

Ms. Mairead McGuinness
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Financial Services, Financial
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Union
European Commission
Rue de la Loi 200
B-1049 Brussels

Ref: Review of the Regulation (EU) 2015/760 on European long-term investment funds (ELTIFs)

Dear Ms. McGuinness,

In light of the impending review of Regulation (EU) 2015/760 on European long-term investment funds (ELTIFs), and as a response to your letter dated 27 October 2020 on the functioning of the ELTIFs framework, ESMA would like to take the opportunity with this letter to highlight some areas of the ELTIF Regulation where improvements could be made. This letter is also aimed at meeting the request for input from ESMA as per Article 37 of the ELTIF Regulation.

As you indicate in your letter, while ELTIFs can play an important role in the post-Covid recovery, only a small number of ELTIFs have been launched. In this respect, you will find in [Annex I](#) of this letter some data gathered by ESMA on the current shape of the ELTIF market.

As the years have passed since 2015 when the original Regulation was published, ESMA has had exchanges with National Competent Authorities on their practical experience in supervising firms in accordance with the rules. In doing so, we have noticed certain areas of the framework that could be improved as part of your review. In addition, the need for investments in the real economy to accelerate the recovery from the COVID-19 requires some areas of the regulatory framework for investment vehicles, such as ELTIFs, to improve further.

This letter shares ESMA's views in [Annex II](#) on the key topics of the ELTIF review where we see the need to consider amendments to the framework.

I hope that these considerations are useful to the European Commission in its review. In case you have any questions, please do not hesitate to contact me or Evert van Walsum, Head of Investors and Issuers Department (evert.vanwalsum@esma.europa.eu).

Yours sincerely,

Steven Maijor



Annex I – Overview of the ELTIF market based on ESMA data

ELTIF Register and survey

Pursuant to Article 3(3), second sub-paragraph of the ELTIF Regulation, ESMA shall keep a central public register identifying each ELTIF authorised under the same regulation and make it available in electronic format. The register is available on the ESMA website¹.

In the context of the collection of information from national competent authorities for the purpose of the register, ESMA recently conducted a survey exercise to map the state of play of the ELTIF industry. The survey aimed at collecting some additional information on a best-effort basis on top of those necessary for the establishment of the register. The information related to AuM, fees, portfolio holdings and performances of ELTIFs.

Main results of the survey

Information related to the ESMA register

As of the date when the survey was conducted (June 2020), there were 25 ELTIFs domiciled in Europe. 8 of them were not marketed yet. Therefore, the total number of active ELTIFs amounted to 17 of which 11 were domiciled in France, 3 in Luxembourg, 2 in Spain and 1 in Italy. While all the funds were domiciled only in 4 countries, they were marketed all over Europe, with the exception of Eastern European countries.²

While these figures are low, in some Member States, such as Luxembourg and Italy, the number of requests for ELTIF authorisations seems to be currently growing; specifically, in Italy this is due to fiscal incentives specified under national law.

Information related to AuM, and portfolio holdings of ELTIFs

The approximate total ELTIFs AuM across Europe only amounted to €1,54Bn, representing a minimum fraction of the total AIFs market (€6,7Tn). French and Luxembourg ELTIFs held the vast majority of the total AuM, respectively amounting to €1Bn and €510Mn. In Italy the total AuM amounted to €20Mn and this amount is due to increase taking into account the abovementioned growing trend of authorisations. For Spanish ELTIF this amount was equal to €7Mn.

ESMA staff made use of the data available in the AIFMD database to gather additional information on ELTIFs' portfolio composition. The results are as follows: 60% of the total AuM (€900Mn ca.) was invested in loans granted to qualifying undertakings³. Roughly 11% of the total AuM (€165Mn) was instead invested in equity and 6% (€90Mn) in non-investment grade corporate bonds. The rest was made up by cash and cash equivalents, including in foreign currencies for hedging purposes.

¹ <https://www.esma.europa.eu/document/register-authorized-european-long-term-investment-funds-eltifs>

² There were no ELTIFs marketed in Bulgaria, Croatia, Estonia, Greece, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia, Slovenia, Iceland, Liechtenstein. However, there is one Luxembourg based ELTIF notified for marketing in Czech Republic since the end of October 2020.

³ Namely unlisted companies or small and medium enterprises (SME). See Art. 10 of the ELTIF Regulation.

Annex II: ESMA's proposed changes to the ELTIF Regulation

The creation of the ELTIF legal framework was aimed to increase European long-term investments in the real economy (which include infrastructure projects, real estate and listed and unlisted SMEs). However, despite the advantages of ELTIFs, the use of this long-term financing alternative is not yet fully succeeding. Bringing ELTIFs more in line with the needs of investors (both retail and professional) would make it a more attractive investment vehicle for professional investors, as well as a savings' placement alternative for retail investors, further improve the access to funding for SMEs and enable the ELTIF framework to reach its purpose in the recovery of the European economy and in the deepening of CMU.

In that respect, and while in certain Member States, it has been observed that ELTIFs are marketed to both retail and professional investors, ESMA would like to emphasise that these two types of investors do not have necessarily the same needs. In light of the specific characteristics of each type of investor, ELTIFs should be attractive to retail investors whilst meeting the specific needs of professional investors. Moreover, fostering further participation of retail investors requires to ensure their full protection through the implementation of mitigation mechanisms to face liquidity and maturity issues. However, these mechanisms may not always be aligned with retail investors' needs, given they imply constraints, e.g. on the ability to redeem shares at a certain point in time. The review of the ELTIF framework should aim to achieve the right balance between these goals making the investment more flexible but ensuring adequate standards of protection for retail investors.

In addition, ESMA is of the view that in the context of the upcoming review, it is important 1) to ensure alignment with the spirit and original objective of the ELTIF Regulation, which is to finance unlisted firms and SMEs, hence the high threshold (70%) on eligible assets belonging to these categories; 2) avoiding excessive liquidity mismatches and potential financial stability risks' concerns should the ELTIF segment grow; and 3) ensuring retail investor are adequately protected if ELTIFs are marketed to them.

This review should also address proportionality concerns and bear in mind the differences between national markets within Europe in order to enable investments from a larger and more diversified number of investors.

As a consequence, it seems relevant to consider the extent to which the review of the ELTIFs framework should focus on the following areas (which broadly follow the order of the articles of the ELTIF Regulation) where amendments could be put forward:

- Eligible assets and investments;
- Authorisation process;
- Conflicts of interests;
- Portfolio composition and diversification;
- Redemptions;
- Disposal of ELTIF assets;
- Prospectus and cost disclosure;
- Local physical presence;
- Specific requirements concerning retail investors;
- Other residual areas.

1. Eligible assets and investments (Article 2 and 10, 11 of the ELTIF Regulation)

ESMA is of the view that further extending and clarifying the scope of ELTIF's eligible assets and investments could contribute to accelerate the creation and further development of ELTIFs.

In this context, ESMA would like to highlight the following aspects:

- i) Clarifying the definition of «real asset» (Article 2(6) of the ELTIF Regulation) is important. In particular, the nature of the real estate referred to in this article could be clarified; commercial property or housing are considered to be real assets only "*where they are integral to, or an ancillary element of, a long-term investment project that contributes to the Union objective of smart, sustainable and inclusive growth*". The definition of a "*long-term investment project that contributes to the Union objective of smart, sustainable and inclusive growth*" could be clarified for instance, with regard to sustainable growth by reference to contribution to environmentally sustainable economic activities in accordance with Regulation (EU) 2020/852 (Taxonomy Regulation). From a more general standpoint, in relation to the other terms included in the abovementioned definition of "real asset" in Article 2(6), given the long-term nature of ELTIFs, the possibility to invest in infrastructure and real estate should be less restrictive;
- ii) Allowing ELTIFs to invest in other types of funds than ELTIF/EuVECA and EuSEF, provided a) these funds invest in the same or similar asset universe as compared to ELTIFs and b) similar investment restrictions as in the case of ELTIFs are applied (eligible asset, diversification, leverage limits for example) would ensure the underlying funds have the same risk profile as ELTIFs. This would extend the investment base and offer an exposure to a wide variety of assets (Article 10 of the ELTIF Regulation);
- iii) Reducing the amount of € 10Mn in relation to the investment in direct or indirect holdings would extend the scope of eligible investments⁴ to real assets with a lower value, and this would allow to take into account the different sizes of national markets across Europe, and foster the development of ELTIFs. However, when reducing this amount, general infrastructures⁵ should still be targeted as the main real asset eligible for ELTIFs;
- iv) Softening the requirement of "majority owned subsidiary" (Article 10(a)(iii)⁶), by allowing the minority co-investment in investment opportunities, could attract more modest promoters of investment projects.

Considering the wording used in article 10(e) of the ELTIF Regulation, it should be also clarified if indirect investments are also allowed in the case of assets other than real assets and, if so, under which conditions. By indirect investments, it is meant situations in which the ELTIF invests indirectly (via another entity as e.g. SPVs, securitisation vehicles, aggregator vehicles, holding vehicles) into the relevant eligible target assets.

⁴ Article 10(e) of the ELTIF Regulation currently specifies that eligible assets include "*direct holdings or indirect holdings via qualifying portfolio undertakings of individual real assets with a value of at least € 10 000 000*"

⁵ As currently specified in article 2(6) of the ELTIF Regulation.

⁶ Article 10(a)(iii) of the ELTIF Regulation currently specifies that eligible assets include equity or quasi-equity instruments which have been (...) "*issued by an undertaking of which the qualifying portfolio undertaking is a majority owned subsidiary, in exchange for an equity or quasi-equity instrument acquired in accordance with points (i) or (ii) by the ELTIF from the qualifying portfolio undertaking or from a third party via the secondary market*"

In relation to Article 11 on qualifying portfolio undertakings, ESMA is of the view that the marketing capitalisation threshold of 500 Mn EUR could be raised to 1Bn EUR. Article 11 of the ELTIF Regulation currently specifies that “a *qualifying portfolio undertaking referred to in Article 10 shall be a portfolio undertaking other than a collective investment undertaking that fulfils the following requirements: ... (b) it is an undertaking which... (ii) is admitted to trading on a regulated market or on a multilateral trading facility and at the same time has a market capitalisation of no more than EUR 500 000 000*”. The rationale would be to enlarge the scope of eligible assets so that more SMEs could benefit from the financing provided by ELTIFs (the average market capitalisation of companies included in the MSCI Small Cap index is \$1.2bn). However, it has to be noticed that the modification of the abovementioned threshold would imply a certain change of the nature of ELTIF, which can be justified by the willingness to further develop this investment vehicle to increase European long-term investments in the real economy, as explained above in the introductory part of this Annex, but this would need to be carefully assessed.

In that same article, paragraph (1)(a) could be amended to allow for the inclusion of certain types of financial undertakings in the definition of qualifying portfolio undertakings (e.g. holding companies) in order to accept financing structures currently common in private equity deals.

In relation to Article 11 on qualifying portfolio undertakings, ESMA is of the view that third-country related issues could also be further specified.

Given recital (4) (*Long-term investments in projects, undertakings, and infrastructure in third countries can also bring capital to ELTIFs and thereby benefit the European economy. Therefore, such investments should not be prevented*), article 11(1) c)⁷ and the main objective of the ELTIF Regulation set in Article 1(2), which is to raise and channel capital towards European long-term investments in the real economy, in line with the Union objective of smart, sustainable and inclusive growth, ESMA is of the view that the extent to which investments in third countries (for all types of assets eligible under the ELTIF Regulation) are allowed could be further clarified. Qualifying undertakings in third countries could also be further calibrated by, e.g. setting a threshold for those investments.

⁷ “A *qualifying portfolio undertaking referred to in Article 10 shall be a portfolio undertaking other than a collective investment undertaking that fulfils the following requirements : [...]*”

(c) *It is established in a Member State, or in a third country provided that the third country:*

(i) *is not a high-risk and non-cooperative jurisdiction identified by the Financial Action Task Force;*

(ii) *has signed an agreement with the home Member State of the manager of the ELTIF and with every other Member State in which the units or shares of the ELTIF are intended to be marketed to ensure that the third country fully complies with the standards laid down in Article 26 of the OECD Model Tax Convention on Income and on Capital and ensures an effective exchange of information in tax matters, including any multilateral tax agreements”*

2. Authorization process (Article 5 of the ELTIF Regulation)

Article 5(2) of the ELTIF Regulation requires that the competent authority of the ELTIF shall give an approval to the EU authorised AIFM who intends to manage the ELTIF. The extent to which this additional authorisation, that supplements the authorisation granted under the AIFMD, is needed and useful may be unclear and may create confusion as regards the responsibilities of the two different competent authorities involved. It could therefore be considered to remove these requirements.

3. Conflicts of interests (Article 12 of the ELTIF Regulation)

Article 12 of ELTIF Regulation foresees that « *An ELTIF shall not invest in an eligible investment asset in which the manager of the ELTIF has or takes a direct or indirect interest, other than by holding units or shares of the ELTIFs, EuSEFs or EuVECA that it manages* ».

This article raises doubts concerning the conditions under which there is a conflict of interests. This regime could be clarified perhaps through the adoption of the regime applicable to EuVECA and EuSEF which is based on the principle of identifying and avoiding conflicts of interests.

Indeed, the prohibition laid down in article 12 would seem restrictive and potentially not in line with recital 25 of the ELTIF Regulation and article 14 of the AIFMD (e.g. if the requirements of article 12 imply that an ELTIF and an AIF managed by the same EU AIFM cannot co-invest alongside with similar terms and conditions in the same assets, this would in particular prevent an investment in the same assets from being a tool aiming at aligning interest between the manager and its funds). Therefore, it would be very helpful to clarify what specific situations are targeted by article 12 of the ELTIF Regulation, at least by specifying that the situations such as the one described in this paragraph are not targeted.

4. Portfolio composition and diversification (Article 13 of the ELTIF Regulation)

The limits of risk spreading (portfolio composition and diversification related thresholds referred to in Article 13(2)(a) to (c)⁸), generally speaking, imply to make 10 investments. In relation to investment in projects or infrastructures of large scale, the need to make 10 investments per ELTIF may be difficult to achieve, and costly in terms of capital allocation.

If it is considered relevant to distinguish between ELTIFs marketed to retail investors and those marketed to professional investors (please see the specific paragraphs in section 9(a) of this Annex on this issue below), in the case of ELTIFs only subscribed by professional investors, it could be considered to raise these limits so that an ELTIF may be allowed, generally speaking, to invest in less than 10 investments

⁸ «An ELTIF shall invest no more than (a) 10 % of its capital in instruments issued by, or loans granted to, any single qualifying portfolio undertaking (b) 10 % of its capital directly or indirectly in a single real asset (c) 10 % of its capital in units or shares of any single ELTIF, EuVECA or EuSEF».

5. Redemptions (Article 18 of the ELTIF Regulation)

ELTIFs are closed-end funds which, except in very limited circumstances (Article 18(2)), only allow redemptions at the end of the life of the fund. This fundamental rule is justified by the illiquid nature of the assets which an ELTIF is invested in. Indeed, the valuation of illiquid assets, taking into account the absence of a market able to provide a fair value on a continuous basis, may be assessed only at the time of the disinvestment. Accordingly, the valuation is a crucial step and a pre-condition to redeem the units of a closed-ended fund, and the availability of liquidity management tools might not be enough to meet these requirements.

At the same time there might be merit in fostering mechanisms able to provide the investors with the possibility to exit from the ELTIF before the end of the life of the fund in order to address the concern of retail investors who may perceive that they are locked in their investments for a long period of time. However, these mechanisms should be able to address the issue mentioned above regarding the valuation of illiquid assets.

In this respect, a possible option would be to develop a regime allowing an ELTIF of indefinite duration, e.g. if admitted to trading on a regulated market⁹ and provided minimum liquidity conditions are met. In case of listed ELTIF, it should be clarified that the disinvestment from the ELTIF would be possible only on the secondary market.

6. Disposal of ELTIF assets (Article 21 of the ELTIF Regulation)

Article 21(1) of the ELTIF Regulation indicates that the ELTIF shall disclose to the competent authority the schedule for the orderly disposal of its assets in order to redeem investors' units or shares after the end of the life of the ELTIF.

This rule seems to be burdensome for the ELTIF manager and might not always be fully needed for the competent authority. It could therefore be considered that this disclosure is only needed if requested by the competent authority. However, in order to better assess whether the withdrawal of the obligation to produce the abovementioned document (the schedule for the orderly disposal of the assets) would be appropriate and would not impede the supervisory activities of national competent authorities, it would be necessary to better understand the nature of the relevant schedule.

7. Prospectus (Article 23 of the ELTIF Regulation) and cost disclosure (Article 25 of the ELTIF Regulation)

The numerous items that have to be included in the prospectus of an ELTIF (as per the requirements of Article 23 in particular) may risk to veil the main message to the investor i.e. that the ELTIF product may not be suitable for retail investors that are unable to sustain such a long-term and illiquid commitment.

⁹ It is to be noted however that there are currently no listed ELTIFs and the costs of listing could be seen as defeating the purpose of ELTIFs due to their size.

It could therefore be considered to order the messages that shall be presented in the prospectus and/or reduce the amount of mandatory information that needs to be included in it.

In relation to Article 25 of the ELTIF Regulation related to cost disclosure, ESMA notes that the reference to both i) an “overall ratio of the costs to the capital of the ELTIF” (Article 25 (2)) and ii) the PRIIPs Delegated Act in Article 25(3) (“ESMA shall take into account the regulatory technical standards referred to in points (a) and (c) of Article 8(5) of Regulation (EU) No 1286/2014”), has created uncertainties on the implementation of Article 25, given the PRIIPs Delegated Act has been subject to changes which may still not be final.

In order to disentangle the moving nature of the PRIIPs Delegated Act, and the requirements of Article 25 of the ELTIF Regulation, ESMA is of the view that the requirements of Article 25 could be modified in one of the two following ways:

- a) In Article 25(3), replace “ESMA shall take into account the regulatory technical standards referred to in points (a) and (c) of Article 8(5) of Regulation (EU) No 1286/2014” with “ESMA **may** take into account the regulatory technical standards referred to in points (a) and (c) of Article 8(5) of Regulation (EU) No 1286/2014”; or
- b) In Article 25(2), replace the words “overall ratio of the costs to the capital of the ELTIF” with “overall cost ratio of the ELTIF”.

8. Local physical presence (Article 26 of the ELTIF Regulation)

Article 26 of the ELTIF Regulation indicates that ELTIF managers are required to set up local facilities in each Member State where they intend to market ELTIFs. This requirement has been recently removed by Directive (EU) 2019/1160 of the European Parliament and of the Council of 20 June 2019 amending Directives 2009/65/EC and 2011/61/EU with regard to cross-border distribution of collective investment undertaking (regarding UCITS and AIFs distributed to retail investors) as it created additional costs and the preferred method of contact has shifted to direct interaction between investors and fund managers (electronically or by telephone).

Removing this obligation from the ELTIF Regulation for all ELTIF investors would be consistent with this option and could make ELTIFs more attractive.

9. Other areas of the ELTIF framework that could be amended

a) Professional investors

The derogation from some requirements for professional investors and/or making more flexible some of the applicable requirements (e.g. the rules related with portfolio composition, increase the borrowing limits, etc.) could make the investment in ELTIFs more attractive for professional investors.

However, in certain Member States, it has been observed that all ELTIFs are marketed to both retail and professional investors. As a consequence, in these Member States, it is unclear whether there would be merit in creating ELTIFs specifically dedicated to professional investors. In addition, it could be argued that the merit of establishing such an ELTIF dedicated

to professional investors, as compared to setting up a similar fund, but as an AIF under the AIFMD, would be unclear.

In this context, it should also be noted that Article 30(4) of the ELTIF Regulation (equal treatment of all investors), if interpreted strictly, could imply that no specific share classes can be launched within an ELTIF opened to retail investors. In that case, professional investors would be dissuaded to invest in an ELTIF opened to retail investors as they would have to pay the same percentage/amount of fees than retail investors although their subscriptions are generally much higher. It could therefore be necessary to further specify/clarify this requirement.

If it is considered relevant to create a specific type of ELTIFs for professional investors only, these ELTIFs could benefit e.g. from a higher level of leverage and more flexibility in terms of portfolio diversification and composition.

b) Investment incentives (including tax treatment)

As highlighted in the Recommendation on European Long-Term Investment Funds of the High-Level Forum on CMU, ESMA is of the view that a favorable tax treatment across the EU would encourage the retail participation in ELTIFs and could be decisive to make ELTIFs more attractive across the EU.

c) Eligibility criteria for investors and consistency with the EuVECA and EuSEF Regulations

As indicated in the ESMA letter dated 18 August 2020 on the Review of the Alternative Investment Fund Managers Directive, there are slightly different approaches used in the EuVECA, EuSEF and ELTIF Regulations as regards the eligibility criteria for investors. This could be standardised.

In addition, from an operational point of view, certain stakeholders have argued that the marketing regime under the ELTIF Regulation seems to be an obstacle for the marketing to retail investors. This also raises questions with regard to the marketing of ELTIFs in third countries, given also the marketing of ELTIFs in third countries is not specified in the Chapter V “Marketing of units or shares of ELTIFs” of the ELTIF Regulation. Other stakeholders underlined the importance of the provision of investment advice and suitability assessments when distributing ELTIFs given that ELTIFs benefit from a retail passport and are complex products.