ELTIFS IN THE EU

THE POSITION IN KEY MEMBER STATES

From the outset of the ELTIF regime, Simmons & Simmons has been supportive of attempts to develop funds which invest in longer term, less liquid assets and which, at the same time, are suitable for investment by retail investors.

Our Paris office advised on the establishment of the first ELTIF in the EU and we have been involved in setting up ELTIFs in three of the four EU jurisdictions in which one has so far been registered.

In this section, we consider the current regulatory and commercial landscape in six key EU jurisdictions (France, Germany, Ireland, Italy, the Netherlands and Luxembourg), looking in turn at the following questions:

Q1. Are there any local regulatory issues that help explain the limited take up of ELTIFs in your Member State?

Q2. Are there any alternative vehicles or regimes which might be seen as competing with the ELTIF in your Member State?

Q3. What is the local appetite for longer term investment (especially for more retail investors)? And how do we think the local market might develop?

The responses we received are set out in the tables below:

Q1. Are there any local regulatory issues that help explain the limited take up of ELTIFs in your Member State?	
France	France was the first country in which an ELTIF was registered and we are finding that French ELTIFs are becoming more popular for a number of reasons. These include: • they are eligible to French unit-linked life insurance contracts; • they can lend monies everywhere in the EU, including in France (ie, no banking monopoly applies); and they can be marketed to retail investors everywhere in the EU.
Germany	No ELTIF has yet been established and registered in Germany. As with the ELTIF Regulation, funds in Germany are subject to somewhat elaborate product regulation with different requirements and levels of protection for retail investors and professional investors. German professional investors and retail investors prefer to invest in funds that are tailored to their specific requirements. In contrast, the ELTIF Regulation is designed for both retail and professional investors – as a result, to provide the appropriate level of protection for both investor types, there is a duplication of requirements, which are seen as unduly restrictive for certain investment strategies targeting specific groups of investors.

Q1.	Are there any local regulatory issues that help explain the limited take up of ELTIFs in your Member State?
	Finally, ELTIFs are not subject to any favourable tax regime in Germany.
Ireland	Despite a high level of interest within the community of asset management advisors in Ireland, the ELTIF has failed to make any impact, with no ELTIF having been registered to date. Rather than being a reflection of general dissatisfaction with the ELTIF regime, though, this may be down instead to the concerted collective effort of the Irish regulatory authority, legislature and industry bodies to update the Investment Limited Partnership (ILP) regime as well as to the highly successful Qualifying Investment Alternative Investment Fund (QIAIF), which operates as a highly effective "catch all" regulated option within the real asset and private asset space. However, the ELTIF is subject to all of the same rigours as would be applicable to an AIF under local rules with the added regulatory burden of the ELTIF requirements, so has not gained traction in an already heavily regulated environment. The "democratisation of private assets" may be the turning point however.
Italy	Italy is one of the leading jurisdictions in terms of how many ELTIFs have been registered. However, since the end of 2020, the establishment of new ELTIFs has substantially stopped. This is mainly because the favourable tax regime previously granted to ELTIF investors has been cancelled and replaced by a more general (still favourable) tax regime, called "Alternative PIR". This is applicable to retail investors of any closed-end investment fund that, among other things, meets certain requirements in terms of investment policy that are less burdensome than those under the ELTIF Regulation. Another relevant factor is that Italian ELTIFs were typically not established with a view to being marketed outside Italy so the marketing passport available under the ELTIF Regulation (and one of the main characteristics of the product) was not a key consideration for Italian AIFMs. As currently structured and regulated, then, ELTIFs seem to have simply passed out of fashion in Italy.
Luxembourg	Luxembourg tops the list of EU Member States in which ELTIFs have been set up. Although the number of ELTIFs has increased in the past months due to certain tax advantages, the product can hardly be considered as a success. The reason for the limited take-up of ELTIFs lies not so much in local regulatory issues but rather in the restrictive requirements of the ELTIF regime itself, which make ELTIFs unattractive to managers for certain strategies (such as debt). ELTIFs are today simply not yet seen as sufficiently efficient, for investors seeking exposure to this type of product. Moreover, an ELTIF must be managed by an authorised AIFM, which results in an extra layer of regulation. By comparison, the EuVECA – the European label for venture capital funds which are marketable to high net worth individuals – does not require its manager to be an authorised AIFM. Last but not least, the attractiveness of the ELTIF regime would be greater if the ELTIF could be used as a fund-of-funds, or as a co-investment fund. This is currently not the case. However, changes are being considered to the scope, to some operating requirements and to the investment universe of ELTIFs, and these will undeniably help enhance the attractiveness of the ELTIF product in the future.
Netherlands	While not specifically a local issue, market participants in the Netherlands have voiced concerns about the strict requirements imposed on ELTIFs. In their joint paper, "Mobilizing impact capital from retail investors, for example, ABN AMRO and Triodos Investment Management advocated adjustments to the ELTIF Regulation, in particular with respect to the EUR 10,000 minimum investment threshold.

Q1.	Are there any local regulatory issues that help explain the limited take up of ELTIFs in your Member State?
	The authoring firms argued that genuine participation of retail investors in longer term projects requires both the abolition of the minimum threshold and a serious commitment to educate retail investors about what they are investing in. Having a minimum threshold of EUR 10,000 limits the potential for a retail investor to diversify its investments and this, in turn, can lead to greater risk and less potential for investors to gain a deeper understanding about their potential product choices.

Q2.	Are there any alternative vehicles or regimes which might be regarded as competing with the ELTIF in your Member State?
France	No.
Germany	German investment law provides an exhaustive range of fund vehicles. Given the illiquid nature of real assets, closed ended fund structures will generally be the most appropriate vehicles. • Closed ended funds for professional investors (*Spezialfonds*) may be established as a partnership, a joint stock corporation or in the contractional form and are subject to very few investment restrictions. Consequently, a German closed ended special fund may be a more appropriate framework for investment strategies in real assets. • For retail investors, the German investment law provides a closed ended fund vehicle for real assets (*Sachwertefonds*). Even though the closed ended fund for retail investors is more restrictive compared to its counterpart for professional investors, with respect to the applicable investment restrictions it offers a less restrictive framework for real assets than the ELTIF regulation. As well as closed ended retail funds, open ended fund vehicles for real estate and infrastructure are also available under German investment law but it is difficult to provide liquidity at the fund level and to determine the appropriate redemption price (in particular in volatile markets). As a result, the establishment of secondary markets for fund units seems more favourable to bridge the gap between the illiquid nature of the asset class and the liquidity requirement of the investors. Although we are seeing increasingly mature secondary markets for closed ended fund units, it should be noted that the spreads remain high.
Ireland	The passing of the Investment Limited Partnerships (Amendment) Act at the end of 2020, together with the Central Bank of Ireland's revisions to its rules relating to closed-ended funds, represent significant enhancements to the Irish private funds regime. The Investment Limited Partnership (ILP) is a common law partnership and whilst we would expect most ILPs to be structured as a Qualifying Investor Alternative Investment Funds (QIAIF), they can take the form of Retail Investor Alternative Investment Funds (RIAIF), thereby gaining access to the broader retail market in much the same way as the ELTIF. Another Irish option which may compete with the ELTIF is a closed-ended ICAV (a corporate vehicle) which can also take the form of a QIAIF or a RIAIF. It should be noted, though, that a RIAIF (whether it is structured as an ILP or as an ICAV) is subject to several investment restrictions and RIAIFs do not have the automatic right to market across the EU under the AIFMD marketing passport. Access to individual markets can, however, be granted on a case-by-case basis. It is in this context that the ELTIF has been of significant interest to the broader Irish asset management community.

Q2. Are there any alternative vehicles or regimes which might be regarded as competing with the ELTIF in your Member State?	
Italy	In terms of Italian vehicles or schemes which may be used for investments in real assets, closed-end investment funds seem still to be the best choice. That said, such vehicles are - with very rare exceptions - reserved to professional investors, as this allows them to be structured with a lot more flexibility (in terms of investment policy, governance, call of commitments, etc.) and so conform to international market practice. Reserved funds may be subscribed by retail investors as well, but the current minimum threshold (EUR 500,000) is too high to consider them as a proper competitor of the ELTIF while, on the other hand, pure retail closed-end investment funds are scarcely used on the Italian market. A possible future development in this respect may be the envisaged lowering of the minimum subscription threshold for reserved funds to EUR 100,000, which has been under discussion for more than a year. The Alternative PIR regime (see Q1 above), applicable to these funds, may provide a significant incentive to the subscription by retail investors.
Luxembourg	In Luxembourg, there are so-called “Part II UCIs” - regulated investment funds that can invest in all types of assets, that qualify as alternative investment funds (AIFs) and which can be marketed to all types of investors, including retail. However, while a Part II UCI can benefit from the regular AIFMD marketing passport for professional investors, unlike the ELTIF it cannot benefit from a marketing passport for retail investors. It is, however doubtful, whether the Part II UCI should be considered as a proper competitor of the ELTIF - the number of closed-end Part II UCIs tailored to retail investors is limited, and, in the last five years, the ELTIF has shown itself to be a more attractive vehicle for the structuring of closed-ended funds. This, though, may be because ELTIFs have an inherent advantage in that they have partly been designed as investment vehicles through which the EIB and EIF can channel their EU infrastructure and/or SME funding. In addition, the EU Commission recognizes that ELTIFs can play a role in delivering mixed public and private investments into the real economy of EU Member States.
Netherlands	An alternative which competes with ELTIFs in the Netherlands is the retail AIF. In the Netherlands, it is possible to market an AIF to retail investors when complying with certain additional requirements which are partially copied from the UCITS regime. As far back as 2013, the Dutch Fund and Asset Management Association (DUFAS) indicated that, while it felt that the ELTIF regime was a good initiative, it did not expect it to be used frequently in the Netherlands due to the restrictions inherent in the ELTIF and the availability of the retail AIF.

Q3. What is the local appetite for longer term investment (especially for more retail investors)? And how do we think the local market might develop?	
France	France is a major eurozone country with one of the highest household savings rate. The main financial investments for households have always been fixed-income products, reflecting both the appetite for risk-free products among savers and their lack of interest in equities. However, in the past few years, there have been signs of an increased interest on the part of the French households in unlisted equity products, including through unit-linked life insurance contracts. French ELTIFs which are eligible to French unit-linked life insurance contracts are more and more in demand by French insurance companies. Private equity managers are adapting themselves and trying to widen access to unlisted equity products, including through ELTIFs.

Q3.	What is the local appetite for longer term investment (especially for more retail investors)? And how do we think the local market might develop?
Germany	In the continuing low interest environment, investors (and, increasingly, retail investors) are searching for adequate returns and are willing to consider alternative investment products. Investments in real assets still seem to provide attractive returns. However, direct investments in real assets may not be obtainable in the desired quantity, can result in clustering risk and are cumbersome and time-consuming to administer. As a consequence, a third party managed scalable product that provides exposure to real assets would offer valuable features to investors. Against this background we expect substantial appetite for real asset funds. A contributing factor will be the German retirement system, which is largely unfunded (pay as you go). Therefore, private saving for retirement becomes more important in the future. Given the long-term investment horizons of retirement saving, longer term investments become more attractive.
Italy	Boosting retail investments in real assets is one of the objectives at the top of the Italian agenda, especially at the conjunction of the pandemic/post-pandemic worlds. The Italian Government and Italian asset managers are conscious of the fact that a huge amount of Italian savings (around EUR 1,500 bn) are sitting in bank accounts, achieving little, and one of their main goals is to find a way to direct at least a portion of these savings to investments in real assets. Financial income and capital gains from an Alternative PIR (which can be a fund) are exempt from income tax and inheritance and gift taxes for Italian resident individuals and pension funds The Alternative PIR regime is thought to be an important instrument in attracting the savings referred to above, but the further goal is to find the right product that matches the illiquid nature of real assets with the reluctance on the part of retail investors to hold a medium-long term investment. Special redemption mechanisms, secondary market and listing of funds' units seem to be the most interesting solutions to look at, and the ELTIF review may pave the way in that direction at the EU level.
Luxembourg	Luxembourg investor appetite today is focused on investments in the real economy and, more particularly, in innovative start-ups, innovative technologies, green/sustainable projects and post COVID-19 pandemic recovery related projects. As publicly stated by the Minister of the Economy, Franz Fayot: "In the last two years the Luxembourg start-up ecosystem has grown considerably, both in terms of the number of start-ups and in terms of programmes and support measures". However, the ELTIF rules currently prevent investment in start-up companies, which are precisely the ones that promote cutting-edge projects in innovative technologies and in green/sustainable projects. Those investments have been the domain of private funds, and the view is increasingly being voiced that retail investors should have better access to private funds and the returns generated by them. The minimum 70% proportion of long-term investments threshold set out in the ELTIF Regulation is constraining ELTIF's liquidity profile and diversification and may partially explain the limited appetite for ELTIFs from local retail investors. Properly tailored adjustments which facilitate marketing to retail investors, improved flexibility in terms of investment rules and a more favourable tax treatment (regarding taxation of dividends or capital gains, and tax neutrality of the ELTIF vehicle) may potentially invigorate interest in the ELTIF from sponsors, managers and retail investors.

Q3.	What is the local appetite for longer term investment (especially for more retail investors)? And how do we think the local market might develop?
Netherlands	One reason why Dutch retail investors never picked up on ELTIFs (there are no Dutch ELTIFs) may be the highly developed Dutch pension system - 70% of the Dutch population invests significantly through pension schemes. In a way, the Dutch working population relies heavily on their employers to ensure capital growth, which could partially explain a low appetite of Dutch retail investors for long-term investing through other products. This might change in the not too distant future as a result of the upcoming reform of the pension system. Although it is not entirely clear what the reform will entail exactly, it is certain that it will place more discretion and responsibility on individual participants with respect to their investments. This, in combination with the current low interest rate environment might stimulate the Dutch retail investment market. A recent study by the Dutch regulator, the AFM, shows that the number of Dutch retail investors has grown by 11% between 2019 and 2020. More than half of that group is investing through investment funds. However, the study also reveals that a 39% of the Dutch retail investors have a portfolio of less than EUR 10,000. As such, a large portion of the Dutch retail investor base is only investing relatively small amounts, and this group may be unlikely to participate in an ELTIF in its current form due to the minimum threshold.

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