European Long-term Investment Funds

On 26 June 2013, the European Commission issued draft regulations (**Regulations**) that proposed a new type of collective investment framework allowing investors to put money into companies and projects that require long-term capital. The European Commission proposal seeks to achieve the general objectives of (i) increasing the means for long-term financing across all sectors of the European economy and (ii) improving the coherence of the single market.

The proposed new type of collective investment framework, the European Long-Term Investment Fund (**ELTIF**), would be structured as an alternative investment fund (**AIF**) as defined in the Alternative Investment Managers Directive (**AIFMD**) and be available for investment to all types of investor across Europe subject to certain requirements. These include requirements in respect of the types of long-term assets in which the ELTIF could invest and the firms that the ELTIFs would be permitted to invest in (infrastructure, transport and sustainable energy projects), how the ELTIF would be required to spread its assets to reduce risks and the information provided to investors.

On 13 November 2013, the European Parliament issued a draft report proposing a number of amendments to the draft Regulations. This was followed by an ECON Committee opinion issued by the European Parliament which forms the basis for the amendments tabled to the ECON Committee on 5 December 2013.

Investor base

The proposed ELTIFs are designed to meet the needs of institutional and private investors who are prepared to see their money tied into long-term assets (such as infrastructure projects) in return for a steady income. The European Commission anticipates that pension funds and insurance companies would be particularly interested in ELTIFs and also potentially private investors who can afford to see some of their savings committed for a long period of time.

EU Passport

The aim of the ELTIF framework is to create a 'second retail passport' that follows the UCITS approach on product specifications and risk spreading. The ELTIF would be required to meet rules designed to protect both investors and the companies and projects they invest in, in order to benefit from this cross-border passport.

Overlap with current EU Legislation

Pursuant to the draft Regulations, ELTIFs will be categorised as investment products within the meaning of the Markets in Financial Instruments Directive (**MiFID**) and would therefore be subject to all of the requirements of that directive in relation to marketing, selling and disclosure. In addition to the disclosure requirements contained in MiFID and the transparency requirements contained in AIFMD, ELTIFs would be required to publish a prospectus which would include all information required to be disclosed by collective investment undertakings of the closed-end type in accordance with the Prospectus Directive. In addition to the requirement to publish a prospectus, the ELTIF would be considered a Packaged Retail Investment Product (**PRIP**) and as a result would be subject to the requirement to have a key information document (similar in format to the Key Investor Information Document required under UCITS IV) explaining the features and its risks.

Pursuant to the draft Regulations, only EU AIFs would be eligible to become an authorised ELTIF and only if it is managed by an EU AIFM - UCITS and non-EU AIFs (and EU AIFs with a non-EU AIFM) would not be eligible for authorisation and marketing as ELTIFs.

Asset allocation requirements

Pursuant to the draft Regulations, ELTIFs would be required, within five years' of authorisation, to invest at least 70% of their capital in non-transferable securities and securities which are generally illiquid and require commitments for a certain period of time, and have an economic profile of a long-term nature. Managers of ELTIFs would be permitted to invest up to a maximum threshold of 30% of their capital in assets other than long-term investments. ELTIF would be prohibited from partaking in the short-selling of assets, entering into securities lending agreements and investing in commodities and financial derivative instruments (other than for the purpose of hedging the duration and currency risk of the other assets). An ELTIF would be permitted to borrow cash amounting to up to 30% of the capital of the fund, however the draft Regulations provide that the ELTIF should only borrow in the currency in which the manager expects to acquire the asset.

Redemptions

Due to the illiquid nature of ELTIF investments in long-term projects, ELTIF are precluded from offering regular redemptions to their investors and investors shall not be able to withdraw money until the specified end date of their investment. However, ELTIFs would be subject to product rules designed to ensure sufficient diversification, address potential conflicts of interest, increase transparency as regards costs and limit the use of derivatives and leverage.

Amendments proposed by the European Parliament

On 5 December 2013, the European Parliament proposed a number of amendments to the Regulations relating to the types of eligible assets, borrowing powers of the ELTIF, proposed redemption rights during the lifecycle of the ELTIF and the structure and transparency requirements of the ELTIF.

The Regulations had proposed to restrict the eligible assets to qualifying portfolio undertakings that are not admitted to trading on a regulated market, multilateral trading facility or organised trading facility. The European Parliament proposes to increase the range of eligible assets to include listed undertakings, particularly small and medium-sized enterprises that issue equity or debt securities but do not have a readily identifiable buyer.

The European Parliament proposal also introduces a distinction between retail investors and professional investors, allowing retail investors a redemption right at least at the mid-point of the ELTIFs life cycle and seeks to extend competent authorities' powers to impose greater conditions on the marketing of ELTIFs to retail investors in line with Article 43 of the AIFMD.

The European Parliament also proposed that a competent authority would have 30 days in which to consider an application of an applicant ELTIF for authorisation.

The Regulations had proposed that an ELTIF would have a fixed termination date however, the proposals provide that in 'exceptional circumstances specified within the rules of incorporation' the lifecycle of the ELTIF could be reduced or extended to allow for greater flexibility.

In order to harmonise the marketing of ELTIFs across all Member States, the European Parliament has proposed to remove the obligation to include in the prospectus "any other information considered by the competent authorities relevant for the purpose of transparency and prospectus disclosures". The European Parliament further proposes that the key investor document should include clear disclosure relating to the redemption rights of a retail investor.

The European Parliament has suggested an amendment to the borrowing powers of an ELTIF such that an ELTIF may encumber assets of the ELTIF up to a maximum of 30% of its capital. The manager of an ELTIF would be obliged to inform investors in advance of any future borrowing needs that arise in the investment strategy.

Commentary

The ECON Committee of the European Parliament is expected to vote on the proposed amendments on 17 February 2014 before the revised proposal goes before a European Parliament plenary sitting on 15 April 2014.

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