

ELTIF: Comments regarding the upcoming trilogue

The European Parliament (EP) adopted the official report on ELTIFs on 17 April 2014. The Council is currently discussing its position in the Council working groups. In view of the discussion in the Council and the trilogue meetings (which will possibly start in autumn) BVI¹ would like to present its views on important areas.

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

EP decided to maintain the Commission's approach and to allow ELTIFs to be open to retail, semi-professional and professional investors on the basis of a definition of the aforementioned investors. The decision to do so shall be with the ELTIF manager. The Council is discussing a minimum investment of 50,000 to 100,000 Euro or less.

We strongly support the notion of allowing retail investments in ELTIFs. Figures illustrate that retail investments could make significant contributions to the financing of infrastructure and other tangible assets.² 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. A minimum investment, however, would contradict any intention of closing this gap since the market for cross-border offering of AIFs to non-professional investors who invest a minimum of 100,000 Euro seems to be very limited. Further, ELTIF shares or units should serve as a supplementary product for the investors' portfolios. A minimum investment might induce the investor to invest more than it would be prudent in light of his/her individual portfolio composition. In Germany, for instance, retail investors may invest in risk diversified closed-ended funds without any minimum investment requirement.

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

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, but at the same time seems to allow capital reductions. These may only be made by way of repayment of capital.

We strongly support any set-up which allows distribution of income. The manager should have the option of deciding against re-investing 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.

¹ BVI represents the interests of the German investment fund and asset management industry. Its 81 members currently handle assets of EUR 2.1 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.

² Figures of Eurostat illustrate that retail investors within the Member States possess (non-invested) deposits of more than € 8.4tn which could be invested in ELTIFs provided an attractive regulatory framework for retail investors (see <http://sdw.ecb.europa.eu/browse.do?node=2019184>).



Should the manager then be obliged to reinvest in unfavourable market conditions, this would be detrimental for ELTIFs' investors. It would then be preferable that the ELTIF manager distributes the original capital commitments rather than being 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)

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 investors. However, redemption rights shall be feasible only after the ELTIF is in halfway of its lifetime and only up to 20 percent maximum of its capital. The Council is discussing to not allow any 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. 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 this 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.

The provisions on the redemption policy of ELTIFs as suggested by the European Parliament are too strict and might undermine the practicability and the success prospects of ELTIFs as future investment products. 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, such limit bears "run risks" insofar as investors might be inclined to redeem their shares or units in case e.g. already 15 percent of the fund's total amount have been redeemed.

As a minimum, investors should have redemption rights in special individual cases such as unemployment or inheritance. Such redemption rights would protect the interest of the investors. Practice shows that investors generally tend not to use such termination rights even in times of economic recessions. The possibility, however, to use such rights would allow for some relief regarding the conflict between illiquid assets, capital lock-up and protection of retail investors.

Investments in AIFs (Art. 10)

EP allows investments in CIUs by way of deviation from a general prohibition. The deviation is unclear since it only relates to the requirement for CIUs not to qualify as financial undertakings.

ELTIFs should generally be allowed to acquire eligible investment assets via project companies. There should not be a difference regarding the legal structure used when financing qualifying portfolio undertakings or investing in real assets. Hence, a CIU with the exclusive purpose of financing qualifying



portfolio undertakings or investing in real assets should be treated like a direct investment for the purpose of the ELTIF's investment restrictions.

Borrowing of Cash (Art. 14)

EP introduced the requirement for borrowing of cash to be aligned with the ELTIF's lifetime. Council currently requires the maturity to not exceed the ELTIF's lifetime. The borrowing of cash is supposed to be limited to 30 percent of the ELTIF's capital.

We understand that the ELTIF's life ends at the point of time when the liquidation period starts: The ELTIF shall dispose its assets after the end of life and only then the diversification rules no longer apply. It seems, however, 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. First, the ELTIF manager might be able to increase the asset value and obtain a higher price if he/she makes further investments in the assets. Secondly, if the borrowing of cash is not connected mandatorily to the ELTIF's lifetime, refinancing would be permitted. Both cases could be advantageous for the ELTIF and consequently for the investors. Hence, it is necessary to clarify 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 of the ELTIF's capital seems too strict. 60 percent borrowing is the current practice on cash borrowing thresholds for funds at national level. It would therefore be too restrictive to narrow the threshold for ELTIFs.

Breach of diversification requirements (Art. 12a)

EP introduced a timeline of six months for the ELTIF manager to rectify breaches of the diversification requirements. Council is discussing whether to allow for appropriate time.

We agree with a general rule to deal with breaches of diversification requirements. The appropriate and required timeline, however, depends on the individual structure and investments of the ELTIF. For some breaches six month might not be enough. Transactions in real estate assets e.g. require six to nine months to be completed. For other real assets it might be longer. We therefore strongly agree with the wording of an "appropriate period". If a fixed period is still being considered, twelve months should be the minimum. In addition, the rule should allow an extension of this period provided the national authority approves. This would allow taking specific circumstances into account.