Fact-sheet
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European Long-term Investment Funds (ELTIF)

Introduction: Investment funds in Europe

Investment funds hold a large proportion of global financial assets. Until last year, in the EU these funds were only regulated by two directives, the Undertakings for Collective Investments in Transferable Securities Directive (UCITS) and the Alternative Investment Fund Managers Directive (AIFM).

The UCITS Directive has set a European-wide framework for most investment funds since 1985. UCITS-managed funds are relatively highly regulated investment funds, which are also available to private investors. However, regulation has been relaxed in recent years. Only under the influence of the financial crisis has investor protection been tightened again. In March 2013, according to the European Fund and Asset Management Association (EFAMA), UCITS funds managed 6,697 billion Euros, or approximately 72% of all European money held in funds.

As a result of the financial crisis, the AIFM directive was introduced for certain "alternative investment funds" (AIF). These are primarily intended for professional investors like other funds (i.e. their managers). Even if the EU Member States are free to authorise AIF for private investors, these funds manage the investments of largely professional investors. Typical AIF include private equity funds, hedge funds, commodities funds and real estate funds. Compared to UCITS funds, they can come with more investment risks and less investor protection.

The Commission's proposal for an ELTIF Regulation

Now the European Commission has proposed to add a further investment funds law to the existing fund Directives: on 26.06.2013, it published a Proposal for a Regulation on European Long-term Investment Funds (ELTIF). The idea to strengthen long-term investments has also been expressed in similar initiatives of the G20 and the World Bank.

The Commission proposal is slated for a vote during the current legislative term of the European Parliament (see table), but it is questionable whether it will be passed.

Table: Legislative Procedure: ELTIF (2013/0214(COD))	
Publication of the Commission proposal	26 June 2013
Vote in the ECON Committee	17 February 2014
Plenary Session of the European Parliament	15 April 2014

ELTIF should help to promote the long-term commitment to "patient capital" and "help increase the pool of capital available for long term investment in tomorrow's economy of the European Union." Long-term investments are considered by the Commission to be investments with a time frame of several years to several decades, including both "tangible assets" and "intangible assets".

The Commission justifies its proposal by stating that investors have an "interest in having an opportunity to invest in long-term asset classes." In addition, there are deficits in existing fund directives in terms of long-term incentives for investment and investor protection. With its focus on securities trading and also the possible short-term retrieval of funds by investors, the Commission argues, the UCITS Directive provides no such incentives. This "deprives the real economy from accessing deeper pools of capital-backed financing". Moreover, the Commission states that the "regulatory fragmentation" between the EU Member States prevents the collection of larger amounts of capital, though this is indispensable for the realisation of major projects. ELTIF should therefore bring together investors from across the EU. Accordingly, there would be a "second retail passport" for ELTIF – the first is for UCITS.

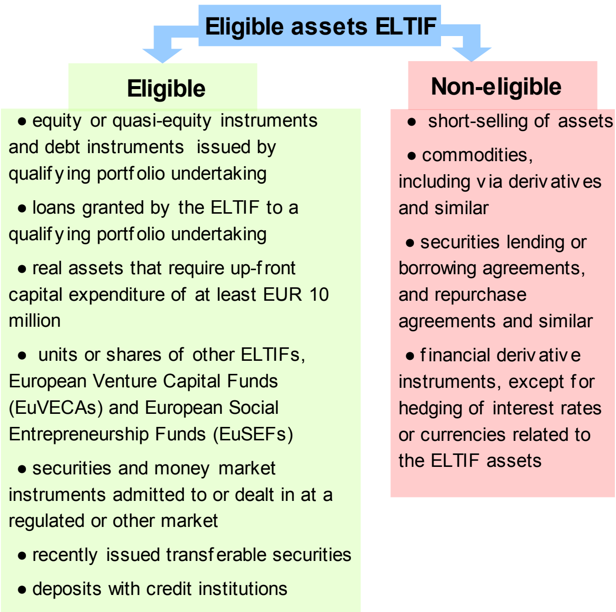
To encourage long-term investments, investors may not redeem their shares before the end of the ELTIF term. The retention period is not set in stone, but must be specified by the fund itself. However, ELTIF shares can be traded on secondary markets, such as on stock exchanges.

In terms of ELTIF asset values, the Commission is specifically thinking of real assets with a value of over 10 million Euros and certain "portfolio companies", which are not traded on the stock exchange. Specifically, the following are mentioned:

- schools, hospitals or prisons
- social infrastructure such as social housing
- transport infrastructure such as roads, mass transit systems or airports
- energy infrastructure such as energy grids
- climate adaptation and mitigation projects
- power plants or pipelines
- water management infrastructure such as water supply systems, sewage or irrigation systems
- communication infrastructure such as networks
- waste management infrastructure such as recycling or collection systems.

In addition to the newly targeted long-term assets, ELTIF shall permit the investment of up to 30% in other assets (see the chart below for an overview). These include most permissible assets for UCITS, including market-listed securities. Investments in other funds are also possible – within certain limits.

Graphic: *Permissible asset values for an ELTIF*



However, there are some important exceptions in ELTIF compared to the permissible UCITS asset values, especially in the area of financial derivatives. Unlike UCITS and AIF, the trade of financial derivatives is much more restricted with ELTIF. Financial derivatives may only be traded to hedge the assets of the respective ELTIF investments. Commodity trading is prohibited in all forms, whereas UCITS allows the investment in commodity financial products.

Investors shall be protected through various regulations. In particular, investors must be provided with leaflets with comprehensive information about the fund and its costs. There are also regulations stipulating the assets must be spread between various investments ("diversification") in order to reduce the concentration of risks. Bank loans shall only be allowed for up to 30% of the fund assets.

Legally, ELTIF are designed to be classified AIF. So the fund must first be registered as AIF before it can additionally take on the status of ELTIF. The conditions under which an AIF may be designated as ELTIF are clearly stated in this process.

The proposal would create an additional fund, directly regulated by the EU. So far, the UCITS and AIFM directives are to be implemented nationally. As in other areas (banks, stock exchanges, rating agencies), ELTIF would mean that fund regulation is more European, although in 2013 funds for venture capital and social entrepreneurship already were regulated by an EU Regulation. Regulations have direct validity within the EU and do not require national implementation.

"Long-term investments": a new attack on public services and institutions

The Commission rightly points out that the financial markets favour short-term, speculative investment, potentially leading to crises. The financing of infrastructure projects is also a laudable goal.

But placing private capital in infrastructure – rather than in speculative investments – is a major step in the wrong direction, as most of this infrastructure is still largely in the public hand. The list of concrete examples above shows that the Commission has learned nothing from bad experiences with privatisation. The capital market is unsuitable for financing prisons, public transport systems, energy networks, schools or sewage plants, because this occurs at the expense of the populace and democracy. Existing funding gaps should be closed by taxes and, if necessary, through government loans.

Obviously, ELTIF would also have ripple effects beyond the EU, as the permissible portfolio undertakings explicitly include non-European countries. This could enable the long-term returns of European investors to occur at the expense of the inhabitants of poorer countries – for example, through sewage fees.

In addition, it remains questionable whether the proposal adequately protects small private investors. Although a limit on loans is to be welcomed, the proposal could also have prohibited loans outright. And despite diversification regulations, significant concentration risks are likely to occur.

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Further information:

Website of the European Commission

Finance Watch

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