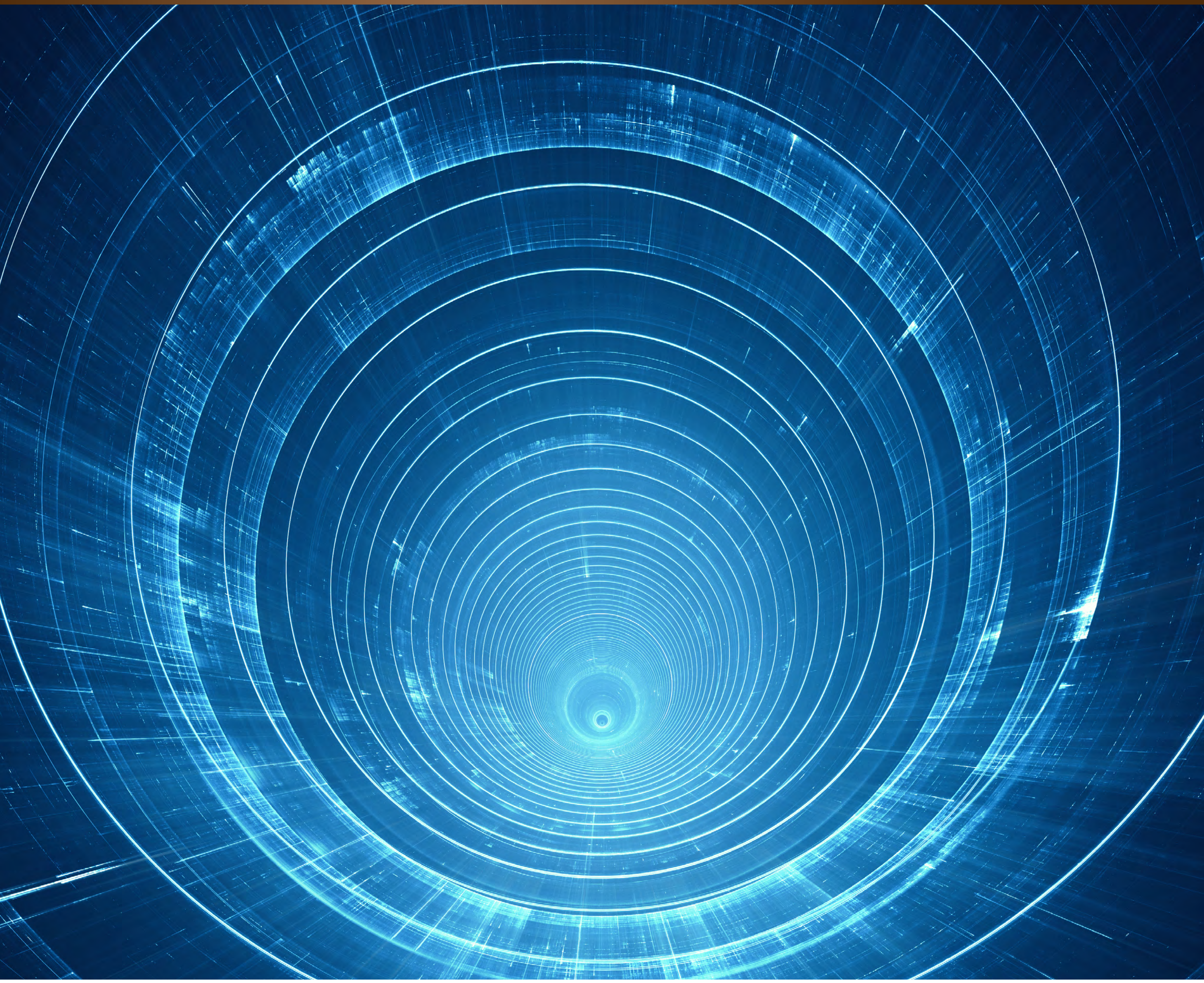
Fresh Momentum for the Reformed European Long-Term Investment Fund (ELTIF)



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J.P.Morgan

Journey to ELTIF 2.0

When the ELTIF regime was initially introduced by the European Union (EU) policymakers in 2015[1], it was hailed as an instrumental part of the Capital Markets Union (CMU) agenda with the primary objective of encouraging more private savings flows into long-term investment funds designed to finance Europe's real economy. Fast forward to nearly a decade later and there is just over a hundred authorised ELTIFs in Europe, most with relatively modest assets under management. While ELTIF products have been launched in a handful of markets (primarily across Luxembourg, France, Italy and Spain) to date, their appeal to investors and investment managers has been dampened by the complexity of the legislative regime, overly restrictive portfolio constraints and certain product features creating barriers to retail investor access. As a result, the ELTIF's wider market adoption has not materialised to the extent it was originally envisaged.

Recognising these challenges and the shortcomings of the original framework, the European Commission (EC) undertook a review of the regulation and subsequently a materially reformed legislation, "ELTIF 2.0[2]", was published in early 2023 and came into force in January 2024. The most significant changes introduced by ELTIF 2.0 are largely centred around asset eligibility, investment restrictions and diversification, marketing and distribution and liquidity all of which are discussed in more detail later in this briefing.

The reformed regulatory framework has brought a renewed sense of optimism to the market and there is a growing expectation that the ELTIF regime may now be able to achieve its full potential by truly opening up retail access to private markets for European savers. ELTIF 2.0 also expands the asset range for ELTIF investment portfolios giving retail investors access to previously unavailable investments including green bonds, minority co-investments, certain types of securitised assets such as mortgage securities, and both corporate and commercial loans. The definition of "real assets" has been broadened to include immovable property, such as highways or electric grids, as well as social infrastructure projects such as retirement homes and hospitals. These changes pave the way for the ELTIF to potentially become a key vehicle in the EU's drive to increase capital flows into investments such as social and infrastructure projects, real estate and small and medium-sized enterprises (SMEs). It is also anticipated that the ELTIF could become an important tool in supporting both the EU's ambitious European Green Deal agenda and the Digital Single Market strategy.

Around the same time as the ELTIF reform was being implemented by the EU, the UK introduced its Long-Term Asset Fund (LTAF) regime also in a direct response to the increasing demand for financial products which facilitate the democratisation of private asset classes and offer the ability to provide controlled liquidity facilities to meet distribution and end investor requirements. While uptake to date has been relatively modest for both products, steady growth is anticipated and the ELTIF reform could now act as a stimulus to accelerate momentum in the EU.

ELTIF 2.0 at a Glance

- Wrapper product with pan-European Passport
- EU AIFMs permitted to operate on a cross-border basis
- Optionality to structure ELTIF as a closed-ended or semi open-ended product
- Widened scope of eligible assets
- Relaxation of diversification and concentration rules
- Increased borrowing limits
- Greater structuring possibilities for fund of funds and master-feeder structures
- Removal of minimum investment limits & investment cap for retail investor portfolios
- Suitability test for retail investors aligned with MIFID II
- Opportunity for minority co-investments and secondary transactions
- Ability to invest in non-EU assets

[1] https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32015R0760

[2] https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32023R0606

Luxembourg and Ireland Developments

The EU authorities' commitment to making the ELTIF regime a success can also be seen through the constructive measures undertaken by the national regulators gearing up to support new fund launches in light of the ELTIF 2.0 regulation coming into force earlier this year.

In **Ireland**, the industry has been extensively engaged with the domestic policymakers to ensure that ELTIF 2.0 is successfully delivered to meet the needs of both investment managers and investors. The Central Bank of Ireland (CBI) consulted with the industry on the introduction of a new standalone ELTIF Chapter in the existing AIF Rulebook to support the domestic implementation of the ELTIF regulation, providing a pathway for ELTIFs seeking authorisation in Ireland. Subsequently, the CBI published its feedback statement[3] in March 2024 along with a revised version of the AIF Rulebook[4] which includes the new Chapter 6 setting out the specific operational and disclosure requirements that will apply as a condition of authorisation. This effectively means that the CBI can now accept applications to authorise closed-ended ELTIFs under domestic fund legislation in Ireland. However, it will not accept applications to authorise open-ended ELTIFs until such time as the final Regulatory Technical Standards (RTS) are published. As an additional welcome development, the CBI also confirmed that ELTIFs which are offered solely to "Qualifying Investors" will be able to avail of the 24-hour fast-track approval process.

In the meantime, in response to growing market interest in ELTIF products, **Luxembourg** – with more than half of current ELTIFs in Europe already domiciled and/or administered there – has been taking steps to further streamline the ELTIF application process as well as create additional incentives for investors. In late 2023, the Commission de Surveillance du Secteur Financier (CSSF) published an updated ELTIF application form[5] which must now form part of each new ELTIF authorisation request. It aims to accelerate authorisations for new ELTIFs and simplify the required information where the ELTIF is not intended to be marketed to retail investors. Prior to this, as a part of the wider investment fund modernisation reform (The Modernisation Law of July 2023), Luxembourg also introduced new exemptions from the subscription tax for specific fund types. Part II Undertakings for Collective Investment (UCIs), Specialised Investment Funds (SIFs), and Reserved Alternative Investment Funds (RAIFs) authorised as ELTIFs as well as Undertaking for Collective Investment in Transferable Securities (UCITS) or Part II funds reserved for investors participating in Pan-European Personal Pension Products (PEPP) are now exempt from the subscription tax regime, hence further promoting investments in ELTIFs and PEPPs.

[3] *https://www.centralbank.ie/docs/default-source/publications/consultation-papers/cp155/feedback-statement-to-cp155-consultation-eltif-chapter-in-the-aif-rulebook.pdf?sfvrsn=96d631a_7*

[4] *https://www.centralbank.ie/docs/default-source/regulation/industry-market-sectors/funds/aifs/aif-rulebook--march-2024.pdf?sfvrsn=996a631a_1*

[5] *https://www.cssf.lu/en/2023/12/request-for-a-european-long-term-investment-fund-eltif/*

Key Changes Under ELTIF 2.0

Authorisation, distribution, and marketing

Removing the requirement for EU Alternative Investment Fund Managers (AIFMs) to obtain authorisation to manage ELTIFs from their national regulator is a key enhancement designed to promote cross-border fund set-ups. Additionally, barriers to entry for retail investors have been removed by abolishing the minimum initial investment amount of €10,000 and, significantly, removing the 10% aggregate exposure limit to ELTIFs for investors with portfolios of €500,000 or less. The burdensome nature of the original product suitability assessment has been scaled down by aligning it with the suitability requirements in the Markets in Financial Instruments Directive II (MiFID II), thus, in combination with the aforementioned changes, enabling retail investors to access ELTIFs with greater ease. ELTIF 2.0 also introduces the optionality to structure ELTIFs as open-ended funds which means that lock up periods can be disassociated from the initial ramp-up period and investors will no longer be able to mandate a wind down of the fund if their redemption request cannot be met.

Asset eligibility, diversification and concentration

Revised thresholds have been introduced to create a dual regime for ELTIFs that can be marketed to both retail and professional investors. The widened scope of eligible assets and greater flexibility for allocations to investments in third countries that can benefit the EU's real economy presents opportunities for investment managers to pursue more globally diverse investment strategies. Additionally, the relaxation of diversification and concentration rules for retail investors and the removal of the same for professional investors offers the most efficient access to the broadest range of investment opportunities.

Eligible assets	ELTIF	ELTIF 2.0 (Retail)	ELTIF 2.0 (Professional)
Eligible Investment Assets	70%	55%	55%
Diversification:			
Instruments issued or loans guaranteed by QPU[6]	10%	20%	No restriction
Capital in a single real asset[7]	10%	20%	No restriction
Capital in ELTIF, EuVECA[8] or EuS[9] EF	10%	20%	No restriction
Capital in UCITS eligible asset by issuer	5%	10%[10]	No restriction
Aggregate value in ELTIFs, EuVECAs and EuSEFs	20%	No restriction	No restriction
Concentration:			
ELTIF, EuVECA, or EuSEF	25%	30%	No restriction
UCITS/AIF	Not permitted	30%	No restriction
UCITS eligible assets	As per UCITS rules	As per UCITS rules	No restriction
Borrowing[11]	30%	50%	100%

Structuring opportunities

Greater structuring possibilities have been introduced including master-feeder fund structures and more flexible options for fund of fund strategies. Master-feeder structures require both funds to be ELTIFs which may temper interest somewhat, but fund-of-funds are permitted to invest in a wider range of target funds including other ELTIFs as well as UCITS and Alternative Investment Funds (AIFs), providing an efficient access route to illiquid asset classes.

[6] *Qualifying portfolio undertakings*

[7] *The definition of a real asset has been simplified to mean an asset that has "an intrinsic value due to its substance and properties" and the EUR 10 000 000 value threshold has been removed.*

[8] *European Venture Capitals Funds*

[9] *European Social Entrepreneurship Funds*

[10] *The 10% limit can be increased to 25% where bonds are issued by a credit institution that has its registered office in a Member State and that is subject by law to special public supervision designed to protect bondholders*

[11] *Borrowing in other currencies is permitted subject to appropriate hedging arrangements*

ELTIF Regulatory Technical Standards (RTS)

The reformed ELTIF 2.0 regime has been generally welcomed by the industry as a step in the right direction to address the limitations and shortcomings of the original regulation by providing greater flexibility to invest in a wider range of assets and underlying fund structures while removing barriers to entry for retail investors.

Although the revamped ELTIF regime has prompted several recent fund launches, some open-ended ELTIF product launches have been postponed as there is a dependency on the final RTS which is subject to deliberation by the EU regulatory authorities. Most recently, the EC has taken on-board industry concerns over certain requirements in the draft RTS proposed by ESMA[12], including the overly restrictive redemption policy and high liquidity requirements, and proposed several amendments for ESMA's consideration[13].

Among the targeted amendments, the EC has proposed:

- removal of the minimum notice period for redemptions;
- amendments to the liquidity related requirements by taking into account the principle of proportionality (to replace the "one-size-fits-all" approach), the existing market practices for retail long-term funds and the unique circumstances of individual ELTIFs;
- alignment of the rules governing the choice of liquidity management tools with the related requirement of Alternative Investment Fund Managers Directive (AIFMD);
- alignment of the cost disclosure methodology with the requirements under the Packaged Retail and Insurance-Based Investment Products (PRIIPs) Regulation, MiFID II and, where applicable, the AIFMD.

In line with EU legislative rules, ESMA was given six weeks to amend the draft RTS based on the EC's proposed amendments, and it may resubmit it in the form of a formal opinion. In the event that ESMA does not resubmit the redrafted RTS within the six-week period or resubmits draft RTS that are not consistent with the proposed amendments, the EC may adopt the RTS with the amendments it considers relevant or reject the draft RTS entirely.

While uncertainties remain regarding the implementation of these amendments in ESMA's RTS, the increased flexibility proposed by the EC would be certainly welcomed by the investment managers and investors. Equally, national regulators are also keenly awaiting the outcome on the RTS to pave the way for the authorisation of open-ended ELTIF structures.

Timeline

- December 2023 - final RTS published by ESMA for the EC review and endorsement
- January 2024 – ELTIF 2.0 enters into force
- March 2024 – the EC proposed amendments on the RTS to ESMA
- April 2024 – ESMA has six weeks to amend the draft RTS based on the EC's considerations and resubmit the amended draft RTS to the EC
- H1 2024 – If ESMA does not resubmit the redrafted RTS within required timeframe, the EC may adopt the RTS with the amendments it considers relevant or reject the draft RTS entirely
- January 2028 – deadline for ELTIFs launched under original 2015 regulation to comply with ELTIF 2.0 framework

[12] https://www.esma.europa.eu/press-news/esma-news/esma-finalises-technical-standards-under-revised-eltif-regulation

[13] https://finance.ec.europa.eu/document/download/6d479235-3dc3-47da-844b-69bcaa2a0913_en?filename=240306-communication-eltif-rts-annex_en.pdf

How J.P. Morgan Can Help

As the ELTIF can be structured as either a closed-ended or semi-open ended fund vehicle, J.P. Morgan Securities Services can customise an end-to-end operating model to combine the capabilities and infrastructure of both our alternative and traditional fund services. We have developed significant expertise in respect of fund structures with allocations to both liquid and illiquid asset classes, and our approach to supporting ELTIF products builds on this by leveraging our flexible fund accounting and transfer agency technology platforms, while adding our depositary services capability.

Our approach to deploying an operating model to support ELTIF products, and other comparable structures, has been to develop a modular technology platform that enables us to tailor the appropriate functionality and align it to the elected requirements of the fund, regardless of the specific regulatory wrapper chosen by our clients. The investment strategy employed, specific accounting requirements and investment manager's distribution strategy are, in effect, the primary drivers for determining the most appropriate operating model that J.P. Morgan can tailor to meet our clients' requirements. This optionality allows us to deploy the right technology solution for each use case, regardless of whether the fund invests directly or indirectly into underlying assets, maintains a commitment register (in the case of closed-ended funds), offers investor active dealing (for open-ended or semi-open ended fund products), or requires an investor-level allocation.

To support the needs of investment managers looking to gain indirect exposure to the private markets, J.P. Morgan offers a dedicated private asset portfolio administration solution. This includes offering capital event and valuation processing and portfolio reporting services to institutional investors and fund-of-funds, leveraging an Artificial Intelligence (AI) platform to automate data feeds and the consumption of non-standard reporting for capital events and valuations from general partners into J.P. Morgan systems. To enhance investment management oversight, we provide transparency reporting for private funds, thus enabling asset level exposure performance measurement.

A key advantage of the newly reformed ELTIF regime is the optionality to structure funds as either closed-ended or open-ended, however this requires a flexible transfer agency platform capable of adapting to the varying dealing frequencies of funds and matching mechanism for investors buying and selling shares on the secondary market. J.P. Morgan's Transfer Agency value proposition is based on extensive experience of supporting both closed-ended and open-ended regulated AIF and UCITS structures in the EU. The investor experience is at the heart of our digital strategy, driving significant investments in our technology. Powerful web-based tools are at the forefront of our service offering, providing online investor KYC/AML support, investor online dealing, investor correspondence and access to account, transaction, and valuation data.

To ensure investor protection, ELTIFs marketing to professional investors require an EU depositary to be appointed in accordance with the AIFMD or, when marketing to retail investors, UCITS Directive.

J.P. Morgan's Depositary Services has extensive experience acting as a depositary to both AIF and

"The revamped ELTIF provides a unique opportunity for alternative managers to offer access to private asset strategies to both professional and retail investors, but it will require modifying their operating models to support.

J.P. Morgan has extensive experience supporting hybrid fund structures and is well positioned to leverage the combined capabilities of its traditional and alternative fund services to create integrated solutions for our clients."

Gavin Tobin
J.P. Morgan Securities Services
Global Head, Private Equity Real Estate Services

UCITS fund structures across the EU overseeing a variety of investment strategies and asset classes, including private credit, private equity, real estate and infrastructure. Our experienced teams and trusted oversight processes enable us to meet our regulatory obligations for funds investing in these types of illiquid and/or less liquid strategies.

In addition to our extensive experience administering traditional UCITS fund structures and AIFs (including private equity, real estate & infrastructure funds, as well as hedge funds), in 2023, J.P. Morgan Securities Services supported the launch of the very first LTAF in the UK market and we now look forward to partnering with clients who are considering their future ELTIF offerings in Europe.

Looking Ahead

While the ELTIF RTS is yet to be fully finalised, the ELTIF 2.0 reform is a significant achievement in providing the industry with a flexible framework that offers retail investors private markets access on a fully harmonised, European-wide basis.

With the reformed ELTIF framework now in force and a growing appetite among investors for diverse and high-performance investment opportunities, J.P. Morgan is fully committed to supporting current and future clients who are considering providing their investors with access to the private asset investment strategies via an ELTIF product, and/or broaden the asset class to a wider investor demographic.

“As the retailisation of private markets gathers momentum, our clients will need flexible solutions tailored to their needs. J.P. Morgan is fully committed to partnering with our clients to develop their ELTIF product offering by providing expertise and leveraging the strengths of our modular product capabilities.”

Dennis Burgers
J.P. Morgan Securities Services, Co-Head, EMEA Platform Sales

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