15 March 2021

France Invest's position paper on the review of the ELTIF Regulation

Executive summary

At the time, France Invest supported the creation of ELTIF, as our members saw it as an opportunity to encourage investors to commit their capital for the long term. Indeed, private equity is a long-term investment: the average length of an investment into companies (the "holding period") is around 6 years. However, we believe that ELTIF has not fulfilled its ambitions and therefore welcome the Commission's proposal for a Regulation amending Regulation (EU) 2015/760 of the European Parliament and of the Council of 29 April 2015 on European long-term investment funds.

France Invest strongly supports the general objective to foster investments in companies and long-term investment projects. We agree that effective tools are needed to channel savings towards long term investments and are convinced that the enhancement of the ELTIF vehicle will contribute to smart, sustainable and inclusive growth.

We call for limitations on the supply side to be removed and, more specifically, to make their structuration more flexible, for instance by including "financial undertakings" in the assets eligible to ELTIF, by allowing them to invest into funds other than ELTIFs, EuVECAs and EuSEFs and by being diversified into funds of funds. We also suggest easing the operating conditions of ELTIFs, in particular removing the ban on co-investment and easing requirements for ELTIFs exclusively marketed to professional investors. In addition, we are of the opinion that a smoother and more harmonised implementation of the Regulation by Member States would contribute to the development of ELTIFs in the EU.

France Invest urges to reduce the demand side barriers to investment in ELTIF impacting institutional and retail investors. More specifically, we suggest enlarging the category of professional investors as per the EuVECA Regulation, in order to include high net worth and/or sophisticated individuals and family office. Regarding retail participation, we are not against lowering of the minimum entry ticket for retail investors, provided this does not imply overly burdensome obligations.

Finally, we call for enhancing the general attractiveness of the ELTIF framework for investors, by making the prudential requirements applicable to institutional investors (e.g. pension funds and insurance companies) more appropriate to ELTIFs' long-term equity investment horizon and introducing an attractive tax regime and enhancing retail investor education with regards long term investments.

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1. France Invest believes that the development of ELTIFs should be promoted.

France Invest supports the EU's objective of ensuring sustainable and adequate long-term financing in Europe. More specifically, we believe that the European Long Term Investment Fund (ELTIF) regime can contribute to the Capital Markets Union (CMU)'s goal to foster investments in companies and long-term investment projects and to take part to smart, sustainable and inclusive growth. In particular in a (post) health crisis period, we are of the opinion that investments by ELTIFs in innovative technologies, green, sustainable and/or climate related projects, post-COVID 19 recovery related projects, financial assets with long term maturities, digital assets and infrastructure and energy should be encouraged.

In our view, the ELTIF framework can contribute to the channelling of investments towards long term projects, and ELTIFs are an opportunity to encourage investors to commit their capital for the long term. In other words, the development of ELTIFs as an attractive investment vehicle can both help underpin the economic recovery in Europe and allow a wider investor base to participate in the upsides of that economic growth.

The venture capital and private equity industry is a substantial long-term investor in Europe's real economy - the average length of an investment into companies (the "holding period") is around 6 years. Against this background, France Invest strongly supports the objective to build a world-leading label for long-term investment, offer investors more investment opportunities in critical real economy areas and improve the access to funding for SMEs.

In our members' view, the main benefit of ELTIFs is to reach sophisticated investors: any direct retail access appears to be on the lower end of the agenda from a pure venture capital and private equity perspective. In any case, it should be noted that ELTIFs are distributed to retail investors mostly through intermediaries.

However, as for now, we can only deplore that the ELTIF regime has been very slow to develop and has not fulfilled its ambitions to raise and channel capital towards European long-term investments in the real economy. Indeed, only 28 ELTIFs have been set up in the EU, with France recording the highest number (11) followed by Luxembourg (10). Only 8 French managers show on ESMA's register.

Therefore, we would like to propose some improvements to the ELTIF regime: we believe that limitations on the supply side should be removed and also propose to reduce the demand side barriers to investment in ELTIF impacting retail and institutional investors.

2. France Invest calls for making the structuration of ELTIFs' portfolios more flexible.

Alleviating the burden on ELTIF managers and allowing more flexibility with respect to portfolio composition and diversification, in particular in respect of non-listed assets, would allow them to offer a wider range of products to investors.

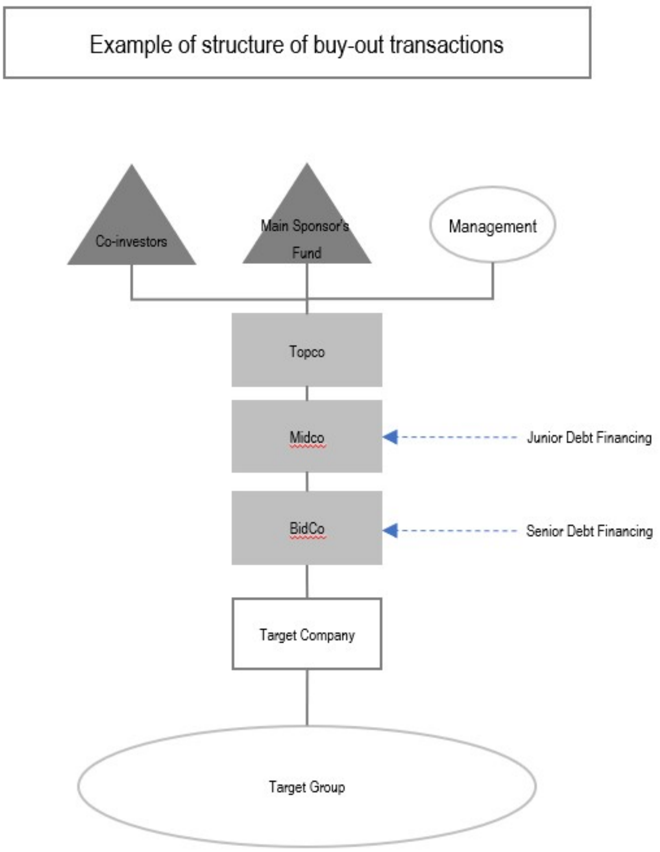
a) ELTIFs should be allowed to invest in financial undertakings.

In our opinion, the slow uptake of ELTIFs in the venture capital and private equity sector is mainly due to the scope of eligible investments, which does not include financial undertakings other than "financial undertakings that exclusively finances qualifying portfolio undertakings referred to in paragraph 1 of this Article or real assets referred to in point (e) of Article 10".

Indeed, very often, long term assets need to be acquired, and their subsequent holding structured, using holding companies, as several different layers/groups of investors/shareholders with differing rights could be invested in the underlying asset alongside an ELTIF. Intermediate financial undertakings are thus put in place to manage different guarantees, corresponding to different risk levels, with a view to meet institutional investors' constraints in terms of risk management.

Moreover, such financial undertakings also allow access to assets while isolating financial risk for investors. For example, ELTIF managers are keen to provide finance to large infrastructure projects without the danger of putting the entire ELTIF at wider risk of incurring liabilities, should that project perform unfavourably. This ensures additional investor protection and potentially higher returns.

Please see below an example of a structure of a buy-out transaction:



The fund undertakes the buyout of a target company through three levels of companies as follows: (a) a top company which receives funding in the form of equity subscription from the fund and from any co-investors invited to invest in the company (Topco); (b) a company which receives debt funding from one or more different sources (Midco); and (c) a company which purchases the target (Bidco).

Ultimately, the choice of the corporate structure used when undertaking a buyout is driven by multiple factors, including: (a) the tax requirements of the funds and the managers; (b) the size of the deal (for instance, on smaller deals a simple buyout structure is often used with only one company); (c) the requirements of the banks (on deals with multiple layers of debt, banks may require that the senior debt is lent to Bidco so that the junior debt is structurally subordinated to the senior debt).

While not every ELTIF will engage in this route, we believe that it is a highly valuable tool to have in the investment kit of the ELTIF manager and should not be prohibited, especially post health crisis, as it can be expected that investors will have to gather in order to finance vast projects. In other words, the derogation set out in article 11 paragraph 2 should be enlarged so that ELTIFs may invest in financial undertakings other than "financial undertakings that exclusively finances qualifying portfolio undertakings referred to in paragraph 1 of this Article or real assets referred to in point (e) of Article 10"; this would indeed lift a significant hindrance to the creation of ELTIFs by our members.

b) ELTIFs should be allowed to invest into funds other than ELTIFs, EuVECAs and EuSEFs.

We believe that ELTIFs should be allowed to invest into funds other than ELTIFs, EuVECAs and EuSEFs, with a view to allow investors to benefit from more diversified investments, including infrastructure, non-listed companies and other long-term assets. Indeed, funds are often set up based on the specific expertise of the teams which manage them. ELTIFs are likely to be focused in their investment behaviour on specific assets/geographical regions and hence, diversification into other assets/areas helps to reduce risk. This is especially important for retail investors.

c) ELTIFs should have the option to be diversified into funds of funds.

In our opinion, it should be allowed to use ELTIFs as funds of funds products. In other words, the limit on investing in other ELTIFs, EuVECAs and EuSEFs should be increased to 100%. This would make ELTIFs more marketable, especially to retail investors, as it would allow a better spreading of risks thanks to greater cross-asset class exposure. Funds of funds also typically have lower volatility than direct investing funds.

It would also result in more opportunities to provide returns to investors during the life of the fund as ELTIFs would be invested in more diversified and numerous underlying assets. Indeed, funds of funds managers are experienced in selecting and monitoring the appropriate underlying funds while this type of investment also offer an additional layer of screening (as managers of underlying funds already conduct research on initial investments).

The implied layering of fees may curb performance but are justified by the value-added service provided by fund of fund managers. In any case, fees should be disclosed to investors with the appropriate level of transparency.

Last, particularly in the context of fully paid-in capital structures, granting accessibility to fund-of-fund strategies (at least during the portfolio ramp-up period) would mean that asset managers could invest on a broader basis in other funds, allowing for faster deployment of capital.

d) The limitation to invest 10% maximum of the ELTIF's capital in a same company should be relaxed.

The obligation to invest 10% maximum of an ELTIF's capital in a same company, real asset or fund should be relaxed. Indeed, this does not make sense for venture capital and private equity. Also, it is particularly difficult to comply with this limitation throughout the life of the ELTIF, as its investments are progressive at the beginning and, in the case of closed ended funds, at the end of its life.

e) Key definitions should be clarified.

- "Real asset"

This would allow to make it explicit that investments in small and medium-sized enterprises (SMEs) are eligible and refer to the European definition of SMEs.

- "Benefitting the European economy"

Our members would welcome additional guidance in respect of the provisions related to investments in third countries. In particular, we call for clarification of the notion of "benefitting the European economy". It would also be useful to harmonise what minimum portion has to be invested in the EU to avoid different interpretations by national competent authorities.

In any case, we would warn against setting up a framework which prevents ELTIF to invest in third countries, as the latter may also ultimately benefit the European economy and investors.

- "Sustainable"

The definition of "sustainable" should be consistent with the concept of "just transition", in order not to take only into account environmental factors. In other words, all 3 factors - E, S and G - should be taken into consideration.

f) The investment restrictions on size of listed company (EUR 500m) should apply only at the time of investment.

We believe that there should be no requirement to exit a successful investment when it reaches a particular size. In particular, this would help promoting investment strategies that focus on young innovative companies.

g) Rules on portfolio composition and diversification should not apply at the beginning of the life of an ELTIF nor towards the end of its life.

3. France Invest recommends easing the operating conditions of ELTIFs.

It should be recalled that managers, including "sub-threshold" managers, have to comply with the AIFMD to be in a position to use the ELTIF passport. On the other hand, the EuvECA passport does not require full AIFMD compliance and allows for marketing to sophisticated investors under defined conditions; this vehicle therefore appears the most appropriate vehicle for venture capital and growth managers which fall under the threshold.

a) The ban on co-investment should be removed.

It should be noted that ELTIFs are managed by AIFMs which are subject to the AIFMD rules on conflicts of interests, as well as to extensive soft law requirements.

We believe that an ELTIF manager should be allowed to manage two different funds which are invested in a same asset, either through equity or debt (so that the interests of investors in the two funds are aligned). For example, it should be allowed for an ELTIF to invest in the same company as an AIF which is set up by the AIFM in order to fulfil the specific needs of an investor.

Furthermore, it should be clarified that a manager may invest some seed money or initial capital into an ELTIF, alongside other investors. Investment by managers in the funds they manage delivers an alignment of interest and is regarded by professional investors as one of the strongest protections.

Last, co-investment will probably prove useful in a post crisis context whereby vast projects will have to be financed and will allow to dilute risks.

b) The ELTIF regime should not restrict the use of borrowed funds for the purposes of managing liquidity, subscriptions and the financing of assets in the investment portfolio.

We would like to highlight that venture capital and private equity funds are closed-ended funds, which are often structured as limited partnerships. Institutional and sophisticated investors make a contractual, binding commitment to the fund, which is drawn down when needed, to be invested in businesses. As such, they are not typically leveraged and do not use leverage as that term is normally used at the level of the fund. Besides, ELTIF managers are AIFMs, subject to the AIFMD, which includes provisions on leverage.

In this context, the ELTIF regime should not restrict the use of borrowed funds for the purposes of managing liquidity, subscriptions and the financing of assets in the investment portfolio. It should be clarified that borrowing facilities (or capital call facilities) that are fully backed by undrawn commitments of investors should not considered to be leverage or borrowing of cash within the scope of Article 16 of the ELTIF Regulation. Indeed, we believe that ELTIF should be allowed to use a borrowing facility to manage cash flows from investors in the funds. In fact, such borrowing does not increase investors' exposure by allowing the fund to invest more than its committed capital - i.e. it is not leverage - because the amount of borrowing is covered by commitments from investors that have not yet been called. In other words, the use of such borrowing facility should be seen as a tool of treasury management, not a source of additional risk.

c) Requirements for ELTIFs marketed to sophisticated investors only should be eased.

We agree that transparency requirements allow investors to make informed investment decisions. However, these requirements should be adapted to the different types of investors, retail or institutional. In other words, if additional safeguards to marketing to retail investors may be appropriate, transparency requirements in relation to professional investors are not adequate and should be alleviated. Against this background, we believe that disclosure requirements attached to ELTIFs marketed sophisticated investors only should be eased, as they imply an additional burden for manager but not much added value to these investors.

- The requirement for ELTIF managers to advise sophisticated investors that only a small proportion of their overall investment portfolio should be invested in an ELTIF should be removed. Such advisory requirements for professional investors are unnecessary and unwarranted as these investors possess the relevant expertise and experience in order to enable them to choose investment products suitable to their needs. These provisions require more disclosure to professional investors and increase the costs of the ELTIF and should therefore be removed.

- Cost disclosures should be adapted to sophisticated investors. In our opinion, cost disclosure is ill-suited to professional investors in stipulating the need to inform investors of the precise costs of an ELTIF. Moreover, it is difficult to determine an overall ratio of the costs to the capital of an ELTIF at the outset of its life, as these costs can change during its life. A more feasible and appropriate disclosure requirement for professional investors would see costs stated as a maximum amount.

- In addition, such ELTIFs should be exempted from the provisions on limits in qualifying portfolio undertakings, limits on diversification and derivatives.

4. France Invest calls for a more harmonised implementation of the Regulation by Member States.

a) The effectiveness of the ELTIF framework should not be impaired by national legislation.

A reason explaining the slow uptake of ELTIFs may be related to the layering of obligations (AIFMD, ELTIF Regulation and national requirements applicable to the fund, in particular in France). Indeed, this implies a layering of costs, which are in turn borne by investors.

Despite the ELTIF Regulation having direct effect in each Member State, a number of national competent authorities have in practice imposed additional local requirements for distribution to retail investors. Satisfying multiple cross-jurisdictional marketing registration and notification procedures substantially increases time to market, costs for investors and burden on fund sponsor. We recommend disallowing the imposition of additional local rules. Compliance with the ELTIF Regulation should be deemed sufficient to begin distributing the product in each jurisdiction.

The passport attached to ELTIFs aims at tapping the potential benefits of the EU single market and raise money from investors across Member States. However, to fulfil this objective, such passporting regime should be applied consistently throughout the EU, which is not the case currently. Despite the ELTIF Regulation having direct effect in each Member State, a number of national competent authorities have in practice imposed additional local requirements for distribution to retail investors. Satisfying multiple cross-jurisdictional marketing registration and notification procedures substantially increases time to market, costs for investors and burden on fund sponsor. We recommend disallowing the imposition of additional local rules. Compliance with the ELTIF Regulation should be deemed sufficient to begin distributing the product in each jurisdiction.

b) The requirement to have "facilities" in each Member State for making subscriptions, making payments to unit-holders or shareholders, repurchasing or redeeming units/shares and making information available should be removed.

We regard it as being sufficient to have such a facility only in the relevant ELTIF's home Member State (and consistent with the cross-border provision of financial services in an internal market). Removing the local facilities requirement from the ELTIF Regulation would be consistent with broader policy towards the distribution of retail funds across Europe.

5. France Invest supports widening investor access to ELTIFs.

In our opinion, the restrictive definition of "professional investors" and the availability to retail investors have hampered the development of ELTIFs.

a) The category of "professional investors" should be extended.

Venture capital and private equity funds admit as investors a number of high net worth and/or sophisticated individuals who have extensive experience that provides them with a sophisticated understanding of the specificities of investing into ELTIFs. These investors are however treated as retail investors as per MiFID2. In addition, members of the management team should be eligible to professional status.

Therefore, we propose extending the category of "professional clients" and allow high net worth and/or sophisticated individuals and family offices who have extensive experience and sophisticated understanding of the specificities of investing into AIFs to choose to be treated as professional clients. More precisely, we propose to replicate the categorisation set out in article 6 of the EuVECA Regulation and include other investors that commit to investing a minimum of EUR 100 000.

b) It could be considered to lower the minimum entry ticket, provided this does not imply overly burdensome obligations.

The aim of making ELTIFs available to retail investors to channel their savings towards long term savings is laudable, and we agree that an appropriate level of protection of retail investors should be ensured. However, in the end, the too burdensome and costly constraints weighing on ELTIFs (at EU level and at national level) result in an eviction of retail investors. It should be highlighted here that ELTIFs are distributed to retail investors mostly through intermediaries, which adds a layer of costs. Moreover, it seems that ELTIFs are not well understood by retail investors and that their education on long term investment should be enhanced.

In this context, we are not against lowering of the minimum entry ticket for retail investors to allow the participation from a wider range of investors, provided this does not imply overly burdensome obligations. It should also be noted here that ELTIFs are distributed to retail investors through intermediaries.

6. France Invest suggests enhancing the general attractiveness of the ELTIF framework for investors.

a) The prudential requirements applicable to institutional investors should be made appropriate to ELTIF's long-term equity investment horizon.

In our view, one of the main reasons explaining the slow development of ELTIFs is that investment into ELTIFs by institutional investors is constrained. We believe that one of the main improvements required to make ELTIFs a success is to make the prudential requirements applicable to institutional investors (e.g. pension funds and insurance companies) appropriate to the long-term equity investment horizon of ELTIFs. For instance, the explicit recognition of ELTIFs in Solvency 2 should encourage insurers' uptake in ELTIFs. Encouraging the use of ELTIFs in unit-linked insurance products would thus be a way to widen the retail investor base further.

For example, the method of calculation of the solvency capital requirements of insurance and reinsurance undertakings, as set out in Delegated Regulation (EU) n° 2017/1542 of 8 June 2017, is based on an aggregation of all of the individual assets they hold. This method does not seem appropriate as, in practice, management companies do not know the complete breakdown of assets in the portfolios of these insurance or reinsurance undertakings.

In other words, we believe that the explicit recognition of ELTIFs in the Solvency 2 framework should encourage insurers' uptake in ELTIFs. Fostering the use of the ELTIFs in unit-linked insurance products would be a way to widen the retail investor base further, as in most cases the distribution of ELTIFs to retail investors is intermediated.

b) An attractive tax regime for ELTIFs should be introduced.

The absence of an appropriate tax regime to compensate for the long term and illiquid nature of the investments of ELTIFs is a significant hindrance to their development. We believe that Member States should introduce tax incentives to encourage investors to commit their savings into ELTIFs.

c) Education of retail investors on long term investments should be enhanced.

Venture capital and private equity funds are closed ended funds which have a life cycle limited in time, between 10 to 15 years. In general, they invest in illiquid assets. It is extremely difficult to allow for any form of redemption at the election of investors within a closed ended vehicle targeting illiquid investments. The vehicle would need to carry significant balances of liquid assets in order to manage the liquidity. This would in and of itself drag performance of the ELTIF and defeat the purpose of encouraging investment in illiquid asset classes.

Investors are well aware that their investments are locked over this period, even though French retail venture capital and private equity funds can provide redemption rights in specific cases of misfortune (death, unemployment, illness…).

In this context, it might be helpful to better educate investors about the inherently illiquid nature of ELTIFs and explain that investing in such funds implies patience.

About France Invest

Established nearly 40 years ago, France Invest brings together venture capital, private equity, infrastructure and private debt teams based in France, as well as the associated professions which support them. Its membership currently counts 340 management firms and 170 associate members.

Venture capital and private equity support unlisted companies for a fixed period of time and provides them with the equity capital, through the acquisition of minority or majority stakes in their capital, needed to finance growth and transformation projects. It supports the creation of start-ups (venture capital), participates in the growth and transformation of many regional SMEs and mid-caps (growth capital) and contributes to the transfer of companies (replacement capital).

France Invest's members represent one of the main growth drivers for the French and European economy and support a significant portion of employment in France and Europe. In 2019, its members raised 41 bn EUR to finance companies, both through equity and debt, and infrastructure projects, over the coming 5 years. French venture capital and private equity is no1 in the EU27 in terms of funds raised, capital invested, and number of companies funded. About half of the funds raised by French venture capital and private equity players come from abroad, and European companies, in particular start-ups and SMEs, are the main recipients of their investments. In 2018, companies backed by French venture capital and private equity created 75,000 jobs.