Position Paper

European Long-Term Investment Fund

March 2020
Executive summary

- The European Long-Term Investment Fund (ELTIF) Regulation\(^1\) was established to broaden access to illiquid assets for retail investors. It was also an initial step towards a more integrated European capital market that would support greater investment in the European economy, something that we now refer to as the Capital Markets Union (CMU) project. ELTIF has therefore always been a core component of the CMU project.

- There has been a low take-up of the ELTIF fund vehicle since its establishment, despite the growing demand for lending-based investment strategies to non-rated or non-listed corporates and projects in Europe. Despite assets under management and the volume of originated deals growing at a rapid pace during the past five years, ELTIF has not been the vehicle of choice despite it having some unique and potentially favourable characteristics.

- A reformed and a well-functioning ELTIF regime, aligned with the needs of investors, has the potential to address many of the challenges highlighted in the Interim Report of the High-Level Forum (HLF)\(^2\) on the CMU. European businesses need access to the capital to fund innovation and support their long-term growth. This will support their transition to more ecologically sustainable models in response and ensure that SMEs have the financial support needed to weather economic shocks or market downturns. It is essential that ELTIF’s role and effectiveness in supporting the flow of finance to the real economy and, in particular, the parts of the economy that are not well served by banks, is understood and enhanced before any additional or new measures are considered.

- The primary challenge limiting greater take-up of ELTIFs lies in the restrictive requirements relating to maturity, eligible assets, liquidity profile and leverage of the fund placed on the asset manager under the Regulation. This combination can make ELTIFs economically unattractive to asset managers in comparison to other investment fund structures and inefficient for many investors seeking exposure to longer-term or illiquid assets such as SME loans or infrastructure.

- The safeguards that accompany the distribution of ELTIFs to retail investors – for example, assessing the suitability of the investment for a client or meeting retail marketing requirements – also create additional operational complexities for the fund manager. The practical consequence of this is that any asset manager looking to establish an ELTIF will typically need to do so in partnership with a wealth manager or private bank of scale for this to be a viable proposition.

- Many of the investor protections that have been introduced hinder the adoption of the vehicle by institutional investors as the ability for retail investors to invest in sophisticated products with illiquid underlying assets brings a host of challenges to the design of the framework. Thus, splitting ELTIFs into a retail version and institutional version to better align regulatory protections for different types of investor should be considered.

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• The final challenge regarding greater take-up of ELTIF relates to withholding tax (WHT) where ELTIF suffers from similar WHT challenges to those affecting investment funds more generally. Borrowers must be able to pay income distribution on a gross basis, and the absence of an exemption from WHT, alongside a swift, predictable and effective clearance procedure makes this problematic. The ELTIF vehicle needs to have tax exemption and its distributions must not be subject to WHT.

• This paper outlines a series of recommendations on how the ELTIF regime can overcome these limitations. If the suggested reforms are implemented, a well-functioning ELTIF regime aligned with the needs of investors, has the potential to become a vehicle that supports the growth of the European real economy and facilitates greater retail investor participation in capital markets.

• The Alternative Credit Council (ACC) calls on policymakers to consider the recommendations offered in this paper in order to achieve this objective.

Background:
The ELTIF Regulation was established in 2015 to channel finance from the capital markets to the real economy, by primarily focusing on debt and equity investments to non-listed companies. An additional objective of the ELTIF Regulation was to improve the ability of both institutional and retail investors to access longer term investment opportunities. The ELTIF regime was also envisaged as an initial step towards a more integrated European capital market that would support greater investment in the European economy, something that we now refer to as the Capital Markets Union (CMU) project. ELTIF has therefore always been a core component of the CMU project.

However, since the establishment of the ELTIF Regulation there has been an extremely low take-up of the fund vehicle by asset managers. This is despite huge growth in the appetite of investors and asset managers for lending-based investment strategies to non-rated or non-listed corporates and projects in Europe over the same period. As assets under management and the volume of originated deals grew at a rapid pace during the past five years, ELTIF was clearly not the vehicle of choice, despite it having some unique and possibly very favourable characteristics.

The ACC currently represents over 170 members that manage over $400bn of private credit assets. The ACC is an affiliate of AIMA and is governed by its own board which ultimately reports to the AIMA Council. ACC members provide an important source of funding to the economy, providing finance to mid-market corporates, SMEs, commercial and residential real estate developments, infrastructure as well the trade and receivables business. The ACC's core objectives are to provide direction on policy and regulatory matters, support wider advocacy and educational efforts, and generate industry research with the view to strengthening the sector's sustainability and wider economic and financial benefits.

See Recital (1) of the ELTIF Regulation - ELTIFs provide 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. By providing finance to such projects, ELTIFs contribute to the financing of the Union's real economy and the implementation of its policies.

A keyword search of the ESMA database suggests that only 6 asset managers have established funds under the regulation although discussions with our members indicate several ELTIFs are supervised by national competent authorities - https://registers.esma.europa.eu/publication/searchRegister?core=esma_registers_upreg

The ACC's Financing the Economy research shows that nearly half of private credit managers expect to increase their investment in Europe over the next three years. See Figure 04, page 23, Financing the Economy – the future of private credit https://acc.aima.org/resources/research/financing-the-economy.html
As discussions on the need to grow Europe’s capital markets continue, it is essential that ELTIF’s role and effectiveness in supporting the flow of finance to the real economy and, in particular, the parts of the economy that are not well served by banks, is understood and enhanced before any additional or new measures are considered.

The European Commission set up its HLF on CMU in November 2019 to review existing policy measures and propose new and targeted actions to further the CMU initiative. The interim report of the HLF makes plain the challenges facing the realisation of the CMU project:

- **Economic prosperity needs proper financing**: European businesses lack access to capital to fund innovation and growth. There is still a need for greater diversity in the sources of finance available to European businesses.
- **Sustainable finance transition**: Significant investment is required by European businesses to support more ecologically sustainable business models. This will not be achieved without deeper and more efficient capital markets.
- **Pensions and savings**: Capital markets are not currently able to fulfil their role as a source of adequate pension and saving income for an aging population.
- **Financial stability and economic resilience**: The European financial system continues to rely heavily on bank lending. This inhibits the dispersion of risk within the financial system and cross-border private risk sharing that Europe needs to improve its resilience to economic shocks.
- **Cross-border co-operation**: The UK’s departure as a Member State of the European Union (EU) means that the main European financial centre is no longer within the EU. This development has added urgency to the need to reform cross-border co-operation within the EU.

A reformed and a well-functioning ELTIF regime, aligned with the needs of investors, has the potential to address many of the challenges highlighted by the HLF’s interim report. We therefore call on the HLF to seriously consider the recommendations in this paper as it formulates proposals that will guide the CMU policy agenda for the next five years.

**How are ELTIFs currently regulated?**

The ELTIF Regulation is closely linked to the Alternative Investment Fund Managers Directive (AIFMD). The AIFMD provides a regulatory and supervisory framework for the management and marketing in the EU of any collective investment fund that is not an Undertakings for Collective Investment in Transferable Securities (UCITS). The AIFMD was designed to focus on Alternative Investment Fund Managers (AIFMs) because the universe of Alternative Investment Funds (AIFs) is so diverse and broad. Policymakers therefore determined that a “product” directive in the style of the UCITS Directive (i.e. one focussed on regulation of the fund) would be inappropriate as this would not to account for the various specificities of each type of non-UCITS fund.

The ELTIF regime is therefore a specific regulatory investment product framework which is linked to the AIFMD as only duly authorised AIFMs are entitled to manage ELTIFs. The regulatory and supervisory framework provided by the AIFMD means that managers of ELTIFs:

- are authorised and supervised by EU national competent authorities (‘NCAs’);
- match the liquidity arrangements of their funds with the liquidity profile of their lending activity;
- implement risk management systems, including stress testing, to identify, monitor and manage risk arising from their investment activity;
are transparent in their use of leverage to their investors and NCAs; and
provide detailed reporting to investors and NCAs.

In addition to the requirements of the AIFMD, all ELTIF managers are also required to meet the separate requirements established by the ELTIF Regulation. These primarily relate to the fund itself, rather than the fund manager. This provides an additional layer of regulatory and supervisory oversight in relation to the ELTIF’s investment activity. Some of the key areas where ELTIFs differ from AIFs are:

- only an EU AIF is eligible to become an authorised ELTIF and only if it is managed by an EU AIFM;
- ELTIFs are generally closed-ended structures, although certain limited liquidity is permitted;
- ELTIFs are only permitted to invest in ‘eligible assets’ and are also subject to restrictions on their investment policies; and
- ELTIFs are subject to specific requirements regarding portfolio diversification, governance and marketing. This includes safeguards for protecting retail investors such as a special suitability test, risk disclosure and threshold obligations.

Opportunities for retail investors

Typically, many illiquid or non-traditional assets have been the sole preserve of institutional investors such as pension and insurance funds. The ELTIF offers retail investors a potentially cost-effective means to access these investment opportunities that would otherwise remain out of reach. This ensures that retail savers have access to assets with the potential to deliver higher returns, while also diversifying their exposure. This is particularly important for many investors in the current low-interest-rate environment. Providing retail investors with access to assets through the ELTIF also unlocks a new source of capital for European businesses, supporting their ability to invest, innovate and compete in the global market.

The ability to market to retail investors is often a key driver for asset managers who have either established or are considering establishing an ELTIF. However, introducing the ability for retail investors to invest in sophisticated products with illiquid underlying assets brings a host of challenges to the design of the framework. Many of the protections that have been introduced in the ELTIF Regulation for the purpose of retail investor protection are the very same features that hinder institutional adoption. Often, without institutional or wholesale market adoption, retail products are even more difficult to launch.

This is not to say that the search for a well-designed retail product should be abandoned, but that one needs to focus first and foremost on the needs of institutional clients and ensure that the vehicle becomes attractive for this market segment, as this will also drive success in the retail space.

As demonstrated by the US Business Development Company (BDC) model, it is possible to design a product that works for both retail and institutional clientele. Many features of the ELTIF Regulation – particularly in relation to retail investors – are already modelled on BDCs, which are long-standing and vital sources of finance for small businesses in the United States. BDCs have some unique features

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7 Defined within Chapter II section 1 – General rules and eligible assets of the ELTIF Regulation https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32015R0760
which make them a popular and efficient investment for retail savers and an excellent source of finance for small and medium-sized businesses:

- Most of the capital invested by BDCs goes directly into the real economy. BDCs are required to lend a minimum of 70% of its capital to non-listed, small and medium-sized US businesses. Thus, BDCs play a unique role in the economy by providing credit to companies that may find it difficult to obtain traditional bank financing;
- The capital they lend is primarily raised from retail investors who, in return, receive income in the form of dividends with BDCs required to distribute at least 90% of income to shareholders annually;
- BDCs can incorporate some leverage to augment the capital they have raised from investors. Where leverage is used, it is done so within prescribed and very clear limits established in legislation;
- BDCs are transparent to their investors, publishing a quarterly summary of each investment held by a BDC and the fair value of such investment. Therefore, any shareholder can look at the balance sheet and income statement on a quarterly basis and see exactly what they own and the value of those assets;
- BDCs have specific liquidity profiles that ensure savers can match their desire to invest in BDCs with their liquidity needs;
- BDCs also make managerial assistance available to their portfolio companies to assist them in growing their business; and
- BDCs are subject to regulatory and supervisory oversight by the Securities and Exchange Commission.

It is estimated that BDC assets under management increased from about $19 billion in the final quarter of 2009 to roughly $105 billion at the end of the first quarter of 2019 (an increase of 452%). The number of investments made by these vehicles grew from about 2,500 to almost 12,500 in the same period. This growth underlines the huge demand for illiquid credit and equity provided to the SME and mid-market corporate segment.

Another example of a successful vehicle enabling retail investment is the UK Investment Trust which, despite it name, is a company listed for trading on the London Stock Exchange and a concept which has existed since the 1860s. Investment Trusts are generally permitted to invest in and/or originate loans within the own self-imposed investment restrictions and parameters. Investment Trusts are closed-ended publicly listed companies of which retail investors may purchase shares. Investment Trusts are able to invest in a broader range of assets (loans, equities, bonds, or real estate) than those available to an ELTIF. As publicly listed companies, Investment Trusts are required to publish an

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8 The Consolidated Appropriations Act (passed 23 March 2018) reformed the asset coverage test to enable BDCs to operate with leverage up to 2:1 (from its previous level of 1:1) if BDC managers elect to do so. It also introduced safeguards should BDCs choose to operate with this higher level of leverage. It is anticipated that the new leverage requirements will encourage further capital to flow into the sector, meaning that even more capital will be available to SME and mid-market businesses. This increase will not directly impact or compromise the responsible lending practices of BDCs and, as noted above, may enable BDCs to invest more capital in lower risk assets. Even with this increase in the asset coverage test, BDCs will also operate with significantly less leverage than found in the traditional lending sector.


10 Ibid.
annual report and audited accounts. They also have a board of directors to which the manager of the trust is accountable, and which is entrusted with protecting the interests of retail investors that hold shares the trust. Investment Trusts are also popular with some institutional investors.

Even allowing for the fact that ELTIFs are a much newer proposition for asset managers and their investors, the take-up of the product compares unfavourably to the success of BDCs and UK Investment Trusts. When seeking to enhance the attractiveness of ELTIF and mobilise greater sums of retail capital into the real economy, policymakers should look at the features of BDCs and Investment Trusts that have made them proven, scalable retail friendly products.

**Barriers limiting the growth of ELTIF**

Our members have identified three key challenges limiting the growth of ELTIFs:

- **Operating requirements placed on ELTIF managers under the Regulation**

  At present, the ELTIF structure compares unfavourably to other funds that can be used to finance lending and other long-term investments. The ELTIF regime will, due to the nature of its investment activity and investor base, always require some necessary components (e.g. eligible assets, liquidity profile and governance). The current design of the regime, however, combines these components in a manner which make it both economically unattractive to asset managers and inefficient for many investors seeking exposure to longer-term or illiquid assets such as SME loans or infrastructure. It is therefore essential that reforms are introduced to the operating requirements for ELTIFs to make it a more attractive investment vehicle.

- **Retail distribution**

  Any asset managers who might consider establishing an ELTIF, for example those with experience in lending or infrastructure finance, typically raise capital from institutional investors rather than retail clients. The safeguards that accompany the distribution of ELTIFs to retail investors – for example, assessing the investment suitability for the client or meeting retail marketing requirements – create additional operational complexities for the fund manager whose systems and processes are typically more aligned to the needs of institutional investors. The practical consequence of this is that any asset manager looking to establish an ELTIF will typically need to do so in partnership with a wealth manager or private bank of scale for this to be a viable proposition. The advisory service provided by a wealth manager or private bank can be an important source of added value to the retail client, but it also increases the costs associated with the product which affects how attractive this may ultimately be.

Another consideration regarding to the retail distribution of ELTIFs is the current definition of retail client within the Markets in Financial Instruments Directive (MiFID). The European Commission recently published a consultation\(^\text{11}\) seeking feedback on whether a ‘semi-professional investor’ category within MiFID would support greater retail participation in the capital markets, while still

ensuring a proportionate level of investor protection. ELTIF is one area where the existing definition of retail client within MiFID, alongside the additional protections specified within the ELTIF Regulation, has hindered the distribution of ELTIFs. Furthermore, although the ELTIF Regulation and the Delegated Regulation are directly applicable in each Member State, the different approaches taken by national competent authorities in relation to retail investor marketing creates uncertainty and additional costs for the asset manager operating cross-border.

• Withholding tax

The final challenge regarding greater take-up of ELTIF relates to WHT. ELTIF suffers from similar WHT challenges to those affecting investment funds more generally but these are compounded by the ELTIFs investment in more complex asset classes. Borrowers must be able to pay income distribution on a gross basis, and the absence of an exemption from WHT, alongside a swift, predictable and effective clearance procedure makes this problematic. As ELTIFs are cross-border lending vehicles this may need to be specified in the Regulation itself rather than leaving investors reliant on double tax treaties within the EU (or domestic regimes) which may not be adequate. It is also essential that any distributions (whether dividends, redemption proceeds or return of capital on a winding up) from the ELTIF must not be subject to WHT.

Enhancing the ELTIF regime

This paper outlines a series of recommendations on how the ELTIF regime can be enhanced to help it achieve its potential as a vehicle channelling finance from the capital markets to the real economy, while also ensuring that retail investors are able to access the investment opportunities needed to deliver a comfortable retirement.

Fund structures:

The ELTIF Regulation requires an ELTIF to be established as a closed-ended structure and for it to have a fixed maturity. A practical consequence of these requirements is that they restrict the assets an ELTIF will consider for investment to those with a sufficiently short duration to ensure there is a suitable buffer between the life of the loan and the life of the ELTIF. This is to safeguard the ELTIF manager from inadvertently breaching the fixed maturity requirement, however it also entails a significant drawback. This requirement increases the proportion of the fund’s life during which investor capital is not fully invested. This reduces the capital efficiency of the ELTIF for the investor and makes ELTIFs less attractive when compared to other vehicles.

Policymakers should consider allowing for the ELTIF structure to exist as a permanent capital or ‘evergreen’ vehicle with no fixed maturity. This could be modelled on the successful example of BDCs with both public and private evergreen ELTIFs. For private ELTIFs, consideration would need to be given to ensuring that appropriate liquidity triggers are available to investors (for example, an annual continuation vote made by a majority of investors or the board of the ELTIF).

Furthermore, some debt investments may be acquired with a view to a secondary exit prior to its natural life, which is a strategy that may be compromised by this restriction. Allowing an ELTIF to be set up as a permanent capital vehicle (i.e. with no fixed maturity) would overcome this issue. Without
an end date and with the ability to raise more capital, managers can truly focus on long-term capital appreciation for investors. This would fit with the policy objectives behind ELTIF while also accommodating the preference of some investors and asset managers to establish these structures for their investments.

**ACC recommendation**

- The ELTIF Regulation should be reformed to facilitate the establishment of fund structures that allow ELTIFs to operate as permanent capital or evergreen vehicles (no maturity). Such an evergreen structure would have no termination date and capital can be raised, repaid or transferred on an ongoing basis.
- A fixed-term ELTIF could be retained for the retail investor sector as a way of providing some form of certainty on exit.

**Operating requirements for ELTIF managers**

The ELTIF Regulation imposes several conditions on the investment strategy that may be pursued by an ELTIF manager. The purpose of these conditions is to ensure that any investments made by the ELTIF are aligned with the policy intentions of the Regulation (longer-term finance for SMEs and infrastructure projects). The evidence of the last five years suggests that the current conditions imposed by the ELTIF Regulation require a re-assessment to determine whether they are unnecessarily inhibiting the growth of ELTIFs.

- At least 70% of an ELTIF's assets\(^\text{12}\) must be invested in eligible assets\(^\text{13}\) (the remaining 30% of the ELTIF's investments can be in liquid assets eligible to be held in UCITS funds). The definition of eligible assets is currently too narrow for ELTIF managers to pursue an effective investment strategy and compares unfavourably to other fund structures that can be used to finance SMEs or investment in infrastructure.
- The restriction on ELTIFs taking direct or indirect exposure to commodities can make it impossible for the ELTIF to hedge its exposure to certain SMEs or infrastructure projects that are heavily dependent on commodity prices. For example, SMEs investing in new plant, machinery or premises may need to manage its exposure to significant changes in the prices of construction materials.
- Qualifying portfolio undertakings must have a market capitalisation of no more than €500m. This restricts the ability of ELTIFs to build sectoral portfolios that mix SMEs, lower and upper-mid market corporates. Removing this restriction would help an ELTIF achieve greater scale, allow faster deployment of capital and reduce overall costs. Improving the efficiency of the ELTIF in this manner would benefit both other borrowers and the ELTIF's investors.

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\(^{12}\) Article 13

\(^{13}\) See Article 9 and Article 10
The requirement for a qualified portfolio undertaking to be established in a Member State (notwithstanding the enabling conditions in Article 11 (1)c)\(^{14}\) positions ELTIF as a solely European investment product. This limits the ability of the ELTIF to offer investors exposure to businesses that are geographically diversified. This is a significant appeal of BDCs which allow 30% exposure to non-US assets, much of which is currently invested in European businesses. Introducing greater flexibility for the ELTIF to invest in non-EU assets would therefore widen the appeal of ELTIFs and support the ability of ELTIF managers to develop balanced and diversified portfolios.

ELTIFs are unable to invest more than 10% of their capital in units or shares of any single ELTIF, EuVECA or EuSEF. This restriction prevents the existence of ELTIF fund of funds. Investing in a fund of fund often offers higher levels of diversification, lower volatility and an additional layer of screening, as the managers of the underlying funds have already conducted research on the initial investments. These features of fund of funds can be particularly beneficial for retail investors. Reforming the ELTIF Regulation to allow for a fund of funds structure would make them more appealing to investors and increase the sums of capital they are able to invest in the European economy.

Managing the portfolio composition and diversification requirements (loans granted to a single borrower cannot exceed 10% of the net capital of the ELTIF that is available for investment) can be challenging for ELTIFs when they are first established (i.e. during the ramp-up period when initial investments are made). Greater clarification in the Regulation – for example in relation to investor disclosure requirements – would provide ELTIF managers with more certainty regarding how to apply the composition and diversification requirements during the initial ramp-up period.

**ACC recommendation**

- The eligible assets and exposure limits for ELTIF need to be broadened in several areas. This will make the ELTIF a more efficient vehicle to deploy capital and make it more attractive to investors.
- Fund of funds structures should be possible to increase the attractiveness of ELTIFs to retail investors.

**Conflicts of interest and co-investment**

The conditions on conflicts of interest imposed by Article 12 of ELTIF Regulation potentially precludes the ELTIF manager or their affiliated funds from investing in the same investment as an ELTIF. This can be challenging where the fund is structured as a limited partnership with the asset managers co-

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\(^{14}\) Article 11 (1)c states that qualifying portfolio undertakings must be established in a Member State, or in a third country provided that the third country is (i) not a high-risk and non-cooperative jurisdiction identified by the Financial Action Task Force; or (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.
investing in the same transaction, either through co-investments or indirectly through other funds within the same group. Refining and clarifying the provisions of Article 12 to provide asset managers with greater certainty on how these conditions apply in these circumstances would remove an existing barrier to the growth of ELTIFs.

**ACC recommendation**

- Refine and clarify the provisions of Article 12 in relation to co-investment in transactions associated with the ELTIF and potential conflicts of interests.

**Borrowing**

Borrowing by ELTIFs is currently limited to 30% of the net capital of the ELTIF that is available for investment. Any use of leverage is, in practice, much lower as the asset managers will not run the risk of breaching the leverage limit, meaning that ELTIFs are effectively unlevered. This contrasts unfavourably with both other fund structures which permit leverage to be employed within specified constraints, and US BDCs which allow borrowing of 100% of Net Asset Value (NAV) or, under certain conditions, up to 200% of NAV (if BDC managers elect to do so and this is endorsed by their investors). Borrowing by ELTIFs to support the financing of assets will enhance their ability to finance SMEs while also allowing the banking sector to play an important role as a financing partner. Temporarily disapplying the restriction on borrowing at the start of the ELTIFs life (the ramp-up period) would also help provide ELTIF managers with greater flexibility in the early stages of the ELTIF's life as they establish its investment strategy.

A further restriction on borrowing by ELTIFs can be found in Article 16, which requires the ELTIF to borrow funds in the same currency as the assets which will be acquired with the borrowed cash. This may not always be the most efficient approach as, depending on the totality of circumstances, it may be more efficient to borrow in another currency. Greater flexibility, subject to safeguards around the way borrowing in other currencies is facilitated, would make it easier for ELTIFs to leverage their capital, provide more finance to SMEs and deliver better returns for their investors.

**ACC recommendation**

- Borrowing limits should be increased to 100% with an option for ELTIFs to increase this to 200%, subject to conditions being met around governance and investor oversight.
- There should be no restriction on how the borrowed funds are used and the Regulation should explicitly allow for the use of borrowing for the purposes of managing liquidity, subscriptions and the financing of assets in the investment portfolio.
- Additional flexibility should be introduced to enable ELTIFs to borrow in other currencies where appropriate.
- A ramp-up period should also be introduced whereby the borrowing limits for ELTIFs are temporarily disapplied at the start of the ELTIFs life.
Marketing and distributing the ELTIF to retail investors

When distributing an ELTIF to retail investors, ELTIF managers must obtain the necessary information to make a suitability assessment. This includes (i) the retail investor’s knowledge and experience in the investment field; (ii) the retail investor’s financial situation, including that investor’s ability to bear losses; and (iii) the retail investor’s investment objectives, including that investor’s time horizon. Many ELTIF managers do not have the capacity to undertake this due diligence on retail investors, as this creates significant complexity for ELTIF managers whose operating infrastructure is more aligned to meeting the needs of institutional investors. This is often the most critical issue when deciding whether to set up an ELTIF. The practical consequence of this is that any asset manager looking to establish an ELTIF must do so in partnership with a wealth manager or private bank of scale.

One way of overcoming this complexity would be to reform the ELTIF Regulation to permit the establishment of publicly listed and private ELTIFs. As noted above, this would be consistent with other retail-focussed lending vehicles such as BDCs and Investment trusts. Although Article 19.1 of the ELTIF Regulation already allows for the admission of units or shares of an ELTIF to be admitted to trading on a regulated market, there has been little take-up of this option in the market. Publicly listed ELTIFs would provide a consistency of approach for retail investors across the EU whilst also providing greater certainty for asset managers. This approach would allow retail restrictions to be eased for publicly listed ELTIFs as they would be compliant with a host of other requirements that are similar to ordinary bonds and shares.

A further issue for ELTIF managers relates to the impact of MiFID distribution rules. These do not align with the ELTIF’s intended market, and the existing cross-border marketing process inhibits the ability of investment managers to scale products. The detrimental impact of these rules on retail investors is not confined to ELTIF, and this has been recognised by policymakers who are now consulting on whether the rules can be updated to address this issue. Updating the MiFID investor definitions and target market rules would support the ELTIF in realising its potential as a retail investment vehicle.

ACC recommendation

- The ELTIF Regulation should be reformed to permit the establishment of publicly listed and private ELTIFs.
- MiFID investor definitions and target market rules should be reformed to enable ELTIF to fulfill its potential as a retail or semi-professional investment vehicle.

Local facilities requirements

ELTIF managers are required to set up local facilities in each Member State where it intends to market units or shares of the ELTIF. This requirement feels anachronistic at a time when investors expect these facilities to be provided via online channels that do not require a local presence in each individual Member State. In practice, this requirement has also been interpreted and applied in different ways by different Member States. This creates an additional operational and compliance burden on the ELTIF manager as well as an unlevel playing field. Furthermore, the local facility requirement has been recently removed for UCITS funds (be they distributed to retail investors or professional investors) in the cross-border distribution of funds directive adopted in June 2019. Removing this obligation from the ELTIF Regulation would therefore be consistent with broader policy towards retail funds across Europe.

ACC recommendation

- Article 26 of the ELTIF Regulation be revised to specify that facilities for retail investors can be provided via digital channels and that Member States are not required to impose local facility requirements on ELTIF managers.
- No local facilities should be required for ELTIFs focusing solely on institutional or professional investors.

Withholding tax

ELTIF suffers from the same withholding tax (WHT) challenges as other investment funds more generally but these are compounded by the ELTIFs investment in more complex asset classes. Borrowers must be able to pay gross, so there needs to be an exemption from WHT and an effective and swift clearance procedure. As this will include cross-border investment, there needs to be a provision in the Directive rather than rely on double tax treaties within the EU (or domestic regimes) which may not be adequate. The fund needs to have tax exemption and its distributions (whether dividends, redemption proceeds or return of capital on a winding up) must not be subject to WHT.

ACC recommendation

- Member States should introduce an exemption for ELTIFs and their distributions from WHT alongside an effective and swift clearance procedure to facilitate this.

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**Summary of ACC recommendations**

| Fund structure | - The ELTIF Regulation should be reformed to facilitate the establishment of fund structures that allow ELTIFs to operate as permanent capital or evergreen vehicles (no maturity). Such an evergreen structure would have no termination date and capital can be raised, repaid or transferred on an ongoing basis.  
- A fixed-term ELTIF could be retained for the retail investor sector as a way of providing some form of certainty on exit. |
| Operating requirements | - The eligible assets and exposure limits for ELTIF need to be broadened in several areas. This will make the ELTIF a more efficient vehicle to deploy capital and make it more attractive to investors.  
- Fund of funds structures should be possible to increase the attractiveness of ELTIFs to retail investors. |
| Conflict of interest and co-investment | - Refine and clarify the provisions of Article 12 in relation to co-investment in transactions associated with the ELTIF and potential conflicts of interests. |
| Borrowing | - Borrowing limits should be increased to 100% with an option for ELTIFs to increase this to 200%, subject to conditions being met around governance and investor oversight.  
- There should be no restriction on how the borrowed funds are used and the Regulation should explicitly allow for the use of borrowing for the purposes of managing liquidity, subscriptions and the financing of assets in the investment portfolio.  
- Additional flexibility should be introduced to enable ELTIFs to borrow in other currencies where appropriate.  
- A ramp-up period should also be introduced whereby the borrowing limits for ELTIFs are temporarily disapplied at the start of the ELTIFs life. |
| Marketing and distributing the ELTIF to retail investors | - The ELTIF Regulation should be reformed to permit the establishment of publicly listed and private ELTIFs.  
- MiFID investor definitions and target market rules should be reformed to enable ELTIF to fulfil its potential as a retail or semi-professional investment vehicle. |
| Local facilities requirements | - Article 26 of the ELTIF Regulation be revised to specify that facilities for retail investors can be provided via digital channels and that Member States are not required to impose local facility requirements on ELTIF managers.  
- No local facilities should be required for ELTIFs focusing solely on institutional or professional investors. |
| Withholding tax | - Member States should introduce an exemption for ELTIFs and their distributions from WHT alongside an effective and swift clearance procedure to facilitate this. |