

ELTIF: Preliminary comments regarding the upcoming trialogue

The European Parliament (EP) adopted the official report on ELTIFs on 17 April 2014. The Council has reached its general approach on 25 June 2014. In view of the trialogue meetings (which will possibly start in autumn), BVI¹ would like to present its views on important areas.

ELTIF as product for Retail Investors without quantitative restrictions (e.g. Art. 24 in Council)

The EP decided to maintain the Commission's approach and to allow ELTIFs to be open to retail, semi-professional and professional investors. The decision is with the ELTIF manager. The Council proposed additional safeguards. Retail investors whose financial instruments portfolio does not exceed 500,000 Euro shall not invest more than 10 percent of their portfolio into ELTIFs. This has to be ensured by the manager or distributor based on information the investor submits.

We strongly support the EP's approach of allowing retail investments in ELTIFs without any minimum investment or further requirements regarding the investor's portfolio. First, retail investments could make significant contributions to the financing of infrastructure and other tangible assets. Secondly, the envisaged introduction of an EU passport for retail distribution of ELTIFs would partly close the gap between UCITS offering retail investment opportunities in securities markets and AIFs which are set up for professional investors. Both aspects are decisive for the attractiveness of the product ELTIF. The Council's approach will lead to significant problems in practice; it is in particular unclear how the ELTIF manager or distributor may ensure that the retail investor's ELTIF investment does not exceed 10 percent of his portfolio. If there is a risk that the ELTIF manager or distributor could be held liable for information provided by the investor, this will affect the ELTIF's success. The other additional safeguards (internal assessment process, requirement for prior advice, provisions of the depositary, etc.) may be beneficial for retail investors and should be sufficient.

Distribution of income to investors (Art. 20, Art. 19, Art. 15)

The EP abolished the restriction suggested by the Commission that the original capital commitments may not be distributed. The Council seems to stick to the Commission's proposal, although it allows for capital reductions.

We strongly support the EP's position. The manager should have the option of deciding against re-investing any capital commitments. Since the ELTIF has to invest in at least five eligible investment assets, some investments will likely have a shorter duration than others. Should the manager then be obliged to reinvest in unfavourable market conditions, this would be detrimental for the ELTIF's investors. It would then be preferable that the ELTIF manager distributes the original capital commitments rather than be forced to reinvest it. Further, such distributions should be recognised as a reason for ceasing to apply the ELTIF investment limits.

Life cycle of the ELTIF and redemption policy (Art. 16)

The EP decided to allow ELTIFs with or without specific lifetime as well as the right for temporary extension upon the ELTIF manager's decision. Further, it adds the possibility of redemption rights for retail

¹ BVI represents the interests of the German investment fund and asset management industry. Its 82 members currently handle assets of EUR 2.2 trillion in both investment funds and mandates. BVI enforces improvements for fund-investors and promotes equal treatment for all investors in the financial markets. BVI's investor education programmes support students and citizens to improve their financial knowledge. BVI's members directly and indirectly manage the capital of 50 million private clients in 21 million households. BVI's ID number in the EU register of interest representatives is 96816064173-47. For more information, please visit www.bvi.de.

investors after the ELTIF is in halfway of its lifetime and only up to 20 percent maximum of its capital. The Council has decided to not allow redemptions at all and to require the manager to define the life time for the ELTIF which might be extended but only subject to specific limitations.

We believe that the decision whether to define the life time should remain with the manager and that redemptions are necessary for the attractiveness of the ELTIF. Generally, the liquidity management, the life time and the redemption policy depend on the type and duration of the assets the ELTIF invests in. Due to ELTIFs being conceived as blind pools, investors investing in ELTIFs will not be able to fully assess the details of their investments. It is indispensable to allow for redemptions of shares or units since trading on secondary markets cannot substitute direct redemptions adequately. Liquidity issues including those deriving from redemption rights might be addressed by a number of mechanisms (e.g. announcement periods for redemptions, redemption fees, gating or queuing). A predefined life time with an option to extend it in specific circumstances might not give the indispensable flexibility to deal with specific unfavourable market circumstances which might last over five years or more. It should be the ELTIF manager's task to decide which mechanisms are the best for the specific ELTIF investment.

But even the provisions on the redemption policy of ELTIFs as suggested by the EP are too strict and might undermine the practicability and the success prospects of ELTIFs as future investment products. Although we generally support the approach and the wording, it is unclear why the redemption should be limited to a maximum of 20 percent where e.g. the ELTIF may invest 30 percent in liquid assets.

Further issues

- **Investments in AIFs (Art. 10):** We support the Council's approach which allows for investments in AIFs which in turn invest mainly in ELTIF assets. The derogation from a general prohibition for investments in CIUs as suggested by EP is unclear.

ELTIFs should generally be allowed to acquire eligible investment assets indirectly. There should not be a difference regarding the legal structure used when financing qualifying portfolio undertakings or investing in real assets.

- **Borrowing of Cash (Art. 14):** We support the EP's proposal to allow borrowing of cash up to 40 percent of the ELTIF's capital. The requirement for borrowing of cash to be aligned with the ELTIF's lifetime is, however, problematic. The Council's proposal to allow borrowing of cash only if the holdings in cash or cash equivalents are not sufficient and only up to 30 percent is too strict.

It seems unrealistic for the borrowing to end before the disposal of the ELTIF's assets. In practice, funds usually need cash also during the liquidation period. It should be clarified that the maturity of the cash borrowing may also extend to this period and is not required to be aligned with the ELTIF's lifetime. Further, the limitation to 30 percent or 40 percent of the ELTIF's capital seems too strict. 60 percent borrowing is the current practice on cash borrowing thresholds for funds at national level.

- **Breach of diversification requirements (Art. 12a):** We support the Council's approach to allow for an appropriate time period to rectify breaches of diversification.

The appropriate and required timeline to heal breaches of diversification depends on the individual structure and assets held by the ELTIF. Transactions in real estate assets e.g. require up to twelve months to be completed. For other real assets it might be longer. The rule should further allow extending the period upon approval by the national authority to take specific circumstances into account.
