Comparing ELTIFs and LTAFs – a new era for illiquid investments on both sides of the river?

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A. Introduction

European Long-Term Investment Funds (***ELTIFs***) and Long-Term Asset Funds (***LTAFs***) are designed to facilitate investments in long-term and illiquid assets, such as private equity, venture capital, private debt, real estate and infrastructure projects. By their nature, these assets are only available in illiquid markets and require a high degree of long-term commitment, which reserved them traditionally for institutional investment only. However, both ELTIFs and LTAFs can be structured to allow access for retail investors alongside professional investors.

Although the introduction of ELTIFs in 2015 by Regulation 2015/760[1] (***ELTIF Regulation***) did not generate the desired demand from both investors and sponsors, they have recently become an increasingly popular investment vehicle across the European Economic Area (*EEA*). This can be mainly attributed to the revision of the ELTIF-Regulation in 2023 (***ELTIF 2.0***).[2] The reform increased the flexibility of the investment vehicle and lowered the entry barriers for potential investors. This accords with the broader market trend of 'retailisation' or 'democratisation of private markets', in that private fund managers are increasingly interested in retail capital, particularly from high-net-worth individuals. This reform also fits with the European Union's (***EU***) political narrative of promoting the long-term participation of private individuals in the capital market.[3]

There has been a similar trend in the UK market, although the LTAF has not yet garnered the same widespread adoption as the ELTIF. On 1 January 2024, the ELTIF Regulation was repealed in the UK. No ELTIFs had been established in the UK at this time, so this legislation will not be replaced. The FCA published final rules for the new UK LTAF regime in Policy Statement PS21/14[4], which took effect in November 2021. The goal was to provide a fund structure better suited to the needs of the UK market. In June 2023, the FCA published revised rules in Policy Statement PS23/7.[5] Like the 'ELTIF 2.0' revision, the FCA's reform made the fund structure more widely accessible to retail investors, as well as self-select defined contribution (***DC***) pensions schemes and Self-Invested Personal Pensions (***SIPPs***). The revised LTAF rules came into effect in July 2023.

In the UK, broadening the investor base for LTAFs is seen as a key strategy for unlocking investments from the expanding DC pension market. A 2022 consultation revealed that DC pension schemes[6] were missing out on greater returns by under-allocating resources to illiquid assets. In response, the Government introduced regulatory changes and statutory guidance to encourage investment by DC pension schemes in illiquid asset classes.[7] The allocation of funds to illiquid assets by

[1] Regulation (EU) 2015/760 of the European Parliament and of the Council of 29 April 2015 on European long-term investment funds; https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32015R0760.
[2] Regulation (EU) 2023/606 of the European Parliament and of the Council of 15 March 2023 amending Regulation (EU) 2015/760, https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32023R0606. According to a statement made by the European Fund and Asset Management Association (EFAMA) on 22 July 2024, since the decision was made to update the ELTIF regime in 2021, the number of ELTIFs has increased from 57 to more than 120, the assets under management of ELTIFs have increased from €2.7bn to more than €13.6bn, and new domiciles have begun hosting ELTIFs.
[3] See *von der Leyen*, Political Guidelines of the 2024-2029 European Commission, commission.europa.eu/document/download/e6cd4328-673c-4e7a-8683-f63ffb2cf648_en?filename=Political Guidelines 2024-2029_EN.pdf, p. 12.
[4] https://www.fca.org.uk/publication/policy/ps21-14.pdf.
[5] https://www.fca.org.uk/publication/policy/ps23-7.pdf.
[6] https://www.gov.uk/government/consultations/broadening-the-investment-opportunities-of-defined-contribution-pension-schemes/consultation-broadening-the-investment-opportunities-of-defined-contribution-pension-schemes.
[7] See "Government response: Broadening the investment opportunities of defined contribution pension schemes"; https://www.gov.uk/government/consultations/broadening-the-

pension schemes now appears to be a growing trend.[8] Since the launch of the first LTAF by Schroders in March 2023, there has been an uptick in interest for the LTAF, with a number of LTAFs subsequently gaining regulatory approval.[9]

Interest in LTAFs may also be fostered as a spill-over effect from the increased use of ELTIFs in the EU, with ELTIF fund managers seeking to target the UK retail market and therefore considering to set up parallel LTAF structures.

Against that background, this client briefing contrasts and compares the key features of ELTIFs and LTAFs regarding

- **applicable legislation and rules** (below A.)
- **product regulation** (below B.), covering
  - **forms** (below B.I.),
  - **competent regulatory authority** and **approval requirement** (below B.II.),
  - **cross-border marketing** (below B.III.),
  - **eligible investments** (below B.IV.),
  - **diversification requirements** and **portfolio composition** (below B.V.),
  - relevance of **sustainability** (below B.VI.),
  - **borrowing** (below B.VII.),
  - **fund-of-fund strategies** (below B.VIII.),
  - **derivatives** (below B.IX.),
  - **fund liquidity** (below B.X.),
- **management** and **governance** (below D.),
- **marketing** and **investor protection** (below E.), and
- investments by **insurance companies** and **pension schemes** (below F.).

Where applicable and relevant, we differentiate between requirements for retail and professional investors.

A. Applicable legislation and rules

I. ELTIF

As noted above, Regulation (EU) 2015/760 of the European Parliament and of the Council of 29 April 2015 on European long-term investment funds, which introduced ELTIFs in 2015, was subject to a major overhaul by Regulation (EU) 2023/606 of the European Parliament and of the Council of 15 March 2023.[10] ELTIF 2.0 significantly amended the ELTIF Regulation to increase the appeal of ELTIFs for both retail and professional investors. ELTIF 2.0 applies as of 10 January 2024, with a five-year transitional period for pre-existing ELTIFs that are still raising capital and an opt-in regime for ELTIFs authorised before 10 January 2024 who choose to opt-in to the amended rules by notifying their national competent authority.[11]

The ELTIF Regulation is complemented by regulatory technical standards (***RTS***) set out in Commission Delegated Regulation (EU) 2018/480 of 4 December 2017 on financial derivative instruments solely serving hedging purposes, sufficient length of the life of ELTIFs, assessment criteria for the market for potential buyers and valuation of the assets to be divested, and the types and characteristics of the facilities available to retail investors.[12]

On 19 July 2024, the European Commission adopted after some back and forth with ESMA a Delegated Regulation which set out draft RTS under ELTIF 2.0.[13] The RTS specify new criteria when derivatives will be used solely for hedging the risks inherent to other investments of the ELTIF, the requirements for an ELTIF's redemption policy and liquidity management tools, the circumstances for the matching of transfer requests of units or shares of the ELTIF, certain criteria for the disposal of ELTIF assets, and certain elements of the costs disclosure. The European Parliament to the Council of the EU now have three months to scrutinise the RTS, extendable by a further three months by either institution. The RTS are likely to be agreed and published in the Official Journal sometime in Q4 2024 and will enter into force the day following publication. The ELTIF market is expected to grow even further once the Level 2 rules enter into application.[14]

An ELTIF can only be managed by alternative investment fund managers (***AIFMs***) authorised in the EU pursuant to Directive (EU) 2011/61 (***AIFMD***).[15] The AIFMD regime therefore also applies, including Commission Delegated

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investment-opportunities-of-defined-contribution-pension-schemes/outcome/government-response-broadening-the-investment-opportunities-of-defined-contribution-pension-schemes#exempting-performance-based-fees-from-the-regulatory-charge-cap.

[8] See, for example Exclusive: Top UK pension fund Nest expects to lift private assets to 30% of holdings | Reuters.

[9] See "International regulatory developments affecting investment management"; https://www.fca.org.uk/news/speeches/international-regulatory-developments-affecting-investment-management.

[10] For a consolidated version of the amended Regulation see https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A02015R0760-20240110.

[11] Art. 2 para.4 ELTIF 2.0.

[12] https://eur-lex.europa.eu/eli/reg_del/2018/480/oj.

[13] COM(2024) 4991 final, https://ec.europa.eu/transparency/documents-register/detail?ref=C(2024)4991&lang=en.

[14] EFAMA, statement, "ELTIF 2.0 Level 2 rules are almost complete" (22 July 2024).

[15] Art. 5 para. 2 ELTIF Regulation.

Regulation (EU) 231/2013 (***AIFMD Level 2 Regulation***).

II. LTAF

LTAFs are governed by rules contained in Chapter 15 of the FCA collective investment schemes sourcebook (***COLL***).

LTAFs can only be managed by a full scope UK AIFM.[16] Those AIFMs are subject to the requirements of both COLL and the Investment Funds sourcebook (***FUND***) and must also comply with other applicable provisions of the UK AIFM regime, including the UK version of the AIFMD Level 2 Regulation and the Alternative Investment Fund Managers Regulations 2013, SI 2013/1773 (***AIFMD UK Regulation***), as well as rules in other parts of the FCA Handbook such as Principles for Businesses (PRIN), the Conduct of Business sourcebook (COBS) and Senior Management Arrangements, Systems and Controls (SYSC).

Consequently, any EU AIFM that contemplates to set up an UK LTAF as a parallel structure for an ELTIF would need to cooperate with a full scope UK AIFM that would delegate portfolio management to the EU AIFM (provided it is permitted to engage in portfolio management in the UK). Vice versa, before the third country passport regime under AIFMD enters into effect, an UK ELTIF manager would need to partner with an EU AIFM to manage an ELTIF by way of a delegation of portfolio management. Once the third country passport is available – which is of course uncertain whether this will ever be the case – an UK AIFM will likely also be permitted to manage EU ELTIF.

C. Product Regulation

I. Forms

1. ELTIF

The ELTIF is an EU-based regulated Alternative Investment Fund (***AIF***) established to enable investment in corporate structures and projects that require long-term capital. It depends on the jurisdiction of establishment which contractual or corporate form ELTIFs can take and whether they are treated as an overlay to existing product categories. As an example, in Germany, the German Federal Financial Supervisory Authority (*Bundesanstalt für Finanzdienstleistungsaufsicht* – ***BaFin***) took a liberal approach in that all possible fund structures for an AIF are available for an ELTIF, which form their own product category rather than leveraging an existing category.[17] In Luxembourg, ELTIFs are typically established as funds set up under Part II of the Luxembourg Law of 17 December 2010 on undertakings for collective investment (***UCIs***), Specialised Investment Funds (***SIFs***), or Reserved Alternative Investment Funds (***RAIFs***).

Master-feeder structures are also permissible, provided that the master fund is an ELTIF.[18]

2. LTAF

The LTAF, also an AIF, is an open-ended fund structure, authorised by the FCA, that similarly enables investment in long-term illiquid asset classes. It can take the following forms:

- an Authorised Contractual Scheme (***ACS***);
- an Investment Company with Variable Capital (***ICVC***); or
- an Authorised Unit Trust (***AUT***).[19]

The FCA also permits master-feeder structures where the feeder LTAF is dedicated to units in either a single qualifying master LTAF or a single sub-fund of a qualifying master LTAF that is an umbrella.[20]

II. Competent regulatory authority and approval requirement

1. ELTIF

ELTIFs must be authorised by the national supervisory authority of the country in which the ELTIF has its registered office.[21] In addition, the AIFM managing the ELTIF requires prior authorisation by the competent authority of the ELTIF.[22] Therefore, if an AIFM manages an ELTIF for the first time, two applications are required to the ELTIF's competent authority. In Germany, the competent authority is BaFin who has published a helpful FAQ detailing, among others, the requirement for the application.[23]

Applicants must be informed within two months after full submission of the application whether the authorisation as an ELTIF is granted.[24]

[16] COLL 15.2.2R. They cannot be managed by small authorised UK AIFMs that are subject to a more limited set of rules and requirements, COLL 15.2.3G(2).
[17] Investment stock corporation (*InvAG*), Investment limited partnership (*InvKG*), and fund in contractual form (*Sondervermögen*).
[18] For the definitions of "feeder ELTIF" and "master ELTIF", see Art. 2, para. 20, 21 ELTIF Regulation.
[19] COLL 15.1.1R.
[20] See definition of "feeder LTAF" in FCA Handbook Glossary, https://www.handbook.fca.org.uk/handbook/glossary/G3544f.html.
[21] Art. 5 para.1 and para. 2 ELTIF Regulation.
[22] Art. 5 para. 2 ELTIF Regulation.
[23] BaFin - Aktuelles - Häufige Fragen zur ELTIF-Verordnung.
[24] Art. 5 para. 3 ELTIF Regulation.

2. LTAF

The FCA is the competent regulatory authority with respect to LTAFs. It is required by law to authorise or reject an authorisation application within 6 months.[25] Details of the application procedures in respect of LTAFs are contained in COLL 2.1 (Authorised fund applications).[26] Further information is available on the FCA website.[27] There are prescribed application forms for ACTs, ICVCs and AUTs, each with a section for providing information about the LTAF. The FCA encourages firms who are considering making an application for an LTAF to engage with the FCA prior to submitting an application.

III. Cross-border marketing

1. ELTIF

ELTIFs can be marketed to retail and professional investors in the manager's home Member State upon notification in accordance with Article 31 of AIFMD. [28] ELTIFs also benefit from a **marketing "passport"**, which enables them to be marketed to retail and professional investors in other states in the EEA upon notification in accordance with Article 32 of AIFMD.[29]

ELTIFs can only be marketed in the UK if they comply with the **National Private Placement Regime** (***NPPR***) and the FCA's requirements with regard to financial promotions are met. EU AIFMs wishing to market ELTIFs to UK investors must notify the FCA under NPPR. This involves completing the FCA's NPPR notification form, submitting detailed information about the fund, and paying the requisite fee. Once registered, AIFMs must adhere to ongoing compliance obligations, which includes providing regular updates to the FCA about any changes in the fund's operations or management structure and ensuring that annual reports are submitted on time.[30]

2. LTAF

Likewise, LTAFs cannot be sold in EEA states unless their **private placement regime** permits this. LTAF vehicles therefore face the same impediments to distribution within the EU as any other third country investment vehicle. They can be marketed within the UK, subject to the FCA marketing rules.

IV. Eligible investments

1. ELTIF

ELTIFs are only permitted to invest in certain eligible investment assets (as described below) and in assets that undertakings for collective investment in transferable securities (***UCITS***) are permitted to invest in pursuant to Article 50(1) of Directive 2009/65/EC (***UCITS Directive***) (assets eligible for investment by UCITS include: transferable securities, money market instruments and financial derivative instruments traded on a regulated market; units of UCITS; and deposits with credit institutions).[31]

An ELTIF is obligated to invest at least **55% of its capital** in **eligible investment assets**.[32] Eligible investment assets include: [33]

- **equity**, **quasi-equity** and **debt** instruments issued by a **qualifying portfolio undertaking** (as defined below) or equity or quasi-equity instruments issued by an undertaking in which a qualifying portfolio holds a capital participation;
- **loans** granted to a qualifying portfolio undertaking with a maturity no longer than the life of the ELTIF;
- **real assets** (defined as an asset with an intrinsic value due to its substance and properties); [34]
- **green bonds** issued by a qualifying portfolio undertaking pursuant to the EU Regulation on European Green Bonds;[35]
- simple, transparent and standardised (***STS***) securitisations where the underlying exposures correspond to:
  - **residential loans** secured by mortgages on residential immovable property or fully guaranteed by an eligible protection provider,
  - **commercial loans** secured by mortgages on commercial immovable property, including offices or other commercial premises,
  - **credit facilities**, including loans and leases, provided to an enterprise or corporation, or
  - **trade receivables** or other asset types, provided that the proceeds from the securitisation are used for financing or refinancing long-term investments; and

[25] FSMA 2000 s. 55V.
[26] COLL 15.1.5G.
[27] See www.fca.org.uk/firms/authorised-recognised-funds/apply-fund-authorisation.
[28] Art. 31 para. 1 ELTIF Regulation, Art. 31 AIFMD.
[29] Art. 31 para. 2 ELTIF Regulation, Art. 32 AIFMD.
[30] For more information, see FUND 10.5 (National private placement), PERG 8.37 (AIFMD Marketing) and https://www.fca.org.uk/firms/nppr.
[31] Art. 9 para. 1 ELTIF Regulation.
[32] Art. 13 para. 1 ELTIF Regulation. The threshold was lowered from 70 % to 55 % by Art. 1 para. 8 ELTIF 2.0.
[33] Art. 10 ELTIF Regulation.
[34] Art. 2 para. 6 ELTIF Regulation.
[35] Regulation (EU) 2023/2631, https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex:32023R2631.

- units or shares of one or several **ELTIFs**, European venture capital funds (***EuVECAs***), European social entrepreneurship funds (***EuSEFs***), **UCITS** and **EU AIFs** that are managed by **EU AIFMs** and invest in assets eligible for ELTIFs, provided that they have not themselves invested more than 10% of their capital in other collective investment undertakings (this limit does not apply to feeder ELTIFs).

A "**qualifying portfolio undertaking**" is defined as an undertaking that meets the following conditions:

- it is **not admitted to trading** on a regulated market or on a multilateral trading facility (MTF), unless it has a market capitalisation of no more than EUR 1.5 billion;
- **it** is established in either (a) an **EEA** state or (b) a third country that is **not a high-risk jurisdiction** for AML purposes nor a non-cooperative jurisdiction for tax purposes; and
- **it** is **not a financial undertaking**, unless it is (a) a **financial undertaking** that was authorised or registered **no longer than 5 years** before the date of the initial investment and is not a financial holding company or a mixed-activity holding company, or (b) a financial undertaking that exclusively finances **qualifying portfolio undertakings** or **real assets** (as defined above). [36]

For the purpose of the investment limit, the assets of the ELTIF and of the other collective investment undertakings in which the ELTIF has invested shall be **combined**.[37]

2. LTAF

Comparing the list of eligible investments, the spectrum of permitted assets for an LTAF is **slightly more flexible** than for an ELTIF. The investment strategy of the LTAF must be to invest at least **50% of the value** of the scheme's assets in **unlisted securities** and **other long-term assets** such as interests in immovables or other collective investment schemes investing in such securities or long-term assets. However, an LTAF could have a strategy of investing mainly in a mix of unlisted assets and listed but illiquid assets.[38]

The scheme assets must (except where otherwise provided by the rules) consist only of one or more of:

- a **specified investment** within articles 74 to 86 of the Regulated Activities Order (***RAO***)[39](this includes, for example, **shares**, **debentures**, government securities, deposits, electronic money, insurance contracts, warrants, **fund units**, pension schemes, options, futures, and contracts for differences) and rights to or interests in one of those specified investments;
- an interest in a **loan** (provided it was not originated to a natural person, the AIFM or depositary of the LTAF or a company in the same group as the AIFM or depositary or a person who uses or intends to use the credit for the purpose of investing in a derivative, unregulated transferable cryptoassets, precious metals, or a commodity contract traded on a recognised investment exchange (***RIE***) or a recognised overseas investment exchange);
- an interest in **land** or a **building**, provided it meets the requirements set out in COLL 15.6.18R (including with regard to valuation and title);
- **precious metals** (gold, silver or platinum); or
- a **commodity contract** traded on an RIE or a recognised overseas investment exchange.[40]

V. Diversification requirements and portfolio composition

1. ELTIF

Regarding the composition of assets, ELTIFs are prohibited from investing more than:[41]

- **20%** of its capital in instruments issued by (or loans granted to) any sin**gle qualifying portfolio undertaking**;[42]
- **20%** of its capital in **a single real asset**;[43]
- **20%** of its capital in units or shares of any **single ELTIF, EuVECA, EuSEF, UCITS**, or **EU AIF** managed by an **EU AIFM** (i.e., forming part of the underlying funds for 'eligible assets' outlined above) and comprising **no more than 30%** of the units or shares of that fund (neither restriction applies to feeder ELTIFs);[44]
- **10%** of its capital in UCITS eligible assets issued by an **individual issuer** (**25%** where **bonds** are issued by an **EU credit institution** subject to public supervision to protect bondholders);[45]
- **20%** of its capital in **STS securitisations** (as per their aggregate value).[46]

The aggregate risk exposure to a counterparty of an ELTIF arising from over-the-counter (***OTC***) derivative transactions, repurchase agreements, or reverse

[36] Art. 11 ELTIF Regulation.
[37] Art. 10 para. 2 subpara. 2 ELTIF Regulation.
[38] COLL 15.6.7G.
[39] Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (SI 2001/544).
[40] COLL 15.6.8R.
[41] Art. 13 et seq. ELTIF Regulation.
[42] Art. 13 para. 2 lit. a ELTIF Regulation.
[43] Art. 13 para. 2 lit. b ELTIF Regulation.
[44] Art. 13 para. 2 lit. c, para. 7, Art. 15 para. 1 ELTIF Regulation.
[45] Art. 13 para. 2 lit. c, para. 5 ELTIF Regulation.
[46] Art. 13 para. 3 ELTIF Regulation.

repurchase agreements may not exceed 10% of the value of the capital of the ELTIF.[47]

Further, an ELTIF may not acquire more than **30%** of the units or shares of a **single ELTIF, EuVECA, EuSEF, UCITS** or of an **EU AIF** managed by an **EU AIFM** (this limit does not apply to a feeder ELTIF investing in its master ELTIF).[48]

For the purpose of the above limits, the assets of the ELTIF and of the other collective investment undertakings in which that ELTIF has invested shall be **combined**.[49]

The aforementioned diversification requirements and concentration limits **do not apply** where ELTIFs are marketed solely to **professional investors**.[50]

The ELTIF reform substantially increased most of the above thresholds, which were originally introduced to ensure that ELTIFs could withstand unfavourable market circumstances. The original ELTIF Regulation provided that ELTIFs could invest more than 10% of their capital in instruments issued by, or loans granted to, any single qualifying portfolio undertaking, in a single real asset, or in units or shares of any single ELTIF, EuVECA or EuSEF. However, those provisions proved too burdensome because they required ELTIFs to make at least 10 distinct investments, which was difficult and costly to achieve. The higher thresholds allow ELTIFs to pursue more concentrated investment strategies and thus have exposures to fewer eligible assets, which reduces transaction and administrative costs. [51]

2. LTAF

LTAFs are subject to more **principle-based diversification requirements**, rather than concrete thresholds as ELTIFs. The over-arching diversification requirement for LTAFs is that there is a "prudent spread of risk" arising from the assets or investments held in the portfolio of the LTAF.[52] Fund managers should consider the risks to which the LTAF is exposed, including:

- **whether** the assets or investments held in the portfolio provide a **sufficient diversification** of exposure including, for example, in respect of the underlying assets or investments held by any holding company or other collective investment scheme, and
- **the spread** of any other risks arising from the assets or investments held in the scheme property of the LTAF such as market risks, credit risks, liquidity risks and counterparty risks.[53]

Other than this, there are comparatively few express spread or diversification requirements for LTAFs.

VI. Relevance of sustainability

1. ELTIF

ELTIF 2.0 amended the ELTIF Regulation to specify that the objective of the Regulation includes the raising and channelling of capital towards investments that promote the European Green Deal.[54] To that end, ELTIF 2.0 clarified that ELTIFs are able to invest in **green bonds**.[55]

The newly introduced Article 37a of the ELTIF Regulation mandates that the Commission carry out a review by January 2026 of sustainability aspects of ELTIFs, including:

- whether to introduce a **label** for "green" or "environmentally sustainable" ELTIFs
- whether there should be a general requirement for ELTIFs to comply with the "**do no significant harm**" principle set out in Art. 2a of Regulation (EU) 2019/2088 (***SFDR***), or whether that obligation should be limited to ELTIFs marketed as environmentally sustainable or green ELTIFs,[56] and
- **other** potential for increasing the contribution of the ELTIF framework to the objectives of the European Green Deal.

Since ELTIF 2.0, the Commission is also required to review by 10 April 2030 whether ELTIFs have made a significant contribution to achieving EU objectives such as those set out in the European Green Deal. [57] Both reviews could result in **legislative proposals** to amend the ELTIF Regulation.

As with any other investment product, where ELTIFs promote sustainable characteristics or commit to make sustainable investments, they are subject to the Art. 8 or Art. 9 SFDR disclosure obligations including the rules on binding elements and the "do no significant harm" principle under the SFDR.[58]

[47] Art. 13 para. 4 ELTIF Regulation.
[48] Art. 15 par. 1 ELTIF Regulation.
[49] Art. 10 para. 2 subpara. 2 ELTIF Regulation.
[50] Art. 13 para. 7, Art. 15 ELTIF Regulation.
[51] See recital 23 of ELTIF 2.0.
[52] COLL 15.6.3R.
[53] COLL 15.6.4G.
[54] Art.1, para. 1, ELTIF 2.0; Art. 1, para. 2 ELTIF Regulation. For more information on the European Green Deal, see https://commission.europa.eu/strategy-and-policy/priorities-2019-2024/european-green-deal_en.
[55] Art. 1, para. 5, ELTIF. 2.0; Art. 10, para. 1, lit. g ELTIF Regulation.
[56] For more information on the "do no significant harm" principle, see ESMA's note of 22 November 2023, https://www.esma.europa.eu/sites/default/files/2023-11/ESMA30-379-2281_Note_DNSH_definitions_and_criteria_across_the_EU_Sustainable_Finance_framework.pdf.
[57] Art. 1, para. 23, ELTIF. 2.0; Art. 37, para. 1, lit. j ELTIF Regulation.
[58] Regulation (EU) No. 2019/2088.

2. LTAF

There are no corresponding sustainability provisions applicable to LTAFs. However, LTAFs may use, like any other investment vehicle, sustainability labels or sustainability-related terms in their prospectus, in which case they must comply with the applicable provisions of the Environmental, Social and Governance sourcebook (***ESG***).[59] Further, LTAFs that qualify as sustainability products must produce public product-level sustainability reports.[60]

VII. Borrowing

1. ELTIF

Retail ELTIFs are permitted to borrow cash up to **50%** of their net asset value (***NAV***), whereas borrowing for ELTIFs only available to **professional investors** is permitted up to **100%** of the NAV. (These limits can be suspended for up to **12 months** where the ELTIF raises additional capital or reduces its existing capital.) Any borrowing must:

- serve the **purpose** of making investments or providing liquidity,
- be **contracted** in the **same currency** as the assets to be acquired (or in another currency where currency exposure has been appropriately hedged), and
- have a **maturity** no longer than the life of the ELTIF.[61]

One important exemption applies: borrowing arrangements that are **fully covered by investors' capital commitments** are **not considered borrowing**. Further, when borrowing cash, an ELTIF may encumber assets to implement its borrowing strategy.[62] For the purpose of the borrowing limits, the assets and the cash borrowing position of the ELTIF and of the other collective investment undertakings in which that ELTIF has invested shall be combined.[63]

2. LTAF

Borrowing by an LTAF is more restricted than for an ELTIF. An LTAF may borrow money provided that the fund's borrowing does not exceed **30% of the NAV** on any day. The limit applies at the level of the LTAF and therefore does not prevent underlying assets from being further leveraged. Borrowing for these purposes means any arrangement (including a combination of derivatives) designed to achieve a temporary injection of money into the scheme property in the expectation that the sum will be repaid.[64]

The AIFM must take reasonable care to ensure that arrangements are in place that will enable borrowings to be closed out to ensure compliance with this limit.[65] Where the limit is breached, the AIFM must take action, at its own expense, to rectify that breach.[66]

VIII. Fund-of-fund strategies

1. ELTIF

Since the revision of the ELTIF Regulation by ELTIF 2.0, ELTIFs are able to invest in a wider range of collective investment undertakings. Target funds are no longer limited to ELTIFs, EuVECAs or EuSEFs, but can now also be "**regular**" **AIFs** or **UCITS**, provided that they invest in **assets eligible for ELTIFs** in accordance with Art. 9 para. 1 and 2 ELTIF Regulation.[67]

However, two material restrictions apply: AIFs are only available for a target fund investment if they are **located in the EU** and **managed by an EU AIFM**,[68] and the target fund must not invest more than **10%** of its assets in **other investment funds**.[69] With the latter restriction, the legislation prevents multi-level fund of funds structures and, in particular, the investment of an ELTIF in existing funds of funds. This restriction is a well-known concept for UCITS[70] and, e.g., German retail fund products (also referred to as "cascade ban" (*Kaskadenverbot*)).

2. LTAF

LTAFs are also able to utilise fund of funds strategies, provided that:

- the collective investment scheme in which the LTAF invests **is** a regulated scheme (i.e. an ICVC, AUT, ACS, or a scheme recognised for the purpose of part XVII of the Financial Services and Markets Act 2000 (***FSMA 2000***)), or
- where the scheme is not a **regulated collective investment scheme**, the AIFM has taken reasonable care to determine that:
- **the** scheme is externally audited;
- **calculation** of **the** scheme's NAV and maintenance of its **accounting** records is **segregated** from the investment management function; and
- the scheme (and any master scheme to whose units it is dedicated) is **prohibited from investing in the**

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[59] COLL 15.4.5R(28A).
[60] COLL 15.5.3R, 15.5.5R.
[61] Art. 16 ELTIF Regulation.
[62] Art. 16 para. 1 subpara. 2 and 3 ELTIF Regulation.
[63] Art. 10 para. 2 subpara. 2 ELTIF Regulation.
[64] COLL 15.6.17R.
[65] COLL 15.6.17R(2).
[66] COLL 15.6.17R(4), 15.7.3R(3)-(5).
[67] Art. 10 para. 1 lit. d ELTIF Regulation.
[68] However, qualifying portfolio companies in which these EU AIF target funds invest may be located in a third country, Art. 11 para. 1 lit. c ELTIF Regulation.
[69] Art. 10 para. 1 lit. d ELTIF Regulation.
[70] Art. 50(1)(e)(iv) UCITS Directive.

LTAF or the AIFM is satisfied that no such investment will be made by the scheme or any fund in which it invests. [71]

An LTAF must not invest more than **20%** of its assets in units in other collective investment schemes which are **unregulated schemes**, **qualified investor schemes**, or **LTAFs**, unless the AIFM has carried out appropriate **due diligence** on each of the other schemes and has taken reasonable care to determine that, after making all reasonable enquiries and on reasonable grounds, the other schemes comply with relevant legal and regulatory requirements.[72] The AIFM must carry out this due diligence on an **ongoing basis**. [73] If the collective investment scheme in which the LTAF invests is an umbrella, these requirements apply to each sub-fund as if it were a separate scheme. [74]

Consequently, also with respect to **fund-of-fund strategies LTAFs** are subject to a **more flexible** and principle based regulation which is not restricting multi-level fund structures.

IX. Derivatives

1. ELTIF

Derivatives are only permitted where the use of such instruments solely serves the purpose of **hedging the risks** inherent to other investments of the ELTIF.[75] Further, as set out above, the aggregate **risk exposure** to a counterparty from **OTC derivative transactions**, **repurchase agreements**, or **reverse repurchase agreements** must not exceed **10%** of ELTIF's capital value when it is marketed to **retail investors**. The same limit does not apply to ELTIFs marketed solely to professional investors.[76]

Article 1 of Commission Delegated Regulation (EU) 2018/480 specifies that the use of derivatives will be considered as solely **serving the purpose of hedging** the risks inherent to other investments of the ELTIF when they meet the following **criteria**:

The derivative instrument may only be used for hedging risks arising from exposures to assets and assets that ELTIFs are permitted to invest in pursuant to Article 9(1) of the ELTIF Regulation (as described under "Eligible Investments" above). The derivative must result in a **verifiable** and **objectively measurable reduction** of those risks at the ELTIF level. Where derivatives to hedge the risks arising from the exposure to the assets referred to above are not available, derivatives with an underlying of the same asset class may be used.

The use of derivatives aimed to provide a return for the ELTIF will not be deemed to serve the purpose of hedging the risks.

The manager of the ELTIF must take all reasonable steps to ensure that the derivatives used to hedge the risks inherent to other investments of the ELTIF reduce the risks at the ELTIF level, including in stressed market conditions.

Article 1 of the Delegation Regulation adopted by the Commission on 19 July 2024 (C(2024) 4991 final) provides a new set of criteria that derivatives must meet to be considered as solely serving the purpose of hedging the risks inherent to other investments of the ELTIF. Most notably, the criteria in the second bullet above was removed for a more principle based test:

The use of the derivatives must be economically **appropriate** for the ELTIF at the ELTIF level and **consistent** with the ELTIF's **risk-profile**.

The use of the derivatives must aim at a **verifiable reduction** of the risks at the ELTIF level. As is currently the case under Commission Delegated Regulation (EU) 2018/480, the manager of the ELTIF must take all reasonable steps to ensure that the derivatives used to hedge the risks inherent to other investments of the ELTIF reduce the risks at the ELTIF level, including in stressed market conditions.

The underlyings of the derivatives are assets to which the ELTIF is exposed, or, where the derivatives to hedge the risks arising from the exposure to such assets are not available, the underlyings are of the same or economically similar asset class.

As noted above under "Applicable legislation and rules", the Delegated Regulation is currently subject to review by the European Parliament and the Council. ELTIFs authorised before 10 January 2024 that do not choose to be subject to ELTIF 2.0 pursuant to Article 2 of that Regulation will remain subject to Commission Delegated Regulation (EU) 2018/480.

2. LTAF

Transactions in **derivatives** are **permitted**. However, when entering into any transaction in derivatives or any commodity contract which could result in any asset becoming part of the LTAF's portfolio, the AIFM must take reasonable care to determine that the transaction can be readily closed out or would at the expected time of delivery relate to an asset which is **eligible for inclusion in the LTAF's portfolio**. [77] If the AIFM's

[71] COLL 15.6.9R(1).
[72] COLL 15.6.9R (2).
[73] COLL 15.6.9R (3). Further guidance on the due diligence required is set out in COLL 15.6.10G.
[74] COLL 15.6.11R.

[75] Art. 9 para. 2 lit. d ELTIF Regulation; COM(2024) 4991 final, 19 July 2024, https://ec.europa.eu/transparency/documents-register/detail?ref=C(2024)4991&lang=en.
[76] Art. 13 para. 4, 7 ELTIF Regulation.
[77] COLL 15.6.12R(1).

determination proves incorrect, the AIFM may acquire the asset if it determines that acquisition is in the interests of the unitholders, provided it has the consent of the depositary, and that asset may form part of the LTAF's portfolio until the position can be rectified. [78]

A transaction in derivatives or a forward transaction may be entered into only if the **maximum exposure** in terms of the principal or notional principal created by the transaction to which the LTAF is or may be committed is **covered globally** (i.e. adequate cover from within the LTAF's assets must be available to meet the LTAF's total exposure, taking into account any reasonably foreseeable market movement).[79] Derivatives and forward transactions may be retained in the scheme property only so long as they remain covered globally. [80] No element of cover may be used more than once, and the total exposure relating to derivatives held in an LTAF must not exceed the net value of the LTAF's assets. [81] An AIFM must, as frequently as necessary to ensure compliance with these provisions, re-calculate the amount of cover required in respect of derivatives and forward transactions. [82]

Transactions in OTC derivatives must be capable of valuation. The AIFM must take reasonable care to determine that, throughout the life of the derivative, it will be able to value the investment with reasonable accuracy on the basis of the pricing model or on some other reliable basis reflecting an up-to-date market value which has been agreed between the AIFM and the depositary. [83]

An AIFM must use a risk management process enabling it to monitor and measure as frequently as appropriate the risk of an LTAF's derivatives positions and their contribution to the overall risk profile of the fund. [84]

X. Fund liquidity

1. ELTIF

While ELTIFs are in principle **closed-end**, the reform now allows for the possibility of **de facto open-ended** ELTIFs, granting redemption rights for investors during the lifetime of the ELTIF under certain conditions that are laid down in the RTS in the Delegation Regulation adopted by the Commission on 19 July 2024 and pending approval by the European Parliament and the Council. It includes requirements on (among others) a **minimum holding period**, the **redemption policy**, and the **liquidity management tools**.[85] ELTIF 2.0 also introduced a mechanism for matching transfer requests, which is further specified in the RTS. [86]

2. LTAF

LTAFs are **open-ended** but are subject to a notice period for **redemptions** of at least **90 days**.[87] LTAFs can also utilise various other **liquidity management tools** such as initial lock-in periods, minimum holding periods, deferral of redemptions, limits or caps on the number of units that can be redeemed on one occasion or over a period of time and side pockets.

AIFMs must also comply with the AIFMD Level 2 Regulation, which contains detailed requirements about liquidity management taking into account the LTAF's investment strategy, liquidity profile and redemption policy. [88] See, for example, Articles 46 to 49 of the AIFMD Level 2 Regulation.

D. Management and governance

I. ELTIF

An ELTIF must be managed by an **EU AIFM** that is **fully authorised** under the AIFMD, unless the legal form of the ELTIF permits internal management and no external AIFM has been appointed.[89] The AIFMD **depositary rules** apply, subject to specific provisions in Article 29 of the ELTIF Regulation concerning the depositary of an ELTIF marketed to retail investors.[90]AIFMs managing ELTIFs are also subject to the **governance requirements** and **valuation rules** of the AIFMD.

In addition to the AIFMD requirements for annual reports[91], the ELTIF Regulation provides that the annual report of ELTIFs must include a cash flow statement, information on the values of the qualifying portfolio undertakings and other assets in which the ELTIF has invested, and the location of the ELITF's assets.[92]

II. LTAF

The requirements applicable to managers of LTAF are comparable to those of ELTIF. An LTAF must be managed by a **full-scope UK AIFM** with permission to manage an

[78] COLL 15.6.13R(2), (3).
[79] COLL 15.6. 13R(1), (2).
[80] COLL 15.6. 15R(2).
[81] COLL 15.6.13R(3), (4).
[82] COLL 15.6. 15R(1).
[83] COLL 15.6.14R.
[84] COLL 15.6. 15R(3).
[85] Art. 18 ELTIF Regulation; COM(2024) 4991 final, 19 July 2024, https://ec.europa.eu/transparency/documents-register/detail?ref=C(2024)4991&lang=en.
[86] Art. 19 para 2a ELTIF Regulation; COM(2024) 4991 final, 19 July 2024, https://ec.europa.eu/transparency/documents-register/detail?ref=C(2024)4991&lang=en.
[87] COLL 15.8.12R.
[88] COLL 15.8.13G(5).
[89] Art. 2 para. 12, Art. 5 para. 2, 5 ELTIF Regulation.
[90] Art. 29 ELTIF Regulation; Art. 21 AIFMD.
[91] Art. 22 AIFMD.
[92] Art. 23 para. 5 ELTIF Regulation.

authorised AIF.[93] The UK AIFMD rules on **depositaries** apply, as modified by COLL 15.[94]

The AIFM must, having regard to the investment objectives, policy and strategy of the LTAF, possess the relevant knowledge, skills and experience to understand the activities of the LTAF and, in particular, the risks involved in those activities and the assets which the LTAF holds.[95] The valuation of assets of the LTAF must be carried out by an external valuer. The AIFM may also carry out valuation of the assets of the LTAF, but only if they can demonstrate that they possess the necessary knowledge, skills and experience and the depositary has determined that the AIMF has sufficient resources and procedures for carrying out a valuation of those assets. [96]

The AIFM must publish a report in respect of each annual accounting period, half-yearly accounting period and quarterly reporting period.[97] The depositary must make an annual report to unitholders which must be included in the annual report of the LTAF.[98]

E. Marketing and investor protections

I. ELTIF

Both institutional and retail investors are eligible to invest in ELTIFs, **without a minimum investment amount** or a minimum threshold with respect to an investor's financial portfolio.

Since the ELTIF reform, **distribution** to retail investors is more closely aligned with the requirements of the **MiFID II Directive**.[99] While ELTIF managers are still obligated to conduct a **suitability assessment** of retail investors and take additional measures to meet the needs of retail investors,[100] the reform has reduced the burden on ELTIF managers wishing to expand into the retail market. For example, the amended ELTIF Regulation forgoes the former special suitability test for ELTIF investors and instead refers to the suitability test of the MiFID II Directive. There is also no longer an obligation to set up local facilities in each of the Member States where ELTIFs are to be marketed.[101] This is in line with the approach taken by the AIFMD to require only **one EU facility** for retail investors since its amendment by the Cross-Border Fund Distribution Directive.[102]

Moreover, ELTIF 2.0 removed the former asset test for retail investors with a portfolio value of less than EUR 500,000, who were not allowed to invest more than 10% of their financial instrument portfolio in ELTIFs and were subject to a minimum investment amount of EUR 10,000.[103] The internal assessment process for ELTIFs that can be marketed to retail investors is now based on the **product approval process** for manufacturers set out in the **MiFiD II Directive**.[104]

II. LTAF

LTAFs were previously categorised as a Non-Mass Market Investment, but the FCA's reforms in Policy Statement PS23/7, intended to broaden their retail distribution, recategorised LTAFs as a Restricted Mass Market Investment (**RMMI**), in line with the FCA's approach for high-risk investments. This means that distribution of LTAFs has been extended from institutional investors to include **mass market retail investors**, as well as **self-select DC pension schemes** and **SIPPs**.

As units in LTAFs are now categorised as RMMIs and may be marketed to retail investors, appropriate risk warnings and risk summaries[105] must be provided, an **appropriateness assessment** must be carried out for all retail investors,[106] and unadvised investors must **confirm** that they have **not invested more than 10%** of their **investable assets in RMMIs**.[107]

F. Investments by insurance companies and pension schemes

I. ELTIF

The European Union legislators are also aiming to facilitate investments in long-term equity investments, including ELTIFs, by insurance companies. On 14 December 2023, the European Parliament and the Council reached a provisional agreement on the directive that shall amend Solvency II[108] which would, among others, revise the conditions for preferential treatment of long-term investments in equity (***LTE***) for the solvency

[93] COLL 15.2.2R.
[94] See COLL 15.7.6R for the duties of the depositary of an LTAF.
[95] COLL 15.2.4R.
[96] COLL 15.2.6R.
[97] COLL 15.5.2R.
[98] COLL 15.5.7R.
[99] Directive (EU) 2014/65 on Markets in Financial Instruments. See reference to Art. 25 MiFID II Directive in Art. 30 ELTIF Regulation concerning the statement of suitability.
[100] E.g., Art. 30 para. 2 lit. a ELTIF Regulation, a duty to inform the retail investor when marketing an ELTIF with a term of more than 10 years.
[101] For more detail, see recital 38 of ELTIF 2.0.
[102] Directive (EU) 2019/1160 amending Directives 2009/65/EC and 2011/61/EU with regard to cross-border distribution of collective investment undertakings.
[103] Art. 30 ELTIF Regulation.
[104] Art. 27 ELTIF Regulation.
[105] See COBS 4.12A, COBS 4 Annex 1R, para 7.
[106] See COBS 10.2.9G, COBS 10 Annex 3.
[107] See COBS 4.12A.22R, COBS 4.12A.25G, COBS 4 Annex 5R.
[108] Directive (EC) 2009/138.

capital requirement (***SCR***).[109] As a consequence, it would be easier to **classify ELTIFs** and other low risk AIFs as **LTE**, benefitting from a **stress factor of 22%** and removing the requirement to **look-through** to the assets at portfolio level. The Parliament has adopted the text of the provisional agreement, which is now awaiting adoption by the Council.[110] The amending directive will apply in Member States two years after its publication in the Official Journal (**2026** at the earliest).[111]

II. LTAF

A similar case can be made for the use of LTAFs by institutional investors. In order to spur economic growth, the UK government has for years been seeking to encourage insurers and pension funds to invest in long-term, illiquid assets. This is as true of the new Labour government as it was of the previous Conservative one.

As noted above, the FCA's changes to its LTAF rules were intended to broaden the investor based not only to retail investors, but also to **DC pension schemes** and **SIPPs**. The FCA has accommodated the LTAF within the permitted links regime so that unit-linked policies can invest in LTAFs so long as certain conditions for investor protection are met.[112]

G. Conclusion

Overall, the regulatory requirements applicable to ELTIF and LTAF are comparable, despite several minor differences in the details. As a rule of thumb, the **LTAF** regime provides for slightly **more flexibility**, as it follows for certain restrictions a **principle-based approach** rather than setting forth **rigid thresholds**. The greatest obstacle to the parallel use of ELTIF and LTAF is, however, the **lack of mutual recognition** of **EU and UK manager regulation**.

The recent revision of both regimes made ELTIF and LTAF vehicles more attractive not only for **retail investors** but to a certain extent also for **professional investors**. Whether EU institutional investors will prefer ELTIF over other professional AIF is yet to be seen, however the recent changes to the LTAF regime have already and are likely to spark more interest of **UK pension schemes**.

[109] The current conditions for preferential treat requirement for long-term equity investments are set out in Art. 171a Delegated Regulation (EU) 2019/981.

[110] https://www.europarl.europa.eu/doceo/document/TA-9-2024-0295_EN.pdf.

[111] See Article 4 of the Amendment Directive.

[112] COBS 21.3.

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