Obstacles to the Development of the EU ELTIF Market

BETTER FINANCE ELTIF Research & Policy Report

BETTER FINANCE

The European Federation of Investors and Financial Services Users

Fédération Européenne des Épargnants et Usagers des Services Financiers

About BETTER FINANCE

BETTER FINANCE, the European Federation of Investors and Financial Services Users, is the public interest non-governmental organisation advocating and defending the interests of European citizens as financial services users at the European level to lawmakers and the public in order to promote research, information and training on investments, savings and personal finances. It is the one and only European-level organisation solely dedicated to the representation of individual investors, savers and other financial services users.

BETTER FINANCE acts as an independent financial expertise and advocacy centre to the direct benefit of European financial services users. Since the BETTER FINANCE constituency includes individual and small shareholders, fund and retail investors, savers, pension fund participants, life insurance policy holders, borrowers, and other stakeholders who are independent from the financial industry, it has the best interests of all European citizens at heart. As such its activities are supported by the European Union since 2012.

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This study is part of the BETTER FINANCE **#FundResearch** project, a research activity aimed at providing qualitative and quantitative assessments of the EU market for "retail" investment funds, focusing on Undertakings for Collective Investment in Transferable Securities (UCITS) and Alternative Investment Funds (AIFs). This paper looks into the market for European Long-Term Investment Funds for individual, non-professional ("retail") investors and seeks what hampers its uptake and development.

This report is accurate as of September 2020 and is partially based on the input received from BETTER FINANCE's member organisations.

EXECUTIVE SUMMARY

ELTIF market

As of September 2020, the ELTIF market comprises 27 ELTIFs authorised in four jurisdictions: France (41%), Luxembourg (33%), Italy (19%) and Spain (7%). Of these, only 11 are distributed on a cross-border basis, while Spanish-domiciled ELTIFs are only distributed locally.

Purpose of this report

After three years, only a handful of ELTIFs are authorised in the EU and distributed cross-border, even though infrastructure financing needs were estimated at least at €2 trillion in 2013. Most ELTIFs do not target "retail" clients. This report seeks to identify what issues or barriers make ELTIFs unattractive for the "retail" sector.

BETTER FINANCE Members' input

BETTER FINANCE surveyed 10 national investor associations to get input on obstacles to the uptake of ELTIFs by retail investors. Except for a few jurisdictions, ELTIFs are not marketed to retail investors. ELTIFs often do not receive preferential tax treatment, are less attractive than other fund structures and have more stringent *suitability* criteria than other AIFs.

Findings/conclusion

The BETTER FINANCE team found **three barriers to the uptake of ELTIFs**: first, the lack of public promotion (tax incentives) compared to other AIFs investing in illiquid assets; second, a lack of an affluent retail investor base; and last, the more stringent investment rules compared to other AIFs investing in illiquid assets.

BETTER FINANCE research

In addition, the research team analysed the regulatory treatment of ELTIFs in three jurisdictions (France, Italy and Belgium). Although ELTIFs are long-term and suitable for retirement savings, retail investors lack the necessary financial literacy, awareness and trust in the finance industry to create a higher demand for ELTIFs.

HLF CMU Recommendations

In June 2020, the High-Level Forum on the Future of the CMU recommended in its final report amending the ELTIF Regulation to provide more investment and redemption flexibility and recommended providing preferential tax treatment to ELTIFs.

BETTER FINANCE Recommendations (*summarised*)

1. **Grant ELTIFs the most favourable tax regime for "retail" investment products investing in illiquid assets across the EU**
2. **Allow more redemption flexibility**
3. **Create a long-term investment and equity culture.**
4. **Apply the UCITS disclosure regime (KIID).**
5. **Make listed small cap equity an eligible asset class.**
6. **Maintain an adequately high investment threshold.**
7. **Follow up on the HLF CMU Recommendations.**

OBSTACLES TO THE DEVELOPMENT OF THE EU ELTIF MARKET

a BETTER FINANCE #FundResearch paper

1. INTRODUCTION

The **E**uropean **L**ong-**T**erm **I**nvestment **F**und (ELTIF) is a subset of one of the six EU labels allowing mutual funds to benefit of *passporting rights*, meaning that authorisation is necessary only in one Member State, following which distribution is free of formalities in any other EU jurisdiction. The six EU labels are: the UCITS (undertaking for the collective investment in transferable securities[1]), the AIF (alternative investment fund[2]), the EuSEF (EU social entrepreneurship fund[3]), the EuVECA (EU venture capital fund[4]), MMF (money market funds[5]) and the IORP (institutions for occupational retirement provision[6]).

In 2013, as part of the project to revamp the EU Single Market for financial services,[7] the European Commission (EC) put forward a Regulation proposal for the **ELTIF** to "*help increase the pool of capital available for long term investment in tomorrow's economy of the European Union with a view to finance transition to the smart, sustainable and inclusive growth*",[8] alongside the EuSEF and EuVECA. These investment vehicles have special purposes and are meant to stimulate certain flows of capital into under-funded markets while safeguarding investor rights.

To give an example, non-listed small- and medium-sized enterprises (SMEs) relied on bank loans, and infrastructure projects relied on public expenditure, due to a lack of funding availability on the market.[9] The European Commission reported a 45% drop in venture capital funding in the aftermath of the two crises (2008 and 2010),[10] on the background of a €2 trillion financing need for infrastructure projects.[11] At the same time, education and research, renewable energy, climate change or eco-friendly technologies needed to find a channel to access the available risk capital of "retail" and institutional investors.

[1] See Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS); according to the European Commission's website, the UCITS is the most popular "retail" investment product, accounting for 75% of collective investments in the retail sector in Europe – see https://ec.europa.eu/info/business-economy-euro/growth-and-investment/investment-funds_en. (http://data.europa.eu/eli/dir/2009/65/oj).

[2] See Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers (http://data.europa.eu/eli/dir/2011/61/oj).

[3] See Regulation (EU) No 346/2013 of the European Parliament and of the Council of 17 April 2013 on European social entrepreneurship funds (http://data.europa.eu/eli/reg/2013/346/oj).

[4] See Regulation (EU) No 345/2013 of the European Parliament and of the Council of 17 April 2013 on European venture capital funds (http://data.europa.eu/eli/reg/2013/345/oj).

[5] See Regulation (EU) 2017/1131 of the European Parliament and of the Council of 14 June 2017 on money market funds (http://data.europa.eu/eli/reg/2017/1131/oj).

[6] See Directive 2003/41/EC on the activities and supervision of institutions for occupational retirement provision (http://data.europa.eu/eli/dir/2013/14/2019-01-13).

[7] See the European Commission's Single Market Act II: https://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2012:0573:FIN:EN:PDF.

[8] Excerpt from the European Commission's Explanatory Memorandum accompanying the ELTIF proposal, COM(2013)0462, available here: https://oeil.secure.europarl.europa.eu/oeil/popups/ficheprocedure.do?lang=en&reference=2013/0214(OLP).

[9] See, for instance, the BETTER FINANCE CMU Assessment Report 2015-2019, where the funding sources for SMEs indicate the high reliance on bank funding - https://betterfinance.eu/wp-content/uploads/CMU-Assessment-Report-2019.pdf.

[10] Ibid.

[11] Matheson Regulatory Note, 'The European Long-Term Investment Funds Regulation', available at: https://www.matheson.com/images/uploads/publications/The_European_Long-Term_Investment_Funds_Regulation_August_2017.PDF accessed 6 July 2020; see also the European Commission website.

The EU co-legislators[12] envisaged the ELTIF with the aim of providing "*finance of lasting duration to various infrastructure projects, unlisted companies, or listed small and medium-sized enterprises (SMEs) that issue equity or debt instruments for which there is no readily identifiable buyer*".[13]

Specific to these investments are the long-term commitment needed ("*patient capital*") and the large scale of financing, coupled with a higher risk profile. As such, the ELTIF project targeted large, long-term institutional investors, such as pension funds or insurance firms, for which eligible projects can provide stable returns at maturity.[14] At the same time, the EC and co-legislators acknowledged that also individual, non-professional ("retail") investors could bring much-needed capital and benefit from long-term returns. However, some ELTIFs may not be deemed suitable for "retail" investors,[15] and those who are must fulfil a list of conditions before selling units to non-professional savers.[16]

How an ELTIF works

An ELTIF is different in many ways to traditional UCITS. Subscriptions and redemptions are not always open but have a fixed period (two or three months) during which investors can buy units, and redemption is possible[17] when stipulated by the manager in the rules of incorporation. Otherwise, the ELTIF Regulation makes it mandatory that investors cannot redeem their units or shares before the end of the life of an ELTIF.[18]

Thus, ELTIF investors are "locked-in" for a longer investment horizon (7 to 10 years), whereas with UCITS investors can "come and go" more easily. However, the investment horizon (*life of the ELTIF*) must be consistent with the projects or assets invested in, meaning that it should "*cover the life cycle of each of the individual assets of the ELTIF*".[19]

After the initial subscription period, the ELTIF manager will invest at least 70% of the capital in certain *eligible assets* such as unlisted SMEs, social infrastructure projects, real estate assets with an economic or social benefit, housing property that contributes to smart and sustainable growth, education or research, as well as goods such as aircraft, trucks or vessels.[20] In addition, ELTIFs are allowed to invest in other UCITS, ELTIFs, EuVECA or EuSEF, while a 30% margin is provided for managers to hold "non-eligible investments" in order to manage cashflows, provided that those investments fall in line with the ELTIF's long-term investment strategy.[21]

In contrast to UCITS, an ELTIF is not allowed to engage in securities financing transactions (such as *securities lending*), short selling, use derivative instruments or get exposure to commodities via derivative instruments. [22]

At the end of the ELTIF's life cycle, redemption can be either in cash[23] or in kind, with investors having the option of transferring their investment into the securities (shares or equity-like

[12] That is, the European Parliament and Council of the European Union according to Art. 294 of the Treaty on the Functioning of the EU.
[13] Recital (1) and Art. 1(2) of Regulation (EU) 2015/760 of the European Parliament and of the Council of 29 April 2015 on European long-term investment funds http://data.europa.eu/eli/reg/2015/760/oj (ELTIF Regulation).
[14] See also Michelle Ridge, Daryl O'Brien, 'The European Long-Term Investment Funds Regulation: Harmonised Rules Have Now Taken Effect Across the EU' (The Hedge Fund Journal, December 2015), accessed 7 July 2020, available at: https://thehedgefundjournal.com/the-european-long-term-investment-funds-regulation;
[15] Article 27(2) of the ELTIF Regulation.
[16] The exceptional nature is derived from the many derogatory provisions on the disclosure and distribution of ELTIFs to the retail sector, i.e. Arts 23 – 30 of the ELTIF Regulation.
[17] Under the exceptions of Art. 18(2) of the ELTIF Regulation.
[18] See Article 18(1) of the ELTIF Regulation.
[19] Art. 18(3) of the ELTIF Regulation.
[20] Art. 10 and 11 of the ELTIF Regulation.
[21] Recital (17) and Art. 13 of the ELTIF Regulation.
[22] Art. 9(2) of the ELTIF Regulation
[23] Article 18(5) of the ELTIF Regulation.

instruments, bonds etc) the ELTIF invested in.[24] However, continuing to invest in the same ELTIF is possible, provided that the rules of incorporation do not establish the liquidation of the vehicle at maturity.

ELTIFs are required to publish a prospectus and a key information document (PRIIPs KID[25]) if marketed and distributed to "retail" investors,[26] and include a prominent warning that the product can be particularly risky and complex. In terms of suitability, ELTIFs have more stringent conditions for retail investment participation (capacity to bear losses or maintain a large investment intact for a longer period).

The ELTIF framework

The ELTIF framework follows the Lamfalussy architecture[27] and is composed of the level 1 regulation (ELTIF Regulation) and the level 2 EC implementing regulation (EU 2018/480[28]) based on ESMA regulatory technical standards (RTS)[29].

Particular to the ELTIF Regulation, is its maximum harmonisation nature, meaning that "*Member States shall not add any further requirements in the field covered by this Regulation*".[30]

Another important provision in the ELTIF framework is the obligation for the European Securities and Markets Authority (ESMA) to establish a free, publicly available database (register) for ELTIFs, which should contain at least the name of the ELTIF, the manager and the country of domiciliation (authorisation), based on quarterly information provided by national supervisory authorities (Art. 33 ELTIF Regulation).

The ELTIF market

According to the register for ELTIFs maintained by ESMA, there are currently[31] 27 ELTIFs registered and authorised by national competent authorities in the EU, of which only 22 are marketed to professional and/or retail investors.

These (very) few ELTIFs are domiciled in just 4 EU jurisdictions, with most in France (41%), followed by Luxembourg (33%), Italy (19%, although only one is currently marketed), and Spain (7%).

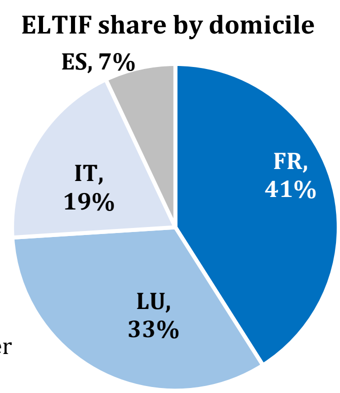


Chart source: ESMA Art. 33 ELTIF register

[24] Article 18(6) of the ELTIF Regulation.

[25] Since ELTIFs distributed to retail investors are considered part of PRIIPs, ELTIF managers will have to comply with the PRIIPs obligations and draft a key information document: see Regulation (EU) No 1286/2014 of the European Parliament and of the Council of 26 November 2014 on key information documents for packaged retail and insurance-based investment products (PRIIPs) – http://data.europa.eu/eli/reg/2014/1286/oj.

[26] Article 23(1) of the ELTIF Regulation.

[27] See the European Commission's explanation on the regulatory process in financial services and what "Lamfalussy architecture" means here: https://ec.europa.eu/info/business-economy-euro/banking-and-finance/financial-reforms-and-their-progress/regulatory-process-financial-services/regulatory-process-financial-services_en.

[28] Commission Delegated Regulation (EU) 2018/480 of 4 December 2017 supplementing Regulation (EU) 2015/760 of the European Parliament and of the Council with regard to regulatory technical standards on financial derivative instruments solely serving hedging purposes, sufficient length of the life of the European long-term investment funds, assessment criteria for the market for potential buyers and valuation of the assets to be divested, and the types and characteristics of the facilities available to retail investors, ELI: http://data.europa.eu/eli/reg_del/2018/480/oj.

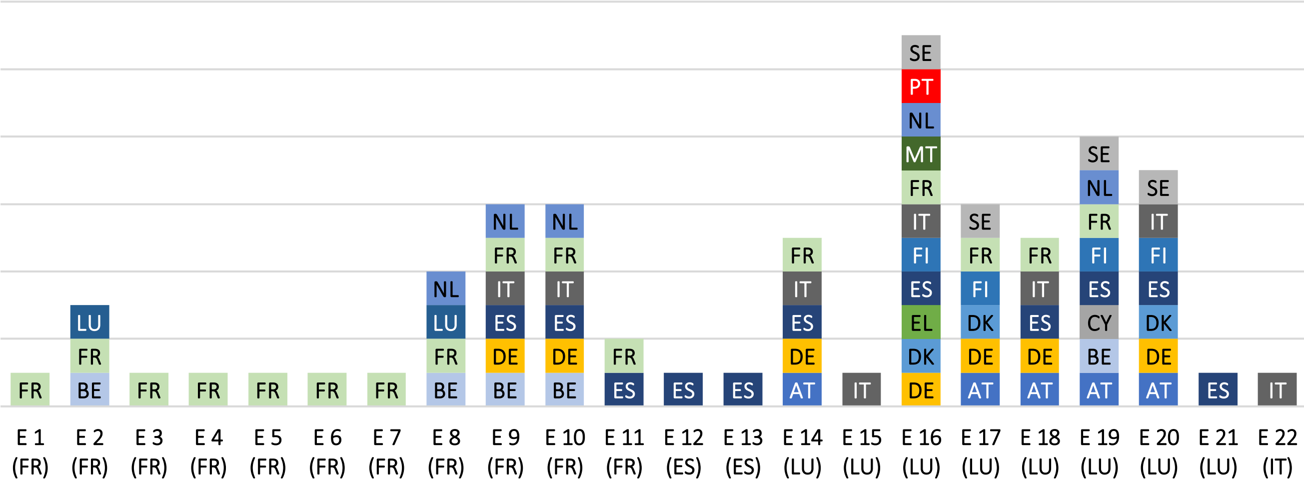
[29] European Securities and Markets Authority, *Final Report on Draft Regulatory Technical Standards under the ELTIF Regulation* (8 June 2016) ESMA/2016/935, https://www.esma.europa.eu/sites/default/files/library/2016-935_final_report_on_eltif_rts.pdf.

[30] Article 1(3) of the ELTIF Regulation; on many instances, EU legislative acts (Directives and Regulations) are of minimum harmonisation, meaning that national legal systems are levelled to a certain extent, leaving the possibility for Member States to further add criteria or provisions in the field regulated by the particular act.

[31] At the date of writing this report, i.e. 10 August 2020, according to http://esma.europa.eu.

In terms of EU distribution, half of the active ELTIFs are currently only distributed in their home state, while the others are also distributed in 16 EU member states,[32] Norway (EEA) and the United Kingdom. However, while all cross-border France-domiciled ELTIFs are distributed at least in the home state and in another jurisdiction, we observed that LU-domiciled ELTIFs (with one exception) are only registered in Luxembourg but distributed entirely in other jurisdictions.

ELTIF domiciles & distribution in the EU



***Note**: "E" stands for ELTIF and the acronym in brackets is the domicile; Source: BETTER FINANCE own composition based on ESMA data; active ELTIFs only*

As we can observe, the ELTIFs that are most distributed cross-border are domiciled in Luxembourg, while the Spanish-authorised ELTIFs are only distributed in the Home State.

The High-Level Forum recommendations

In November 2019, the European Commission set up a High-Level Forum (HLF) of expert stakeholders representing industry, academics and consumers to work on recommendations for building a Capital Markets Union (CMU). Part of the work of the HLF concerned ELTIFs and the need for targeted reviews of its regulatory framework to accelerate its take-up by investors.

The Final Report of the HLF (*A New Vision for Europe's Capital Markets*[33]) highlighted that "*the EU has been suffering from a chronic shortage of financing for companies*"[34] that needed long-term commitments in order to innovate, grow and become more competitive on the global market. It was emphasised that a stronger ELTIF market would not only "*help catalyse wider interest in late stage growth finance of unlisted companies, infrastructure funding, and supporting sustainable investment objectives*"[35] and market-based lending (drawing comparison to the benefits of the US Business Development Companies), but should also further increase "retail" investors' participation into capital markets by "*providing an attractive investment vehicle to capture investment from sophisticated retail investors for long-term, real economy-focused investment*".[36]

The HLF Final Report identifies four areas of improvement and the need to:

- reduce investment barriers, in particular for the retail sector,
- clarify investment requirements,

[32] The jurisdictions are: Austria, Belgium, Cyprus, Germany, Denmark, Greece, Finland, France, Ireland, Italy, Luxembourg, Malta, the Netherlands, Portugal and Sweden.
[33] High-Level Forum on the Future of the Capital Markets Union, *A New Vision for Europe's Capital Markets: Final Report of the High-Level Forum on the Capital Markets Union*" (June 2020) European Commission, https://europa.eu/!gU33Hm (hereinafter HLF Final Report).
[34] Ibid, 12.
[35] Ibid, 38.
[36] Ibidem.

- incentivise capital market investments and
- establish a common withholding tax procedure.

2. BETTER FINANCE Member Survey

The purpose of this report is to assess potential barriers to the development of an EU ELTIF market. Although managers could only apply for registration of ELTIFs from 2017, by the time of writing (August 2020) only 28 ELTIFs had been set up in the EU.

The outstanding question is whether the provisions of the ELTIF Regulation are fit-for-purpose or have deterred AIF managers from setting up ELTIFs. At the same time, the question arises whether national law provisions have created **disadvantages** for this label. Although Member States are not allowed to modify or add any provision to the ELTIF framework (*maximum harmonisation*), this prohibition is limited to the topics regulated by the ELTIF Regulation, and in some cases supplementary legal provisions were needed to adapt the ELTIF label to existing national law.[37]

For instance**, taxation is not subject to the maximum harmonisation rule of the ELTIF Regulation and can play a pivotal role in the attractiveness** of an ELTIF, both for asset managers and investors.

BETTER FINANCE surveyed its member organisations to get the input from individual, non-professional investors on experience at local level with ELTIFs, since this investment vehicle was created to gather long-term, risk capital for SMEs and infrastructure projects also from EU citizens.

The research team gathered input from 10 national associations (from BE, BG, DE, DK, FR, LU, PT, SK, UK)[38] based on the survey sent out, focusing on three main questions:

1. whether retail ELTIFs are domiciled or distributed in a particular jurisdiction;
2. whether there is some form of preferential legal treatment for ELTIFs; and
3. whether there are more stringent requirements to distribute ELTIFs to "retail" investors.

Note: The following descriptions stems from BETTER FINANCE's member organisations, not from the research team.

Domicile and distribution of ELTIFs

Q: Are you aware of the existence of ELTIFs domiciled in your jurisdiction? If yes, are those sold to "retail" investors?

With the exception of Germany and Italy, BETTER FINANCE members are not aware of ELTIFs being marketed or distributed to non-professional investors. In Bulgaria there are no ELTIFs domiciled or distributed at all, and in Belgium the main distributors (banks) do not offer either of the 5 ELTIFs. In terms of institutional investors, distributors may need incentives to offer them over other AIFs (such as commissions, rebates etc). To our member's knowledge, none of the 3 ELTIFs available in Denmark, nor the one in Portugal, were distributed to retail investors. In Slovakia, there are no ELTIFs authorised, nor distributed to institutional or retail investors.

In Germany, individual investors still have a low overall awareness of ELTIFs and investing in them; the minimum entry requirements (generally €100,000) have narrowed ELTIFs'

[37] News item from the French Government of 4 October 2017: https://www.gouvernement.fr/conseil-des-ministres/2017-10-04/modernisation-du-cadre-juridique-de-la-gestion-d-actifs-et-d.

[38] It is important to note that in almost a half of EU jurisdictions ELTIFs are not even distributed or marketed, which rendered the survey basis for BETTER FINANCE much smaller than its membership basis.

accessibility to HNW (High Net Worth) investors, although the legal requirement is of €10,000 for investors with an overall investment volume of €100,000.

Luxembourg is the second largest ELTIF domicile in the EU and, paradoxically, none of these funds are distributed or marketed in Luxembourg; the **only two** ELTIFs that are marketed in Luxembourg are authorised in France. However, the Luxembourgish investors' association claims that this may be the case since ELTIFs, being a class of AIFs, are not intended for the wider public, but for "informed investors", which are defined as either institutional (banks, insurers, asset management companie), professional (HNW clients) investors or individual investors who opt-in to the "well-informed" status, subject to a minimal investment of €125,000.

Moreover, in Luxembourg there seems to be a bias towards *long-term* de-regulated AIFs (so-called reserved AIFs), which mostly claim to also be long-term oriented just as ELTIFs but benefit from less stringent requirements.

Tax treatments

<u>Do ELTIFs receive some form of preferential tax treatment? If not, are other types of funds invested in non-listed assets that are tax-incentivised in your country? If yes which ones? And what kind of tax incentive?</u>

In Portugal, the closest fund legal structure to ELTIFs are funds of funds for internalisation[39] which grants special taxation and regulatory treatment. Otherwise, the tax regime for investment funds that are invested in securities is:

1. returns which are not considered capital gains, are taxed independently through withholding tax; for interests (i.e. on the bonds) the rate is 20% and for dividends the rate is 25%;
2. a rate of 10% is applied to returns which are considered capital gains, the positive difference between capital gains and losses; and
3. returns which are not considered capital gains and are obtained outside of Portugal, are taxed autonomously at a rate of 25%.

In Belgium, there are specific products for investing in start-ups, small caps or non-listed companies that do receive tax benefits. However, these are not marketed or recognised as ELTIFS, although comparable, and the tax incentive is limited to Belgian-domiciled companies. The same goes for Denmark, where there is a tax incentive for private persons investing in non-listed equities, according to which an individual can deduct up to €30,000 per year. The programme was established to channel more financing to SMEs and starts-ups.

In Slovakia, ELTIFs do not receive any preferential tax treatment. The same goes for any other non-listed assets or funds. Only financial instruments listed on stock-exchanges (bonds, stocks or ETFs) under special "long-term investment savings schemes" receive a special tax treatment. This scheme allows "retail" investors to avoid paying income tax on capital gains only if at least one out of the following 2 conditions is met:

- the individual investor buys and holds financial instruments listed on the stock-exchange (ETFs, bonds, stocks, certificates, etc.) since at least 1 year (time test);
- the investor actively trades the listed financial instruments but does not withdraw from the portfolio for at least 15 years (long-term investment saving scheme) and the maximum amount invested each year is €3,000.

[39] See Portuguese Law-Decree no. 68/2018, available at: https://dre.pt/home/-/dre/116090202/details/maximized.

In Luxembourg, regulation has aligned insurance companies' interests with those of ELTIFs through capital gains relief, making it more attractive for these institutional investors to fund ELTIFs. However, there are no other tax incentives offered to institutional or retail investors in Luxembourg.

The German member association indicated that there are no preferential tax treatments for fund legal structures investing in non-listed assets, compared to the ELTIF. However, these vehicles are marketed as being cheaper and more transparent than closed funds, and tradable.

Marketing and distribution of ELTIFs

Are you aware of stringent legal requirements for the establishment or marketing of ELTIFs to "retail" investors in your jurisdiction?

In Belgium, the Financial Supervisory Authority (FSMA) took a very strict interpretation of the rules transposing MiFID II in terms of "complex" products, which cannot be offered to "retail" investors. As such, if an ELTIF is deemed to be complex, it would simply fail the MiFID II suitability requirement and not be marketed to the retail sector. Moreover, the regulatory authority also adopted a strict interpretation of the type of information that can and has to be provided to retail investors. Although it is not a ban, it created hurdles for asset managers and makes ELTIFs unattractive to be distributed to retail investors. In France, ELTIFs have no further requirements than those provided by the EU regulation.

In Slovakia, the whole process of establishing and marketing funds is regulated by the key legal act on collective investment,[40] meaning that there are no more or less advantageous requirements for setting up ELTIFs compared to other investment vehicles.

Although there are no discriminatory legal requirements to establish ELTIFs, the German member association deems that it may be an issue of investment advice. According to them, the lower levels of fees make ELTIFs less attractive for advisors providing this service for closed-ended funds. According to one of the French associations, illiquidity, and stringent rules on each investment (eligible assets), are two major impediments to the uptake of ELTIFs in France.

The Danish association highlighted that such issues are not applicable, but has been advocating to let private persons have the opportunity to invest alongside pension funds in private equity funds, including the partly state-owned fund *Vækstfonden* (Dansih Growth Fund) and their sub funds. This would give Danish individual investors the opportunity to obtain exposure to illiquid, non-listed SMEs and projects. In Luxembourg, as in most other jurisdictions, ELTIFs are simply a sub-set of AIFs, and do not have additional legal requirements to be set up. However, pursuant to the ELTIF regulation, the operational conditions (portfolio diversification and eligible assets) make ELTIFs a more stringent investment vehicle than many regulated AIFs.

3. BETTER FINANCE own research

The BETTER FINANCE team undertook additional desk research to identify barriers to the development of the ELTIF market. The research covers the jurisdictions of France, Italy and Belgium.

In general terms, literature at the time of the entry into force of the ELTIF Regulation quoted concerns from finance professionals with regards to ELTIFs' attractiveness for institutional and retail investors, as well as for AIF managers.

[40] Act No. 203/2011 on collective investment, available in English here: https://www.nbs.sk/_img/Documents/_Legislativa/_BasicActs/A203_2011.pdf.

While some asset managers indicated that the ELTIF Regulation may have been burdened with too much "*operational complexity and regulatory restrictions*",[41] some pointed to the inflexibility on portfolio diversification rules[42] and eligible investments,[43] underlining that the ELTIF label may not be fit-for-purpose.

For instance, the concentration rules limiting ELTIFs to a maximum of 10% in illiquid assets, with a maximum accumulation of 40% for the entire ELTIF portfolio,[44], were pointed out as unfit for social infrastructure projects.

At the same time, the ELTIF was received by financial institutions with some enthusiasm since it broke the banking sector's monopoly of lending to SMEs.[45] In certain jurisdictions where only appointed credit institutions could provide loans to businesses, the provisions of Art. 10(c) of the ELTIF Regulation allowed a specialised part of the fund management industry to originate loans as well.[46]

However, some public authorities have raised concerns[47] over the aspect of not deviating from its purpose – i.e. to bridge finance needs for SMEs and infrastructure or social projects. Indeed, originating and disposing loans for SMEs – which is organically similar to securitisation – poses certain risks which cannot be fully contained within the ELTIF framework.

It was also noted that ELTIFs lacked promotion by public authorities, in particular in terms of fiscal harmonisation or preferential tax treatments to make this label more attractive for asset managers and investors.[48] Where it was promoted (FR and LU), empirical evidence shows that 74% of currently marketed ELTIFs have been authorised.

Retail investors

In addition, some asset managers indicated a lack of an investor basis, particularly on the "retail" side: while institutional investors and private banks were targeted for ELTIFs, finance professionals indicated "retail" investors lacked the financial literacy and experience to be interested at all in holding assets for the long-term.[49] Some correctly highlighted that the lack of trust and reliability in the finance industry manifested by the retail sector also weighed heavily on citizens' reluctance to invest in ELTIFs.[50]

Indeed, the ELTIF did not emerge as a creation of the market – in response to demand – but rather as a regulatory tool to address a market inefficiency.[51] Moreover, although "retail" investors are long-term oriented, biased investment advice has redirected financial services users to short-term holdings. Therefore, a *long-term investment culture* was lacking – and still lacks –not helping to

[41] Lizzie Meager, 'DEAL: Luxembourg's First ELTIF' (19 December 2016) International Financial Law Review, available at: https://www.iflr.com/article/b1lspwxvvq3s59/deal-luxembourgs-first-eltif.
[42] Sandra Sebag, 'Les Fonds ELTIF Doivent Encore Faire Leurs Preuves' (8 July 2019) Institut de l'Epargne Immobilière & Financière, available at https://www.ieif.fr/revue_de_presse/les-fonds-eltif-doivent-encore-faire-leurs-preuves.
[43] Ibid.
[44] Article 13(5) of the ELTIF Regulation.
[45] Amelie Labbe, 'ELTIF Model Brings New Approach to Lending in France' (20 July 2016) International Financial Law Review, available at: https://www.iflr.com/article/b1lspv0rrjx7vm/eltif-model-brings-new-approach-to-lending-in-france.
[46] See also Joshua Pasanisi, 'France's Banking Monopoly Cracks Open' (11 December 2017) International Financial Law Review, available at: https://www.iflr.com/article/b1lv05t0gbmsy7/france39s-banking-monopoly-cracks-open.
[47] See Autorité des Marchés Financiers, *Guide sur les Fonds Européens d'Investissement à Long-Terme (FEILT ou ELTIF)*, January 2016, available at: https://www.amf-france.org/sites/default/files/contenu_simple/guide/guide_professionnel/Guide%20sur%20les%20fonds%20europeens%20d%27investissement%20a%20long%20terme%20%28FEILT%20ou%20ELTIF%29.pdf.
[48] Joshua Pasanisi, 'European Long-Term Investment Funds: Institutional Wine on Retail Bottles?' (24 March 2016) International Financial Law Review, available at: https://www.iflr.com/article/b1lspsc9rnjv2m/european-long-term-investment-funds-institutional-wine-on-retail-bottles.
[49] Linklaters, 'ELTIF: A Critical Piece of Europe's Saving and Investment Puzzle', Linklaters Luxembourg ELTIF Conference Report (2015), available at: https://www.linklaters.com/pdfs/mkt/luxembourg/ELTIF_A_Critical_Piece_of_Europes_savings_and_Investment_Puzzle_Oct2015.pdf.
[50] Martin Parkes (BlackRock) in Linklaters, 'ELTIF: A Critical Piece of Europe's Saving and Investment Puzzle' (n 49).
[51] Labbe, 'ELTIF Model Brings New Approach to Lending in France' (n 45).

whet individual, non-professional investors' appetite to "buy and hold" investments for longer horizons.

Looking at the suitability requirements in the ELTIF Regulation, one can deduct that the ELTIF was not created for the "retail" sector at large, but for a small part comprised of more experienced investors with larger funding availability, referred to as *High-Net Worth* (HNW) investors.[52] While MiFID II does not distinguish between HNW and "low net worth" - both falling under the non-professional clients' category - the entry ticket requirement (at least €10,000 minimal investment), loss-bearing and long-term "lock-in" capacity did, in fact, restrict investment advisors from directing many retail investors to ELTIFs.

France

In France, the Financial Markets Authority (Autorité des Marchés Financiers, hereinafter AMF) issued guidelines in reference to the eligibility of French AIFs to apply for the ELTIF label.[53] As such, professional investment funds (such as securitisation vehicles or specialised financing undertakings) and funds offered also to "retail" investors can obtain the ELTIF label, thus extending the regime to already existing investment vehicles. Moreover, in order to be granted authorisation as an ELTIF, the AMF requires for the vehicle to already be authorised as a French AIF.

What may have triggered an increased uptake of ELTIFs in France is the break from the banking sector's monopoly to grant loans to SMEs - as explained above. France was among the few jurisdictions where only credit institutions were authorised to originate loans to businesses,[54] whereas in many other EU Member States this was already possible through certain funds with no additional requirements,[55] some small asset managers (AIFMs) even exempt from authorisation with national competent authorities. This makes it easier for asset management companies to create ELTIFs since the French Monetary Code and the AMF regulations impose no additional criteria above what is required through the AIFMD (AIF Managers Directive). Moreover, based on the AIFM passport, a non-French asset manager who has been authorised as an AIFM in another EU jurisdiction can benefit from its AIFM passport to establish an AIF and obtain the ELTIF label for it.

Moreover, the specific rules applicable to each investment vehicle selected under French law (that is an AIF) will remain applicable to the ELTIF, which levels the playing field between existing legal forms of investment funds and the ELTIF label.

Moreover, three professional investment vehicles have been allowed since 2015 to grant loans to SMEs satisfying the criteria of the ELTIF Regulation: professional specialised and private equity funds, and securitisation vehicles.[56] However, these funds cannot be marketed or sold as ELTIFs *per se* if the AMF does not authorise them as such (in other words, these AIFs do not benefit from the AIF passport).

In terms of "retail" distribution, French law does not add any additional criteria for distribution to retail investors other than those stipulated in Article 30 of the ELTIF Regulation and in the AIFMD, the most important being the *suitability assessment*. As such, if a "retail" investor is

[52] BETTER FINANCE prefers avoiding this term and, instead, using the term of *non-professional qualified investors* – see the recommendations on distribution for retail investors of the High-Level Forum on the Future of the Capital Markets Union, *A New Vision for Europe's Capital Markets: Final Report of the High-Level Forum on the Capital Markets Union*" (n 33).

[53] See AMF, *Guide sur les Fonds Européens d'Investissement à Long-Terme (FEILT ou ELTIF)*, (n 48).

[54] Pasanisi, 'France's Banking Monopoly Cracks Open' (n 47).

[55] Jeremy Pickels, Nora Bullock (Hogan Lovells), 'ESMA's Loan originating Fund Regime Unpicked' (11 July 2016) International Financial Law Review, available at: https://www.iflr.com/article/b1lsptst5fqczp/esmas-loan-originating-fund-regime-unpicked.

[56] Hubert Blanc-Jouvan, 'France: A New Era for Direct Lending Funds' (Ashurts.com, 5 May 2016) accessed 10 August 2020, available at: https://www.ashurst.com/en/news-and-insights/legal-updates/france-a-new-era-for-direct-lending-funds/.

deemed to be financially prepared and have a suitable investor profile to be locked-in an ELTIF, then a FR-domiciled AIF that is authorised as an ELTIF will be marketed to the "retail" sector as well.

Based on ESMA's register of ELTIFs, the research team analysed the French-domiciled ELTIFs to learn about distribution to retail investors and available pool of capital at the end of the subscription period. Due to a lack of publicly available documentation, we cannot be sure of the total Assets under Management (AuM), although existing publications point to more than €2.2 billion. However, of the 7 ELTIFs for which we could find information, we believe that only 3 are available to retail investors. According to one of French national associations, the 11 ELTIFs registered in France do not hold more than €0.8 billion in AuM.

In France, ELTIFs receive no form of preferential treatment whatsoever. Capital gains are taxed at a flat rate of 30%, which is paradoxical since French investors benefit from various tax breaks when investing in SMEs directly or through funds.

Direct investments in SMEs benefit of a 25% tax break on income tax with a cap on investments at €50,000 for a single person (€100,000 for a couple). The maximum tax break is €12,500 (€25,000 for a couple) and capital gains are not subject to tax. The minimum holding required to benefit of fiscal stimulus is 5 years.

However, the innovation funds (Fonds Commun de Placement dans l'Innovation, FCPI) and neighbouring funds (Fonds d'investissement de proximité, FIP) benefit from an up to 25% tax break on income tax with a cap on investment at €12,000 for individuals (€24,000 for a couple). The maximum tax break is €3,000 for an individual (€6,000 for couples), there is no tax on capital gains and the minimum holding period is 5 years.

Moreover, in 2020 several fund structures that were also registered as ELTIFs were launched, without being marketed as ELTIFs per se. This is because it seems more attractive for asset managers to adopt domestic law labels such as the FCPR ("*Fonds Commun de Placements à Risque*") granting investors exemption of all income taxes on capital gains or the FCPI ("*Fonds Commun de Placement dans l'Innovation*") which is even more tax-advantageous. As such, these newly established ELTIFs obtained tax advantages by virtue of their domestic fund structures, not thanks to the ELTIF label.

Italy

The *Decreto Crescita* (Legislative Decree no.34 / 19, art.36-bis) has introduced tax concessions in relation to ELTIFs specialised in Italian SMEs or which mainly invest own capital in companies "rooted" in Italy, starting from the year 2020. The incentives also apply to share subscriptions of collective investment undertakings (*organismo di investimento collective del risparmio* - OICR) which fully invest their assets in units or shares of ELTIFs specialised in Italian SMEs.[57]

In particular, investments in ELTIFs with the following characteristics can benefit from tax incentives:

- the assets raised by the same manager must not exceed €200 million for each year, up to an overall maximum limit for each manager of €600 million;
- at least 70% of the capital of the ELTIF must be invested in
    - equity or quasi-equity instruments or in debt instruments issued by "eligible portfolio companies", also acquired on the secondary market;
    - in loans granted by the ELTIF to the aforementioned companies;

[57] Assogestioni, 'ELTIF, Una Panoramica Sulle Agevolazioni Fiscali' (Assogestioni.it, 8 October 2019) vailable at: https://www.assogestioni.it/articolo/eltif-una-panoramica-sulle-agevolazioni-fiscali.

- in real assets, for a value of at least € 10 million, indirectly through participation in eligible portfolio companies.

For the purposes of the legislation, "eligible portfolio companies" are companies that do not carry out activities of a financial nature (unless they are companies that exclusively finance eligible portfolio companies), that are resident in Italy or in an EU or EEA state with a permanent establishment in Italy. They must be companies not listed on a regulated market or, if listed, with an average capitalisation of less than €500 million.

Moreover, the *Decreto Crescita* introduces a tax benefit for Italian resident individuals investing in ELTIFs: any income arising directly from investments in ELTIFs or indirectly from investments in mutual funds which invest their entire portfolio of assets in ELTIFs, and any capital gains arising from the disposal or the redemption of the above units or shares of ELTIFs, are not subject to tax.

With regard to the recipients and the nature of the tax incentives, similarly to the provisions for investments held in the PIR (Piani individuali Risparmio) they concern only natural persons resident in Italy and consist of the exemption from taxation of income deriving from participation in the ELTIF or in funds of ELTIF (instead of applying the ordinary tax rate of 26%) and in the exemption from inheritance tax of the units or shares of the ELTIF or of the ELTIF funds which, therefore, do not contribute to forming the hereditary assets.[58]

The conditions for benefiting from the tax relief are, in principle, the same as those provided for the PIR,[59] but more generous as regards the amount of eligible investments. To benefit from the exemption scheme, the units or shares of the ELTIF specialised in Italian SMEs (or the ELTIF fund) must be held for a period of at least five years (minimum holding period). However, it is possible to disinvest from the units or shares even before the expiry of the five years and, in order not to lose the tax advantage, the related value must be fully reinvested in another ELTIF (or ELTIF fund) within 90 days of the sale or from the redemption of units or shares.

However, the tax advantages for ELTIFs are not yet concretely usable by investors. It is necessary to wait for the authorization of the European Commission which recognizes the compatibility of the measures in question with the rules on state aid. A decree by the Minister of Economy and Finance is also envisaged that will concretely define the application methods of the tax benefits. In February 2020, Italy asked the European Commission to urgently provide an answer on the authorization of the tax incentives for ELTIFs.[60]

When comparing individual savings plans (PIR) with ELTIFs, the latter are better structured to facilitate capital flow to SMEs compared to PIR. However, ELTIFs haven't provided any tax advantage so far. New changes applicable from 2020 will provide tax breaks for Italian ELTIFs but the European Commission still needs to approve the legislation in question (*Decreto crescita*). Therefore, in reality ELTIFs did not have time to take off, considering that something similar already exists on the market and tax advantages have been introduced only in 2020 (still under approval by EU Commission).

[58] Francesco Bonichi, Elisa Cesetti, 'INSIGHT: Italy Introduces Tax Incentives to Support New Investments' (Bloomberg Tax, 12 August 2019), available at: https://news.bloombergtax.com/daily-tax-report-international/insight-italy-introduces-tax-incentives-to-support-new-investments.

[59] Redazione Soldionline, 'PIR (Piani Individuali Risparmio): cosa sono. Le novità 2020' (Soldionline.it, 27 November 2019), available at: https://www.soldionline.it/guide/prodotti-finanziari/piani-individuali-di-risparmio-pir

[60] Redazione Advisor, 'Eltif, l'Italia Chiede all'UE l'ok Sulla Defiscalizzazione' (Advisoronline.it, 14 February 2020) available at: https://www.advisoronline.it/strumenti-finanziari/investimenti-alternativi/54449-eltif-l-italia-chiede-all-ue-l-ok-sulla-defiscalizzazione.action

Belgium

Specialised publications noted that Belgium did not adopt a regulatory framework to facilitate or incentivise the uptake of ELTIFs.[61] In Belgium, the eligible assets under the ELTIF Regulation can be invested in through a special vehicle under national law, *private equity funds*. However, these have not been very attractive to institutional investors either, since Belgium lacks a regulatory framework that makes infrastructure investments efficient and transparent, as well as fiscal incentives.[62] Since private equity funds (such as real estate funds) have not taken off either and asset managers choose French- or Luxembourg-domiciled funds, it comes as no surprise that there was limited interest in ELTIFs.

United Kingdom[63]

As apparent from the introduction of the ELTIF market, these investment vehicles have not stirred as much interest as expected in the United Kingdom (UK) either. Although the UK will no longer be part of the Internal Market, in light of the significant role it played for EU capital markets (both from a regulatory and market development point of view), the research team decided to include an analysis on the factors deterring asset managers from offering, and retail clients investing in, these vehicles in the UK.

To begin with, the overall reasons can be summarised as follows:

- the criteria for "*eligible assets*" were considered overly restrictive;
- the regulatory framework failed to recognise and make allowances for the liquidity transformation benefits afforded by listing the shares of ELTIFs;
- at the same time, some stakeholder perceived too much focus from the asset management industry on Assets under Management (AuM) driving illiquid assets (such as property) into inappropriate (open-ended Non-UCITS Retail Schemes, "NURS") vehicles;
- the pre-existence of a developed (and less restrictive) Investment Trust or Investment Company market;
- a currency mismatch for most European domiciled funds.

Although ELTIFs have been created to cater both for the needs of illiquid, socially important investments and those of individual investors and institutional investors, it is always difficult to address these needs within a single framework of rules. As a result, building safeguards for retail investors is often overly restrictive for their professional counterparts. This has been the case with ELTIFs, where restrictions on financial undertakings and large capitalisation stocks seem overly and arbitrarily restrictive.

The fundamental concern for retail investors taking exposure to illiquid and long-term assets is liquidity. The funds' market suffers from a fundamental imbalance due to an excessive focus by issuers on the use of open-ended fund structures (UCITS and NURS). These vehicles are inappropriate for investments in illiquid, long-term and difficult to value assets because clients (investors) must be able to redeem their shares at all times, which creates difficulties for liquidity management, as has been shown by the repeated suspension of redemptions by the UK property

[61] Therese Loffet, Thierry Tilquin, Kevin Alfers, 'A "ELTIF" Status for Belgian Alternative Investment Funds?' (21 August 2019) Lime Advocats/Advokaten, available here: https://lime-law.s3.amazonaws.com/documents/latest-thinking/Latest-Thinking-A-ELTIF-status-for-belgian-alternative-investement-funds.pdf?mtime=20191108154057&focal=none; see also . TILQUIN et K. ALFERS, 'Le Fonds Européen d'Investissement à Long Terme et les Investissements Immobiliers', numéro spécial de la revue Jurimpratique (Revue pratique de l'immobilier), Larcier, 2017, p. 289.

[62] Jean-Paul Bombaerts, 'Les Fonds ELTIFs Pour Relancer l'Economie' (L'Echo, 25 June 2020) available at: https://www.lecho.be/economie-politique/belgique/economie/les-fonds-d-investissement-a-long-terme-ne-percent-pas-en-belgique/10235452.html.

[63] Based on input received from one of BETTER FINANCE's member associations in the UK.

funds. To give an example, in early March 2020, all open-ended UK property funds available to retail investors were suspended,[64] which in our view is a serious concern for investor protection.

At the same time, very few individual ("retail") investors are in a position to commit capital to an investment strategy for multiple years into the future, especially on such long horizons (7-10 years). The requirement for a liquidity transformation process is very effectively addressed within the UK by the Investment Trust or Investment Company market, which comprises listed closed-ended vehicles. The Investment Trust concept addresses the needs of retail investors by allowing the shares of closed-ended, long-term investment vehicles to be traded on the stock market. Retail investors are able to value and liquidate their holdings on a continuous basis, while managers enjoy the benefits of locked-in patient capital.

There are complications to this mechanism, evidenced by the tendency of the shares to trade at a premium or - more frequently - a discount vis-à-vis the portfolio Net Asset Value (NAV). A consistent discount represents a clear cost to investors for accessing market liquidity, and also makes secondary capital raises difficult for managers. Matters are further complicated by the development of discount control mechanisms, whereby a manager commits to buy back shares if the discount widens beyond a certain level.

However, this is a complex matter, and some recommendations need to be tailored to certain markets' needs. In the case of the UK, steps need to be taken cautiously, but it would appear that the following items need to be addressed through a regulatory response:

- restrict the use of open-ended structures in relation to illiquid, long-term or hard to value assets (which might be achieved either by a ban or by introducing fixed[65] or variable redemption notice periods);
- promote the use of closed-ended ELTIFs whose shares are admitted to trading on public stock markets by allowing such instruments to be sold to a broader retail investor base and by relaxing the investment restrictions for such funds.

Without these adjustments the ELTIF will find limited demand in the UK; managers are motivated to shoehorn illiquid assets into open ended funds, and Investment Trusts are a superior and more flexible solution than ELTIFs due to their liquidity transformation characteristics. Nevertheless, these policy considerations may be valuable for other EU27 markets as well.

[64] Imogen Tew, 'All Property Funds Expected to Gate "Within Hours" as £11bn Trapped' (FTAdviser.com, 18 March 2020) available at: https://www.ftadviser.com/investments/2020/03/18/all-property-funds-expected-to-gate-within-hours-as-11bn-trapped/.

[65] To learn of the UK Financial Conduct Authority's proposed response, see Imogen Tew, 'FCA Eyes 180-day Wait for Property Fund Withdrawals' (FTAdviser.com, 3 August 2020), available at: https://www.ftadviser.com/investments/2020/08/03/fca-eyes-180-day-wait-for-property-fund-withdrawals/?page=2.

4. POLICY RECOMMENDATIONS

Considering this research's findings, BETTER FINANCE puts forward several recommendations to increase the uptake of ELTIFs by individual investors and create a safe and trustworthy environment for individual, non-professional investors.

1. *Grant ELTIFs the most favourable tax regime for "retail" investment products investing in illiquid assets in every EU Member State*

As seen in the few recent cases, asset managers also apply for the ELTIF label, but it may be often that the driver to establish such a fund comes from other, more attractive, domestic labels (such as the FCPI) which are tax-incentivised rather than the ELTIF itself.

Although the requirements to set up ELTIFs are very accessible, any previously authorised AIF being able to be converted to an ELTIF, the more stringent operational and investment rules for ELTIFs make it less attractive for firms (asset management companies) to set up. Moreover, considering also the more stringent suitability requirements for retail investors, many asset managers may opt to simply offer national tax-favoured long-term oriented AIFs, or unregulated AIFs investing in illiquid assets, rather than ELTIFs.

In light of the recommendations of the HLF CMU Final Report, the EU Commission should propose to Member States a "*preferential tax treatment*" for ELTIFs in order to boost its uptake.

2. *Allow more redemption flexibility*

Both this report and the conclusions of the HLF CMU Final Report found that many non-professional individual investors may be deterred from investing in ELTIFs due to the stringent redemption requirements imposed by the ELTIF Regulation (Art. 18). While the spirit of the ELTIF should be maintained, i.e. to be a long-term commitment for illiquid non listed investments, providing flexibility on redemption policies by ELTIF managers for individual investors may reduce the inherent risk profile of ELTIFs and increase their attractiveness in the retail sector.

3. *Create a long-term investment culture*

As mentioned by stakeholders, ELTIFs lack a base of affluent investors due to a lack of awareness, financial education, long-term investment culture, but most importantly an adequate level of trust and reliability in the finance industry and capital markets (e.g. the Wirecard scandal). EU authorities must stimulate <u>independent</u> (unbiased) adult financial education at the point of sale and at the workplace (employee share ownership) to make ELTIFs more accessible and popular among individual investors, especially since these vehicles are suitable for long-term savings, as long as they remain a small part of the total.

4. *Apply the UCITS disclosure regime (Prospectus and KIID)*

For the moment, ELTIFs are subject to the PRIIPs disclosure regime, which is highly detrimental to retail investors, in particular as it discloses only non-intelligible, not comparable and misleading future cost ("reduction-in-yield") and performance projections, and no actual long term performances compared to the benchmarks of the fund managers, and no actual costs. The own initiative report of the Economic and Monetary Affairs (ECON) Committee of the European Parliament stated the importance of making past performance available to investors and of not using past performance to predict future returns (which is unfortunately precisely what the PRIIPs rules are mandating) .

Moreover, the ECON Capital Markets Union (CMU) report, the Final Report of the High-Level Forum on the Future of the CMU and the European Commission's New CMU Action Plan called for a review of the PRIIPs regime to ensure that meaningful information is disclosed to investors.

Thus, BETTER FINANCE recommends amending the ELTIF Regulation in order to apply the UCITS Key Investor Information Document (KIID) instead of the PRIIPs Key Information Document (KID). This would entail modifying Article 23 of the ELTIF Regulation as follows:

"The units or shares of an ELTIF shall not be marketed to retail investors in the Union without prior publication of a key ***investor*** *information document in accordance with ~~Regulation (EU) No 1286/2014~~* ***Articles 78 – 82 of Directive 2009/65/EC and with Commission Regulation (EU) No 583/2010***~~"~~.

Currently, UCITS are still exempt from publishing the PRIIPs KID under the PRIIPs Regulation ("UCITS exemption"). However, the UCITS KIID exemption (Art. 32(1) of Regulation (EU) No. 1286/2014) will cease on 31 December 2021, when all investment funds still applying the UCITS disclosure regime will transition to the PRIIPs disclosure regime. If by that time the EU co-legislators and the EU Commission do not extend the UCITS exemption or do not change the unclear, misleading and not comparable information in the PRIIPs KID, BETTER FINANCE calls for an amendment of the ELTIF Regulation requiring the publication of long-term past performance relative to the benchmarks of the ELTIF managers and actual cost disclosure.

Ensuring the availability of relative long term past performance and actual cost disclosure in the ELTIF Key (investor) Information Document can take many forms, such as: attaching an annex to the PRIIPs KID or introducing a link or cross-reference to where such information can be found.

5. *Make listed small-cap equity an eligible asset*

Asset managers have also indicated that more flexibility in terms of eligible investments is needed. The EU economy, especially after the economic shock sent by the global health crisis, needs fresh risk capital – available from individual, non-professional investors – to revive the economy and SMEs. Therefore, listed small-cap equity should be made an eligible asset for ELTIFs.

The HLF CMU Final Report recommended amendments to the definition of real estate assets and to the thresholds for qualified portfolio undertakings, which BETTER FINANCE has supported.

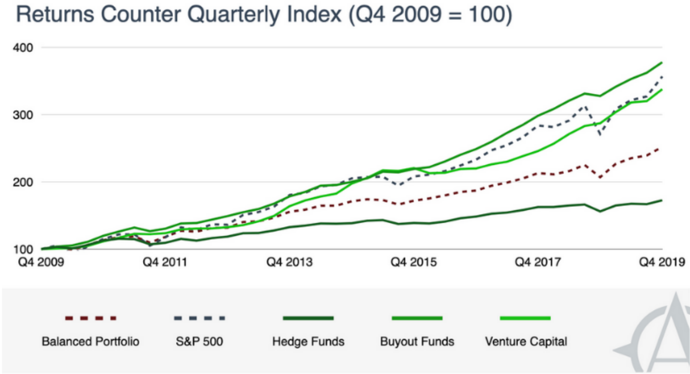
However, less stringent amendments to the ELTIF Regulation – regarding eligible assets and leveraging - would entail an increase of the risk and illiquidity of ELTIFs making them less suitable for the average individual, non-professional investor.

BETTER FINANCE calls on the European Commission to ensure that any amendment to the operational criteria and investment restrictions brought to the ELTIF will be reflected in the suitability and distribution rules applicable for "retail" investors.

6. *Maintain an adequate investment threshold for a product investing mostly in illiquid assets*

Although a good investment vehicle for retirement provision (if it remains a small part of the overall pension "pot" of EU citizens) and for socially important projects, ELTIFs are still a risky and illiquid investment. As such, ELTIFs may not be suitable for many retail clients, reason for which adequate safeguards and thresholds should be maintained for the majority of "retail" investors.

BETTER FINANCE highlights a significant concern that, due to the different layers of fees, ELTIFs can be more costly than private equity investments:



<u>*Source*</u>: American Compass, *The Returns Counter* (Oct. 14, 2020)[66]

Considering the findings of BETTER FINANCE's study on the *Correlation between Cost and Performance of EU Equity Retail funds* (2019), demonstrating the very important impact fees have on investment returns, we consider that ELTIFs are not designed for the broad "retail" segment.

As such, BETTER FINANCE recommends that the minimum initial investment requirement of Art. 30(3) ELTIF Regulation should be maintained at €10,000, which is already quite low when considering that, at the same time, many issuers of more liquid and much less risky listed straight corporate bonds now often set the nominal value per bond at €100,000, thus de facto kicking out the few remaining "retail" investors from the bond markets.

However, a small part of "retail" investors have a higher level of understanding of capital markets, of investment risks, and have a higher loss bearing capacity. These investors, although still qualified as "retail" clients under MiFID II, could be part of the "affluent" segment of ELTIF individual investors. Nevertheless, considering the distribution requirements under Articles 27 – 28 of the ELTIF Regulation, this category of investors may not have access to buy units in ELTIFs.

As such, BETTER FINANCE recommends the EU Commission to enable less stringent MiFID II investment restrictions for ***qualified non-professional investors***, for example by changing the name and definition of the "professional investor" category in MiFID II, and easing the conditions to qualify for this category for certain financially literate non professional individual investors

7. *Follow-up on the other HLF CMU Recommendations*

This report makes specific recommendation in light of its findings; however, other targeted amendments may be needed to ensure that the ELTIF is a success story.

The High-Level Forum on the Future of the CMU put forward as well ~~the~~ other ~~several~~ recommendations regarding ELTIFs to facilitate their uptake in the EU, which the European Commission and co-legislators should follow-up on to achieve the objectives set out in the ELTIF regulation.

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[66] Link here: https://americancompass.org/projects/coin-flip-capitalism/returns-counter/.

Acknowledgments

The BETTER FINANCE research team wishes to thank their colleagues from the national member associations who answered the survey and provided valuable input towards the elaboration of this report, in particular:

(BG) Desislav Danov, FinTech Guardian
(BE) Ben Granjé, Vlaamse Federatie van Beleggers
(DE) Christiane Hölz, Deutsche Schutzvereinigung für Wertpapierbesitz
(LU) Jean Medernach, Luxembourg Association of Private Investors (INVESTAS)
(DK) Niels Mengel, Dansk Aktionærforening
(UK) Mark Northway, UK ShareSoc
(FR) Guillaume Prache, Fédération des Associations Indépendantes de Défense des Epargnants pour la Retraite (FAIDER)
(SK) Ján Šebo, Inštitut Sporenia a Investovania (ISI)
(FR) Aldo Sicurani, Fédération des Investisseurs individuels et des Clubs d'investissement (F2iC)
(PT) Octavio Viana, Associação de Investidores e Analistas Técnicos (ATM)

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The writing and publication of this report is co-funded by the European Union. There is no implied endorsement by the EU or the European Commission of work carried out by BETTER FINANCE, which remains the sole responsibility of BETTER FINANCE.

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