ELTIF 2.0 – the key to democratised private markets

Democratisation of private markets has long been a top priority for asset managers, regulators and industry bodies. In Europe, the European Long-term Investment Fund (ELTIF) has been viewed as the key conduit in connecting retail or non-institutional capital with private markets strategies.

Although originally launched in December 2015, the original ELTIF framework was quickly seen as not fit for purpose, with limited initial take-up of the ELTIF.

By listening to industry participants and, in line with the EU Commission's wider objectives to increase long term investment and flow of capital in private assets, particularly from retail investors, a revision of the ELTIF framework was commissioned in November 2021. This culminated in the updated ELTIF 2.0 legislation that came into effect on 10 January 2024.

What are the key changes?

A broadening of the scope of permissible investments

The broadening of the permissible ELTIF investments focused on providing redefined definitions on what an ELTIF can and cannot invest in, along with resetting the threshold levels for eligible assets.

The ELTIF 2.0 framework removes the €10Mn value set originally for an eligible real asset and instead sets the real asset definition to cover all assets that have 'intrinsic value due to their substance and properties'. To further broaden the pool of eligible assets, the new framework includes redefined terms for 'Qualifying Portfolio Undertakings' with certain financial undertakings, for example fintechs, now eligible. It also includes an increased market capitalisation value for listed qualifying companies now set at €1.5Bn, up from €500Mn. In addition, ELTIF 2.0 has brought securitisations into scope with securitisations carrying the 'STS' label along with certain green bonds, eligible up to 20% of an ELTIF.

Under the new framework, minority co-investments will also be deemed eligible, allowing an ELTIF to operate in a similar manner alongside more traditional private markets funds.

One of the most talked about asset amendments to the ELTIF framework is the allowance for ELTIFs to be set up as a Fund of Funds, meaning ELTIFs can now invest 100% in other EU AIFs and UCITS.

The new framework also provides clarity around the ability for an ELTIF to invest in non-EU assets, with the stipulation set that an asset may not be in a high-risk money laundering or non-cooperative tax jurisdiction.

Redefining portfolio characteristics

While the pool of eligible assets has been significantly broadened by ELTIF 2.0, the new framework allows for more concentrated investment strategies, with the diversification limit increased from 10% to 20% per eligible investment. Alongside this, ELTIF 2.0 has also lowered the capital threshold that an ELTIF must invest in eligible investments from 70% to 55%, allowing managers more flexibility when managing portfolios that may offer potential liquidity.

ELTIF 2.0 has also increased the leverage ratios from 30% up to 50% of NAV for ELTIFs marketed to retail investors; where marketed solely to professional investors this leverage can be up to 100% of NAV.

Although ELTIF 2.0 doesn't allow for full open-ended or evergreen structures and ELTIFs remain, in essence, limited duration funds, there is the ability to structure as a 'de-facto' open-ended fund. This is achieved through eased redemption provisions and a potential secondary market through a matching mechanism. Linked to this, ELTIF 2.0 has shortened the lock-up period and removed any mandatory lock-up during the initial ramp-up period.

The retail investor

The ELTIF is proposed to have the biggest impact when connecting retail investors with private markets strategies. While the original ELTIF was designed with this in mind, ELTIF 1.0's stipulations around retail investors were cumbersome and not user-friendly from either an investor or fund manager perspective. ELTIF 2.0 removes some of these challenges with the eradication of the minimum €10,000 investment amount along with removing the 10% cap on portfolio exposure to the ELTIF where a retail investor has liquid assets of less than €500,000.

To further assist with ease of access, the updated framework removes the requirement for local facilities in each EU state and removes the need for the provision of 'investment advice' to retail investors prior to investing in an ELTIF, allowing an AIFM to directly market an ELTIF in Europe.

Interestingly, while there is a great deal of natural focus around retail investors and the ELTIF, the updated framework does make a differentiation between ELTIFs marketed to retail and those which will be marketed to professional investors only. A number of the diversification, threshold and concentration limits are not applicable when looking purely at professional investors.

ELTIF Regulatory Technical Standards

Although the updated ELTIF 2.0 framework came into effect on 10 January 2024, the market is still awaiting ESMA's level 2 Regulatory Technical Standards ('RTS'), which will ultimately underpin the legislation. The RTS provisions are currently under review following ESMA's submission of its final ELTIF report to the EU Commission in December 2023.

It is the RTS that will be used to determine and clarify key aspects around redemptions, fee disclosure obligations, liquidity management and the ability for investors to dispose of ELTIF shares before end of life via the 'matched secondary market mechanism'. The guidance from the RTS will be crucial in providing the industry with the correct provisions for making the ELTIF a success, particularly when looking at ELTIFs aiming to operate as 'open-ended or semi-liquid' products.

Industry feedback to date has been critical of the RTS, with industry participants viewing the draft RTS as too restrictive and potentially overburdensome, particularly when looking at 'open-ended' ELTIF products. While ESMA's report is ultimately final, the European Commission can reject or look to amend the report and it has until March 2024 to do so.

Moving forward

With ELTIF 2.0 legislation becoming effective on 10 January 2024, fund managers and the industry are not waiting around for ESMA's Level 2 RTS. Luxembourg, which is the current domicile of choice for the ELTIF, has already seen a number of ELTIF 2.0 products set up. In Ireland, The Central Bank of Ireland is expected to begin shortly authorising ELTIF 2.0 products under the updated AIF Rulebook.

It's clear that although some further ironing out of detail is required through the RTS, ELTIF 2.0 provides the industry with the much needed updates that make this a viable product. A more flexible framework that offers retail investors private markets access on a fully-harmonised, European-wide basis has long been in demand from the industry. ELTIF 2.0 entirely meets this demand and affords huge opportunity to both fund managers and retail investors when looking to connect with long-term strategies that have traditionally only been accessible by professional and institutional investors.

If you would like to discuss ELTIF 2.0 in more detail, please reach out to your usual Waystone representative or contact us below.

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