

MFSA

MALTA FINANCIAL SERVICES AUTHORITY

Circular to the financial services industry on the European Long-Term Investment Funds Regulation

The Authority would like to draw the attention of the investment services industry to [Regulation \(EU\) 2015/760 of the European Parliament and of the Council of 29 April 2015 on European long-term investment funds](#), hereinafter referred to as the “ELTIF Regulation”/“the Regulation”. The ELTIF Regulation came into force on 8 June 2015 and acquired direct applicability in Member States as of 9 December 2015. In Malta, the [Investment Services Act \(European Long-Term Investment Funds\) Regulations](#) were published on 4 March 2016 in order to provide the Authority with the powers necessary for implementation of the Regulation.

Rationale

The ELTIF Regulation introduces a new type of collective investment scheme designed to channel private capital towards long-term projects such as infrastructure and real estate. It forms part of the Commission’s drive to mobilise capital in the EU and complements Regulations 345/2013 and 346/2013 of the European Parliament and of the Council on [European Venture Capital Funds](#) and [European Social Entrepreneurship Funds](#), respectively, both of which have been applicable in Member States since 22 July 2013.

What are ELTIFs?

ELTIFs are a new type of regulated fund for investment in long-term financing in the European real economy. To qualify as an ELTIF, a collective investment scheme is required to be an EU alternative investment fund (“AIF”) of any legal form permitted in its home Member State and managed by an EU alternative investment fund manager (“AIFM”). This implies that both the ELTIF and its manager will be subject to Directive 2011/61/EU (the “[AIFMD](#)”) as well as to the ELTIF Regulation. The ELTIF Regulation contains provisions regarding such issues as the eligible assets of an ELTIF, portfolio composition and diversification, and marketing.

Authorisation of ELTIFs and ELTIF managers

The designation “ELTIF” or “European long-term investment fund” may only be used by an EU AIF and only after having applied for and been granted authorisation as an ELTIF by its competent authority. An application for authorisation is required to include certain information as stipulated in the Regulation, such as the identity of the proposed manager (together with its fund management experience and history) and information on the proposed custodian. The proposed AIFM itself will also be required to apply to its own competent authority for approval to manage an ELTIF. Such application should include information on

any delegation arrangements intended to be set in place and information on the investment strategies, risk profile and other characteristics of any other AIFs managed by the AIFM. Where the competent authority of the ELTIF and of the AIFM are one and the same, the AIFM's application should refer to the documentation previously submitted for authorisation under the AIFMD.

An internally managed AIF may apply for authorisation as an ELTIF provided that such application is filed simultaneously with an application for authorisation as an AIFM under the AIFMD.

Eligible investments and investment policies

An ELTIF is only permitted to invest in “eligible investment assets” and in assets that are eligible for investment by UCITS, such as equities, bonds, money market instruments, and units of other UCITS. Eligible investment assets comprise the following:

- (i) equity, quasi-equity or debt instruments that have been issued by qualifying portfolio undertakings, which are essentially non-financial unlisted companies or non-financial listed companies with a market capitalisation of less than €500m and which are established either in the EU or in a third country meeting certain requirements as stipulated in the Regulation;
- (ii) loans granted by the ELTIF to a qualifying portfolio undertaking;
- (iii) units or shares of other ELTIFs, European Venture Capital Funds (“EuVECAs”) and European Social Entrepreneurship Funds (“EuSEFs”) that have not themselves invested more than 10% of their capital in ELTIFs; and
- (iv) direct or indirect holdings via qualifying portfolio undertakings in individual real assets with a value of at least €10m or its equivalent.¹

At least 70% of the capital of the ELTIF is required to be invested in eligible assets by the date specified in the ELTIF's rules or instruments of incorporation, which date should be no later than 5 years from date of authorisation of the ELTIF or half the life of the ELTIF, whichever is the earlier. In exceptional circumstances and upon submission of a duly justified investment plan, the competent authority may approve an extension of this time limit by no more than one year.

The Regulation also lays down investment policies regarding portfolio composition and diversification such that:

- (i) no more than 10% of the capital of the ELTIF may be invested in:
 - (a) instruments issued by or loans granted to any single qualifying undertaking;
 - (b) a single real asset, whether directly or indirectly; or

¹ The ELTIF Regulation defines a “real asset” in terms of “an asset that has value due to its substance and properties and may provide returns, including infrastructure and other assets that give rise to economic or social benefit, such as education, counselling, research and development, and including commercial property or housing only where they are integral to, or an ancillary element of, a long-term investment project that contributes to the Union objective of smart, sustainable and inclusive growth.”

- (c) units or shares of any single ELTIF, EuVECA or EuSEF; and
- (ii) no more than 5% of the capital of the ELTIF may be invested in assets eligible for investment by UCITS where those assets have been issued by a single body.

These investment limits may be derogated from where certain conditions are met, effectively allowing the 10% limit referred to in point (i)(a) and (b) to be raised to 20% and the 5% cap referred to in point (ii) to be raised to 25% under certain circumstances.

An ELTIF is also subject to certain borrowing restrictions such as the prohibition on any borrowing that represents more than 30% of the value of the capital of the ELTIF and the fact that borrowing should serve the purpose of investing in eligible assets (other than loans granted to qualifying portfolio undertakings) in situations where the holdings in cash or cash equivalents of the ELTIF are not sufficient to make the investment concerned. The manager of an ELTIF is required to specify, in the prospectus of such ELTIF, whether or not it intends to borrow cash as part of its investment strategy.

In view of their tendency to create leverage, the following activities are also prohibited to ELTIFs:

- (i) the short selling of assets;
- (ii) the acquisition of direct or indirect exposure to commodities via financial derivative instruments;
- (iii) the entering into of securities lending or borrowing, repurchase transactions or any other agreement which has an equivalent economic effect and which poses similar risks if more than 10% of the ELTIF's assets would be affected thereby; and
- (iv) the use of financial derivative instruments, except for purposes of hedging.

Redemption and distribution of proceeds and capital

As a general rule, the redemption of the units or shares of an ELTIF is not permissible prior to the end of the life of the ELTIF. The life of an ELTIF should be consistent with the long-term nature of ELTIFs and should be sufficient to cover the life-cycle of each of its individual assets, measured according to the illiquidity profile and economic life-cycle of the asset and the stated investment objective of the ELTIF. The implication of this is that investment in an ELTIF could tie up investor funds for a lengthy period of time relative to certain other retail investments. In recognition of this and in the absence of any derogation as described below, the rules or instruments of incorporation of the ELTIF should clearly state that redemptions to investors will commence on the day following the date of the end of the life of the ELTIF. The procedures for redemption and for the disposal of assets should also be specified.

The “no redemption” principle may be derogated from under certain conditions as stipulated in the Regulation. Such conditions include the condition that redemption does not take place prior to the date intended as that by which the ELTIF shall meet its investment target and the condition that the manager of the ELTIF be able to demonstrate that an appropriate liquidity management system and effective procedures are in place for monitoring the liquidity risk of the ELTIF.

Transparency Requirements

The marketing of an ELTIF within the EU requires the prior publication of a prospectus and, in the case of an ELTIF marketed to retail investors, a key information document drawn up in accordance with Regulation (EU) No 1286/2014 (the “[PRIIPS Regulation](#)”). The prospectus must include all information necessary to enable investors to make an informed assessment regarding the proposed investment and the risks attached thereto. The ELTIF Regulation lays down the minimum requirements of the prospectus, some of which are inherent to ELTIFs and some of which emerge from other instruments of Union legislation.² In particular, the prospectus and any other marketing documentation is required to inform investors of the illiquidity inherent in an ELTIF.

An ELTIF is also required to publish an annual report drawn up in accordance with the AIFMD but also containing certain additional items such as a cash flow statement and information on any participation in instruments involving Union budgetary funds.

Marketing of units or shares of ELTIFs

ELTIFs are a hybrid form of investment fund in that the units or shares of an ELTIF may be marketed to both professional and retail investors upon due notification in terms of Article 31 of the AIFMD (where the marketing is intended to take place only in the home Member State of the manager) or Article 32 of the AIFMD (where marketing is intended to take place in Member States other than the home Member State of the manager). For each ELTIF managed by it, the manager is required to specify to competent authorities whether or not it intends to market the ELTIF to retail investors.

The Regulation contains a number of provisions specific to ELTIFs that are marketed to retail investors. For instance, the manager of any such ELTIF is required to establish and apply specific internal processes for the assessment of the ELTIF’s suitability or otherwise for marketing to retail investors. Meanwhile, when directly offering or placing units or shares of an ELTIF to a retail investor, the manager of the ELTIF is required to carry out a suitability test based on the retail investor’s knowledge and experience in the investment field relevant to the ELTIF, the investor’s financial situation (including his ability to bear losses), and his or her investment objectives and time horizon. Investment advice should be provided to the investor by the manager or the distributor on the basis of the suitability test. Furthermore, despite the fact that ELTIFs are classified as AIFs, it is only those entities eligible to act as custodians of UCITS that are eligible also to act as custodians of ELTIFs. Furthermore, the custodian of an ELTIF may not discharge itself of liability in the event of loss of a financial instrument held in custody by a third party, nor may liability be excluded or limited by agreement where the ELTIF is marketed to retail investors. The reuse by the custodian of assets held in custody is only permissible under certain conditions.

² The AIFMD, Directive 2003/71/EC (the “[Prospectus Directive](#)”) and Regulation (EC) No 809/2004 (the “[Prospectus Regulation](#)”).

Regulatory Technical Standards

The ELTIF Regulation requires ESMA to draft regulatory technical standards (“RTS”) relating to: (i) the use of financial derivative instruments for the purposes of hedging; (ii) the circumstances in which the life of an ELTIF is considered sufficient in length to cover the life-cycle of each of the individual assets of the ELTIF; (iii) assessments and valuations carried out for the purposes of drawing up an itemised schedule for the orderly disposal of ELTIF assets; (iv) costs disclosure; and (v) the types and characteristics of the facilities put in place for subscriptions, making payments to unit- or shareholders, repurchasing or redeeming units or shares and making available the information which the ELTIF and the manager of the ELTIF are required to provide.

ESMA published its draft RTS for consultation on 31 July 2015 and the responses thereto were published on 20 October 2015. ESMA is now expected to finalise the RTS within the next few months.

Contacts

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26 April 2016
