European Commission proposes ELTIF RTS amendments

Insights - 21/03/2024

Updates to the European Long-Term Investment Fund Regulation, known as ELTIF 2.0[1], entered into force on 10 January 2024. These long awaited amendments to the ELTIF Regulation[2] were expected to combine the best of both worlds - professional and retail, open and closed-ended - into one 'fit for all purpose' vehicle.

ELTIF 2.0 aimed at striking a fine liquidity balance, in order to reconcile the presence of retail investors with a wider array of eligible illiquid assets. However, ever since the adoption of the final text, market players have expressed particular concerns in relation to its impact on open-ended ELTIFs.

Liquidity requirements, liquidity management tools (**LMTs**), notice periods and cost disclosures have been in the spotlight since the European Securities and Markets Authority (**ESMA**) submitted the first draft Regulatory Technical Standards (**RTS**)[3] to the ELTIF Regulation in December 2023.

The EU Commission's view on the draft RTS

On 6 March 2024, the EU Commission gave its views on the draft RTS, communicating[4] to ESMA its proposed amendments and reiterating the necessity for the draft RTS to remain not only within the mandate under the ELTIF Regulation, but to also align with the objectives of the ELTIF reform.

In a nutshell, the Commission highlighted that one of the principal objectives of the ELTIF 2.0 was to incentivise the use of ELTIFs by providing their managers with the flexibility to pursue a broad range of investment strategies and objectives, in particular with regards to their portfolio composition (including long-term projects).

The Commission concluded that ESMA's draft RTS are not aligned with these objectives, as they do not sufficiently cater for the individual characteristics of different ELTIFs. It expressed the intent to adopt the RTS submitted by ESMA once the indicated concerns are taken into account and necessary modifications made.

In this briefing we summarise the key areas identified by the commission as inconsistent with the objectives of the ELTIF Regulation and/or exceeding the limits of ESMA's mandate under it.

Notifications of material changes to the redemption policy

The current text of the draft RTS states that ELTIF managers shall inform the competent authority of the ELTIF of material changes to the redemption policy, as soon as practically possible and no later than within three business days from the date that material change became known or should have become known to the ELTIF manager.

The Commission considers ELTIF managers should not be authorised to materially change the redemption policy without prior authorisation of the regulator. Instead, any material change should be notified to the national competent authority before it occurs, unless such material changes are beyond the control of the ELTIF manager.

Minimum notice period for redemptions

At the moment the RTS foresee a minimum redemption notice period of 12 months to be given by individual investors, with a possibility for an ELTIF to permit shorter notice periods, calibrated based on the on the minimum liquid assets and limited to the maximum percentage of redeemable assets.

The Commission's view is that the wording of the draft RTS implies a general requirement for all ELTIFs, notwithstanding their specificities (eg investment strategy, assets, leverage profile) while the length of notice periods should not be linked to only fixed percentages of liquid and redeemable assets.

Furthermore, in relation to the draft RTS provisions on the determination of the minimum holding periods, there exists a risk of misinterpretation of these holding periods coinciding with notice periods, which should not be the case given the envisaged flexibility for open-ended ELTIFs.

Taking into account all the above, the Commission considers the requirement for a minimum 12-month notice period should be removed.

Liquidity requirements related to standardised notice periods requirements

In addition to the removal of the minimum length of the notice period itself, the Commission also commented separately on the calculation criteria for notice periods.

Proposing percentages of liquid and redeemable assets as the only two calibration criteria which should be simultaneously applied for determining the length of the notice period does not sufficiently take into account the individual situation of each ELTIF and would not fit those funds pursuing long-term strategies.

The Commission has highlighted the need for requirements linked to LMTs and redemption policies to be more proportionate to long-term investment strategies and fine-tuned against multiple factors. As an example, it has suggested the possibility for the liquidity profile of an ELTIF to be determined through proportionate and calibrated application of either (i) the maximum percentage of redeemable assets, redemption frequency, and notice periods, or (ii) the redemption frequency, minimum percentage of liquid assets and the maximum percentage of redeemable assets.

Choice of LMTs - alignment with the AIFMD

Current draft RTS provide that the manager of an ELTIF must select and implement at least one anti-dilution LMT (among anti-dilution levies, swing pricing and redemption fees) and may also implement other LMTs in specific circumstances.

Given that such limitations to the use of LMTs are not required by the ELTIF Regulation, and seems unjustified with the flexibility as an overarching regulatory objective, there is no reason why ELTIF Regulation should depart from LMT requirements of the upcoming Alternative Investment Fund Managers Directive II (AIFMD II)[5].

The Commission is of the view that the draft RTS should not impose additional ELTIF-specific requirements on the use of LMTs or otherwise limit ELTIF managers' choice in that regard.

Redemption gates - activation conditions to be clarified

The draft RTS require ELTIFs to link redemption gates to notice periods or the size of liquid assets, and to impose redemption gates in certain specific circumstances.

According to the Commission, this is not in line with the possibility to allow redemptions during the life of the ELTIF within the limits of minimum liquid assets. This sets additional requirements, going beyond what is laid down in the ELTIF Regulation.

Cost calculations and disclosures

The Commission's final remarks relate to the misalignment of the cost disclosure methodology in the draft RTS (percentage of the capital) with that in the Packaged Retail and Insurance-Based

Investment Products Regulation (**PRIIPs Regulation**[6]), the AIFMD and, ultimately, the ELTIF Regulation itself (reduction in yield).

In addition, it seems that the draft RTS do not take into account layers and granularity of cost disclosures on different levels, ie those in precontractual, PRIIPS KID and periodic disclosures.

In order to avoid additional operational burdens, the draft RTS should align with the above mentioned regimes.

Next steps

All of the above remarks have been communicated to ESMA, which now has six weeks to amend and resubmit the draft RTS on the basis of Commission's proposed amendments.

Upon the expiry of that period, should ESMA not submit the amended draft RTS or submit draft RTS that are not in line with the proposed amendments, the Commission has the option to directly adopt the RTS and the amendments it considers relevant.

Given the impact ELTIFs 2.0 are expected to have, the market has welcomed these amendments to the RTS, which should allow for a broader use of ELTIFs and pave the way to the success of the revamped regime. The Commission recognises that the full potential of ELTIF 2.0 in terms of market reach may only be unlocked if open-ended ELTIFs benefit from a more flexible liquidity regime.

How can Ogier help?

Our dedicated Investment Funds team in Luxembourg can advise funds and their managers on compliance with the new rules and their implementation. For more information, please reach out to the team listed below.

[1] Regulation (EU) 2023/606 of the European Parliament and of the Council of 15 March 2023 amending Regulation (EU) 2015/760 as regards the requirements pertaining to the investment policies and operating conditions of European long-term investment funds and the scope of eligible investment assets, the portfolio composition and diversification requirements and the borrowing of cash and other fund rules

[2] Regulation (EU) 2015/760 of the European Parliament and of the Council of 29 April 2015 on European long-term investment funds, as amended

[3] Final Report - Draft regulatory technical standards under the revised ELTIF Regulation of 19 December 2023, ESMA34-1300023242-159

[4] Communication to the Commission on the intention to adopt with amendments the Commission

Delegated Regulation supplementing Regulation (EU) 2015/760 of the European Parliament and of the Council with regard to regulatory technical standards specifying obligations concerning hedging derivatives, redemption policy and liquidity management tools, trading and issue of units or shares of an ELTIF, and transparency requirements and repealing Delegated Regulation (EU) 2018/480, including the Annex to the Communication [C(2024) 1375 final]

[5] Proposal for a Directive of the European Parliament and of the Council amending Directives 2011/61/EU and 2009/65/EC as regards delegation arrangements, liquidity risk management, supervisory reporting, provision of depositary and custody services and loan origination by alternative investment funds [procedure 2021/0376(COD)]

[6] Regulation (EU) No 1286/2014 of the European Parliament and of the Council of 26 November 2014 on key information documents for packaged retail and insurance-based investment products

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