FeBAF General Comments to the Proposal of REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL on European Long-term Investment Funds

FeBAF shares the Commission's goal of ensuring sustainable and adequate long-term financing of undertakings (companies and projects) in the European Union, as we indicated in our response to the Commission's Green Paper on Long-term Financing of the European Economy[1]. Since the onset of the economic crisis, intermediaries' long-term financial support to European companies has inevitably suffered from the increasing regulatory and capital burdens (Basel standards and Solvency). The proposed ELTIF has the potential to facilitate to finance long-term accumulation, to satisfy the needs of ultimate recipients, notably SMEs and infrastructure projects.

Providing effective and efficient intermediation channels for long-term financing is a complex and multi-dimensional task and we commend the Commission's efforts to create a new product and brand to encourage investors to commit their capital for the long term.

We believe, however, that the Proposal should be improved in a number of respects in order to create an attractive investment vehicle. In general, we would make one main point.

The Proposal suffers from a lack of flexibility, a key component in all investment activity, as some provisions regarding the structure of the proposed ELTIFs are unduly restrictive.

In attempting to attract both retail and professional investors into the same ELTIF, there is a risk of unwittingly discouraging the latter from investing in the proposed funds. If all of the requirements which are necessary for the protection of retail investors are also applied to professional investors, then the ELTIF may look less attractive. Similarly, we recognize the inherent difficulty in attempting to provide for the liquidity needs of retail investors in a long-term investment vehicle.

We believe that the provisions of Chapter IV, in particular, should provide a **differentiated regime for retail and professional investors**. Institutional and retail investors exhibit different investment behaviours. While long-term institutional investors have the expertise, the willingness and the ability to invest in assets with a long-term perspective, this is often not the case for retail investors. Given the existence of a secondary market for trading ELTIFs, the investment behaviour of retail investors has the potential to generate volatility in the market value of the funds, which would ultimately translate into excessive volatility in intermediaries' balance sheets.

<u>We propose to have two separate types of ELTIFs, one for professional investors and one for retail investors, both of which would bear the ELTIF brand</u>. The "Retail ELTIF" (or ELTIF–R) would be

[1] FeBAF Response to the European Commission Green Paper on Long Term Financing, June 2013,

subject to higher transparency and information requirements than the "Professional ELTIF" (or ELTIF-P). Professional investors would not be prevented from investing in a Retail ELTIF, but they would then be treated as de facto retail investors in terms of requirements and obligations. If this proposal is accepted, it would be necessary to define whether an ELTIF-P can be regarded as an UCIT.

A delicate related issue is whether an ELTIF should be able to offer **redemption rights to investors**. This would typically apply to open-ended vehicles for retail investors. More generally, many FeBAF associates believe that the ELTIFs manager should be given the discretion to decide whether to establish ELTIFs with or without redemption rights according to the underlying investor base and the ELTIF's investment strategy. ELTIFs should, consequently, be structured so as to offer, where applicable under the redemption policy regime, regular redemptions before the end of life of the ELTIF. The rules or instruments of incorporation of ELTIF would disclose the redemption rights policy and its main features.

Requiring all ELTIFs to have a predetermined lifetime will create unnecessary impediments to the success of ELTIFs. Many FeBAF associates supports a more **flexible regime allowing for a lifetime** fully in line with the investment strategy of the fund, which could require either a definite or a non-definite lifetime. Special conditions for extensions or early interventions in the case of a definite lifetime are welcome.

Key specific points

- With reference to the lack of flexibility in the Proposal, a specific point refers to the ban for an ELTIF to invest in an eligible investment asset in which the manager has or takes a direct or indirect interest, other than by holding units or shares of the ELTIF it manages. While we recognise the risks related with conflicts of interest, we believe that appropriate regulation and supervision can define rules of the game which would enable sufficient operational flexibility. Directive 2011/61/EU already provides for rules on conflict of interests. The conflict of interests' regime is essentially based on the management of the conflict itself. Preventing managers from investing in assets related to the manager could result in an excessive limitation to the activity of the ELTIF.The ELTIF proposal envisages a multiple authorisation regime for ELTIFs: the authorisation to be accorded to the fund intending to be marketed as an ELTIF by its national competent authority; the approval to be accorded to a EU AIFM intending to manage the ELTIF by the national competent authority of the ELTIF. Such multiple registrations would be redundant and therefore inappropriate if we consider the case of an already authorised and registered AIFM. We believes that the authorization regime for ELTIF should be simplified.

- The current regulatory framework is not adequate for attracting investment from insurance companies which are a primary potential target of the new type of fund.

  A range of national regulations (via Solvency I) impose restrictions regarding investments in funds other than UCITS. Such restrictions should be eliminated to allow investments from insurers. In addition, Solvency I rules in a range of jurisdictions are currently designed to prevent insurers from investing in non-redeemable structures. Only the elimination of such limitations would allow insurers to invest in non-redeemable ELTIF structures prior to Solvency II coming into effect.

  Moreover, insurers have significant concerns regarding the currently foreseen treatment under Solvency II. The ELTIF proposal, as currently envisaged, would create capital disincentives with respect both to available capital (the price volatility generated by the secondary market trading would generate volatility in insurers' own funds and solvency positions, despite the fact that insurers would use these assets to match long-term and illiquid liabilities) and to required capital (reflected in the solvency capital requirement). Currently envisaged charges are similar to those applied to the most risky equities: this is not reflective of the long-term risks actually faced by an insurance company investing in ELTIFs and, in any event, represents a clear disincentive.

  In order to make ELTIFs a feasible choice both for occupational retirement provision institutions and for insurance companies, it is important that necessary adjustments are made to their regulatory capital requirements so that the high capital requirements foreseen when investing in illiquid assets will not apply in the case of ELTIFs. Moreover, any additional national regulatory restrictions should be assessed and amended as necessary.

- The ELTIF proposal defines very rigid diversification limits. Given the illiquid nature of underlying assets, portfolio rebalancing in the case where a limit would be surpassed (due to valuation changes) is not as straightforward as for liquid securities. We believe that diversification limits should be able to also reflect the illiquid nature of underlying investments and to provide more flexibility in order to minimise costs potentially caused by forced sales of illiquid assets.

- It is often the case that investments in assets such as infrastructure projects require intermediate holding entities able to, for example, facilitate co-investment in a very large size project. The current proposal does not fully cope with this requirement. According to the proposal an ELTIF cannot invest in eg a qualifying portfolio undertaking through private equity funds, other AIFs or SPVs. We advocate for the extension of the scope of eligible assets, in order to allow for both direct and indirect exposures in illiquid assets. Such an extension of the scope should in any case not endanger the transparency of the fund: transparency regarding underlying assets and exposures has to be appropriately addressed and ensured by the fund managers.

- Nothing should prevent an ELTIF from seeking admission of these shares or units to a regulated market as defined in Article 4(14) of Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments, to a multilateral trading facility as defined in Article 4(15) of Directive 2004/39/EC, or to an organised trading facility, thus providing investors with an opportunity to sell their units or shares before the end of life of the ELTIF. The rules or instruments of incorporation of an ELTIF should therefore not prevent units or shares from being admitted to or from being dealt in regulated markets, nor should they prevent investors from freely transferring their shares or units to third parties who wish to purchase those shares or units. However it should be noted that, according to experiences in national markets to date, trading in secondary markets may work in some markets, but in others this option may entail high premiums or important discounts on the units or shares of ELTIFs that are admitted to or dealt on regulated markets, which would prevent, in practice, investors from using this alternative. Therefore, this option is not sufficient to substitute for the suggested redemption facilities.

The points made here represent a common reference framework of FeBAF associates' positions and therefore reflect shared views. More specific, and directly operational, comments may be drawn from FeBAF associates' submissions, which may also present detailed drafting suggestions, with a view to improving the Proposal.

We refer in particular to the comments provided, and submitted, by Assogestioni (attached). We also find relevant comments in the position paper by the European Private Equity and Venture Capital Association – EVCA (attached).