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YOUR GUIDE TO UNDERSTANDING REGULATORY DEVELOPMENTS TO NAVIGATE THE CAPITAL MARKETS

European Long Term Investment Fund: New Investment Vehicle to Change the Long Term Investment Lanscape in the EU to Benefit Corporates

By Nora Wouters, Orestis Omran on May 22, 2015

On April 20, the Council adopted the final text of a regulation aimed at establishing a new collective investment vehicle, the so-called European Long-term Investment Fund ("ELTIF"). The rational of this innovative addition to the traditional investment vehicles in the EU was the need to increase the available funds for long-term investment in Europe, while providing investors with considerable long term, stable returns.

The defining characteristic of the investment vehicle is the specific set of asset classes on which they shall focus and that naturally require long term commitments by investors. This will include (i) non-listed undertakings that issue equity; (ii) debt instruments for which there is no readily identifiable buyer; (iii) real assets that require significant up-front capital expenditure; (iv) SMEs admitted to trading on a regulated market or on a multilateral trading facility. Existing fund structures are not able to address the same needs as ELTIFs, especially for investments to major infrastructure projects that the latter definitely target.

Nevertheless, a formula was introduced to allow for flexibility for ELTFs. In particular, a maximum 30% of their capital may be invested to non long term asset categories, which may enhance their capital and allow for better hedging. The rest 70% shall be invested in the eligible asset categories mentioned above.

Investor protection is a hot topic for ELTIFs, as with all recent EU financial regulation, given that these funds address also retail investors. For example, retail investors with an investment portfolio of up to EURO 500,000 may not exceed in ELTFIs an aggregate amount exceeding 10% of their portfolio as long as the amount invested in an ELTIF is EUR 10,000 or greater. It is up to the fund manager to ensure compliance with the retail investor rules, however it is not certain how compliance will be secured. A type of balance sheet review by competent authorities may be applied in practice to achieve such compliance. ELTIFs will be structured as Alternative Investment Funds under Directive 2011/61/EU and will essentially be managed by Alternative Investment Fund Managers. The experience of the latter will be of outmost importance to ensure compliance and smooth management of the new vehicles, while the application of so called "safe harbor provisions" that in practice exclude retail investors may also kick in.

Overall, the ELTIF constitutes clearly EU's response to attract private capital for long term investments of systemic importance, such as infrastructure and yet another effort to increase the importance of private capital in areas, which were traditionally considered as part of the core governmental competences. In addition, the new vehicle will motivate the movement of private capital piled up in low return long term bank accounts towards infrastructure projects with larger returns, including for example energy performance contract projects (see https://www.mckennalong.com/media/resource/1927_EnergyPerformance_brochure-FINAL.pdf).

Professional and retail investors, who need investment security and do not expect a short term return should consider the ELTIF. Experience stemming from the practical application of the new regulation is evidently still missing in the markets; in this regard, it is advisable that potentially interested retail investors should wait for the first relevant projects to be materialized prior to proceeding with a fund placement to any such vehicles. Even then, expert legal counseling is required to deal not only with the regulatory aspects of the new legislation but also with tax and compliance issues. The new regulation will be effective 20 days after its publication in the Official Journal of the EU.

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