Baker McKenzie.

Client Alert

10 January 2024

Europe: ELTIF 2.0 regime enters into force

Luxembourg positions itself as the leading European jurisdiction for launching ELTIFs under the new regime

In brief

The regulatory reform of the European long-term investment funds (ELTIFs) enters into force on 10 January 2024, following its approval by the European Parliament and the Council in February 2023.

Regulation (EU) 2023/606 ("**Regulation**") aims at revitalizing a vehicle that was put in place back in 2015 but which, in the words of the Regulation itself, "did not scale up as expected."

With this in mind, the new regime tackles the shortfalls identified both on the managers' side, as they will now find themselves dealing with a much more flexible product in items such as eligible assets, borrowing, or concentration and diversification rules, as well as on the side of the investors, notably retail investors, whose access to this investment product now becomes simpler.

In Luxembourg, which has positioned itself as the main European hub for ELTIFs (as more than 50% of the total ELTIFs authorized in Europe are domiciled in Luxembourg as of the date of this publication),[1] market actors are keeping a close eye on that cornerstone, while it remains to be seen what the practical application of the reform will be.

For further information and to discuss what these new developments mean to you as an ELTIF manager, distributor or investor, please get in touch with your Baker McKenzie specialist.

Contents

Key changes

Updated investment rules

Enlarged asset eligibility

The new ELTIF regime expands the scope of eligible assets, both by incorporating new categories and by enlarging pre-existing ones. The minimum amount of capital to be invested by an ELTIF in eligible investment assets is reduced from 70% to 55%.

ELTIFs will now be able to invest in the following:

- Real assets

  There is no minimum value per asset requirement, as the prior EUR 10 million minimum has been removed. The requirement that real assets must be held either directly or, if indirectly, via a qualifying portfolio undertaking, is also removed.

- Other investment funds

[1] Register of authorized European long-term investment funds: https://www.esma.europa.eu/document/register-authorised-european-long-term-investment-funds-eltifs.

ELTIFs may now also invest in units of Undertakings for collective investment in transferable securities (UCITS) and other EU Alternative investment funds (AIFs), provided these in turn invest in eligible investments under the Regulation, and have not invested more than 10% of their assets in any other collective investment undertaking (which will allow for fund-of-funds ELTIFs to be set up). Reference is also now made to the creation of ELTIF master-feeder structures, provided that both the master and the feeder vehicles qualify as ELTIFs.

- Securitized assets

  ELTIFs are allowed to invest in "STS" (i.e., simple, transparent and standardized) securitizations, with specific underlying exposures.

- Green bonds

  ELTIFs may now invest, specifically, in bonds issued pursuant to the Regulation of the European Parliament and of the Council on European green bonds.

Extended scope for qualified undertakings and access to third countries assets

When investing in equity or quasi-equity and debt instruments, ELTIFs may do so in instruments issued by "qualified portfolio undertakings," whose definition has now been extended, as follows:

- Innovative recently authorized financial undertakings such as Fintech are now eligible investments ("recent" being understood as authorized or registered less than five years before the date of the initial investment).
- The maximum capitalization that a listed qualified portfolio undertaking may have is now raised to EUR 1.5 billion, as opposed to the previous EUR 500 million limitation.

Further, it will now be sufficient that the third country (where the qualified undertakings is established) is not identified by the European institutions as a high-risk third country or as a non-cooperative jurisdiction. With regard to qualified undertakings established in third countries, an agreement ensuring full compliance with certain tax rules, made between a third country and the home member state of the ELTIF manager, as well as every other member state in which the units or shares of the ELTIF are intended to be marketed, is no longer required.

Less stringent diversification and concentration rules

In terms of diversification, the limitation on the capital that may be put into a single investment is increased, so that ELTIFs shall not invest:

- More than 20% of their capital, previously 10%, in instruments issued by, or loans granted to, any single qualifying portfolio undertaking
- More than 20%, previously 10%, in any single real asset
- More than 10%, previously 5%, in eligible assets for UCITS under Directive 2009/65/EC where those assets have been issued by any single body
- More than 20% of the value of the capital of the ELTIF in STS securitizations
- More than 20% (previously 25%) of the units or shares of a single ELTIF, EuVECA, EuSEF, UCITS or EU AIFs (this limitation will not apply to feeder ELTIFs in relation to their master ELTIFs)

The aggregate risk exposure to a counterparty of the ELTIF stemming from over the counter (OTC) derivative transactions, repurchase agreements or reverse purchase agreements shall not exceed 10% of the value of the capital of the ELTIF.

Increase of borrowing thresholds

The previous borrowing limitation of up to 30% over the ELTIF's capital value is now raised to up to 50% of the ELTIF's net asset value for ELTIFs open to retail investors, and up to 100% of the ELTIF's net asset value for ELTIFs open to professional investors only.

In addition, the Regulation now also mentions the following:

- Borrowing may also be incurred to pay costs and expenses (and not solely to make investments).
- The previously existing limitation to encumber assets up to 30% of the ELTIF's capital value has now been removed.

Manager co-investments

The ELTIF manager, undertakings belonging to the same group as the managers, and their staff, are now permitted to co-invest in ELTIFs, as well as to co-invest with the ELTIFs in the same assets, provided that arrangements have been put in place to adequately address conflicts of interest and that these conflicts are adequately disclosed.

Investors: Flexible regime for professional investor ELTIFs, simplified access for retail investors

Flexible regime for professional investor ELTIFs

The Regulation sets out a differentiated regime for ELTIFs targeting professional investors only (i.e., excluding retail investors), which now benefit from less stringent rules. In particular, these ELTIFs will benefit from the following:

- The exemption from certain diversification and concentration rules
- The maximum borrowing limits are increased

Simplified access for retail investors

The Regulation removes the following barriers to retail investors willing to invest in ELTIFs:

- No requirement to invest a minimum of EUR 10,000 anymore
- No obligation to cap their investments in ELTIFs to 10% of their aggregate investment anymore

Secondary market transactions: Transfers matching mechanism

As for the investors' transfer of their ELTIF units, it is now envisaged that ELTIF managers may put a mechanism (policy) in place for matching the transfer requests from investors wishing to exit the ELTIF and the requests of those wishing to invest in it. The policy shall provide details on items such as the transfer process, the periods of time during which the transfer may be requested and the rules for determining the execution price.

Practical aspects

Grandfathering period

While the Regulation enters into force on 10 January 2024, it sets out a grandfathering period, as follows:

- ELTIFs authorized in accordance and complying with the previous regime (Regulation (EU) 2015/760) shall be deemed to comply with the (new) Regulation until 11 January 2029.
- ELTIFs authorized in accordance and complying with the previous regime, but that do not raise additional capital, shall be deemed to comply with the Regulation, without a temporary limitation.

Input from the regulators

On 15 December 2023, the Luxembourg regulator — the *Commission de Surveillance du Secteur Financier* (CSSF) — published its updated ELTIF application form, which managers must use when filing an ELTIF approval request.

The CSSF underlines that the updated form aims to accelerate the authorization process, as this will now allow the CSSF to clarify key points from an early stage.

In addition, on 19 December 2023, the European Securities and Markets Authority published its draft regulatory technical standards for the Regulation, which cover the following, among other points:

- The circumstances in which the life of an ELTIF is considered compatible with the lifecycles of each of the ELTIF individual assets, considering the long-term nature of this product
- The circumstances for the use of the transfers matching mechanism addressing, in particular, the information that ELTIFs will nee to disclose to investors

Takeaways

The Regulation puts a series of measures in place that, in general terms, have been perceived by market actors as a major improvement on the pre-existing ELTIF regime.

In this context, our main takeaways on the ELTIF 2.0 regime are as follows:

- While the ELTIF remains European in nature, the broadening of its geographical scope grants this product a more international dimension, making it an attractive option for managers sourcing investments outside of the EU but that still want to raise capital from EU investors (notably, from retail investors).
- The ELTIF remains a regulated product, subject to regulatory approval and ongoing supervision, which is a key element for certain categories of investors, such as institutional investors having their own regulatory constraints and retail investors seeking a certain level of protection. At the same time, ELTIFs allow these investors, in particular retail investors, to gain exposure to a more diverse scope of alternative assets (equity, debt, real assets, units in other funds).
- On the managers' side, the distinctive and market-recognized long-term nature of the ELTIF may prove useful for capital raising activities, i.e., the ELTIF 2.0 will make it easier for managers to secure commitments when launching funds with a long-term investment strategy.
- The removal of the barriers to investment by retail investors can be regarded as an interesting "pilot test" in the context of the private markets retailization debate, and managers may use the ELTIF 2.0 regime as a means of testing the retail investors' appetite for alternative asset investments.
- In this context, Luxembourg positions itself as the leading European jurisdiction for launching ELTIFs under the new regime. The experience acquired by both the industry and the regulator under the original ELTIF regime provides a unique background for managers seeking to launch new products under this regime.

Baker McKenzie.

Contact Us

Catherine Martougin
Partner
Catherine.Martougin@bakermckenzie.com

Laurent Fessmann
Partner
Laurent.Fessmann@bakermckenzie.com