What do the Proposed ELTIF 2.0 RTS mean for (open-ended) ELTIFs?

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A major update to the EU's Regulation 2015/760 for long-term investment funds ("ELTIF 2.0") applies as from 10 January 2024. It is henceforth worthwhile analyzing the Final Report on the Draft regulatory technical standards published by the European Securities and Markets Authority ("ESMA") on 19 December 2023 ("ELTIF 2.0 RTS"). Since ESMA published its Consultation Paper in May 2023, in particular, the redemption policy, minimum holding period and mandatory liquidity management tools ("LMTs") of European long-term investment funds ("ELTIFs") have been points of discussion. This contribution sheds some light on the proposed LMTs in the context of AIFMD 2 that may still be reconsidered by the European Commission and offers some insights as to its impact on (open-ended) ELTIFs, if adopted in current form.

LMTs, AIFMD 2 & ELTIFs

ELTIFs, by default, are required to be managed by authorized alternative investment fund managers ("**AIFMs**"). ELTIFs are subject to the generic AIFMD (2.0) requirements and the specific ELTIF 2.0 (RTS) rules apply on top of those.

Currently, LMTs are not harmonized throughout Member States. In order to ensure consistent harmonisation in the area of liquidity risk management by AIFMs of open-ended alternative investment funds ("**AIFs**"), AIFMD 2 harmonizes the types of LMTs (set out in Annex V AIFMD 2) which may selected by AIFMs. These include redemption gates, notice periods, liquidity fees on redemption, swing/dual pricing, anti-dilution levy and redemptions in kind. An AIFM that manages an open-ended AIF shall select, at least, two appropriate LMTs for possible use in the interest of the AIF's investors, with the exception of money market funds. AIFMs shall also implement detailed policies and procedures for the activation and deactivation of any selected LMTs. When activating/deactivating NAV suspensions or side pockets AIFMs are required, without delay, to notify the national competent authority of their home Member State.

The same holds true for other LMTs, if these are not foreseen in the fund documentation. In this respect, ESMA is required to develop regulatory technical standards ("**RTS**") to develop the characteristics of the LMTs, as set out in Annex V AIFMD 2. Furthermore, ESMA is required to develop guidelines on the selection and calibration of LMTs by AIFMs for liquidity risk management and for mitigating financial stability risks that should also include indications on the circumstances in which side pockets can be activated.

A "lex specialis" regime is under AIFMD 2 in place for "loan-originating AIFs" for which ESMA is also requested to develop RTS to determine the requirements with which a loan-originating AIF must comply in order to maintain an open-ended structure.

After AIFMD 2 will be applicable, the ELTIF 2.0 LMT regime will apply on top of the AIFMD 2 requirements. The "lex specialis" regime under AIFMD 2 in place for "loan-originating AIFs" shall, however, apply without prejudice to ELTIF 2.0.

ELTIF 2.0 – A "Lex Specialis LMT Regime"

ELTIF 2.0 and (semi-)open-ended AIFs

While ELTIFs can only be structured as limited-duration funds and, therefore, cannot be considered as "true" evergreen funds, under ELTIF 2.0, ELTIFs could nevertheless be structured as "de facto" open-ended funds with a long fixed duration (e.g. 99 years).

In addition, ELTIF 2.0 has eased the "redemption regime" for ELTIFs. ELTIF managers must, however, fulfil a list of exhaustive criteria when managing open-ended ELTIFs in relation to, amongst others, redemption policies of ELTIFs that clearly set out the procedures and conditions for redemptions, the authorization of this policy and the liquidity management tools to be employed by the local competent authority, the fair treatment of investors, a "liquidity pocket" and the application of the "pro rata principle" for redemption exceeding the "liquidity pocket".

In this respect, it is to be noted that under the ELTIF 1.0 regime, investors were mandatorily locked-up until the end of the ELTIF ramp-up period. Under ELTIF 2.0, the lock-up may be decoupled from the ramp-up period. Redemptions may, however, not be granted before the end of a minimum holding period (which does not apply to feeder ELTIFs) or before the lock-up period. Contrary to ELTIF 1.0, investors may under ELTIF 2.0 not request the winding down of an ELTIF anymore if their redemption requests have not been satisfied within one year.

ELTIF 2.0 RTS – LMTs

ELTIF 2.0 contains a provision in which ESMA was requested to develop RTS that specify certain elements of the ELTIF redemption regime in more detail, such as the minimum holding period, the minimum information to be provided to the competent authority of the ELTIF the requirements to be fulfilled by the ELTIF in relation to its redemption policy and LMTs and criteria to assess the percentage of the "liquidity pocket".

In this respect, ESMA published its final report on 19 December 2023 that has been submitted to the European Commission for endorsement and final approval. In general, the ELTIF 2.0 RTS are well-received, as they are principle-based and allow both fund managers and competent authorities for a sufficient degree of flexibility. Most concerns raised, such as the "comply-or-explain" minimum holding period of three years, during the consultation period have been addressed by ESMA in its final report. However, there is one item which makes it difficult to operate open-ended ELTIFs, namely the mandatory LMTs to be employed for ELTIFs. Although the AIFMD and also the agreed text of AIFMD 2.0 leave fund managers a certain degree of discretion in picking a set of LMTs that fit the specific fund in question, ELTIF 2.0 strictly regulates a minimum set of LMTs to be employed. In addition to NAV suspensions, these should include a mandatory notice period that is, by default 12 months, one anti-dilution liquidity management tool, which could be anti-dilution levies, swing pricing or redemption fees and redemption gates.

From Recital 6 ELTIF 2.0 RTS, it is clear that such notice period has been chosen to allow for a reliable, sound and updated valuation of assets of the ELTIFs, as well as to ensure an appropriate level of liquidity of the ELTIF's underlying assets that is appropriate to avoid liquidity mismatches.

To avoid dilution of investors, risks in relation to financial stability and first mover advantage related issues, ELTIF managers are required to implement, at least, one of the mentioned anti-dilution LMTs. If any of the anti-dilution LMTs is considered not to be adequate for a specific ELTIF, ELTIF managers may also select and implement other LMTs. For retail ELTIFs, managers would need to provide a justification to the competent authority why other LMTs are more appropriate and in the interest of investors.

To reduce the probability of a NAV suspension of an ELTIF, ELTIF managers are required to implement redemption gates to mitigate the risks related to financial stability and stressed market conditions, where numerous or voluminous redemption requests may not be able to be processed by the ELTIF manager or the fund administrator; and where the sale of assets to meet those requests is either impossible or implies a sale at a highly discounted price.

LMTs under the ELTIF 2.0 RTS – An Impracticable Mandatory Cocktail?

The ELTIF 2.0 RTS require a minimum notice period of 12 months for investors. Those open-ended ELTIFs that wish to implement a shorter notice period are required to comply with rigid standards in terms of both liquidity pockets and redemption gates.

If redemption notices are less than 12 months, the proposed maximum redemption gates are generally considered to be high enough to meet market standards, in particular, as they are "ceilings", which are fairly high. However, the minimum liquidity pockets required for ELTIFs with a notice period of less than 6 months are 40% as a minimum, which is more than double than the current Luxembourg market and regulatory practice for products with either monthly or quarterly redemption windows. In order to approach such standards, managers would need to impose a minimum notice period of, at least, 9 months to a year. These high liquidity pockets where 40% of the assets would be held in UCITS eligible assets will negatively impact the return profile of (semi-)open-ended ELTIFs and make them unattractive. This would be a pity for an initiative in which all involved parties have heavily invested to allow for a market-friendly reform that would be operable.

Outlook: LMTs & Open-ended ELTIFs – Quo Vadis?

From the above, it is clear that the minimum liquidity pockets required under the ELTIF 2.0 RTS for ELTIFs having notice periods with less than 9 months are too restrictive and not in line with the current market and regulatory practice for (semi-)open-ended funds. Although the mentioned restrictions cause uncertainty in relation to the viability of open-ended ELTIFs in the market, it remains to be seen whether the European Commission will pick up the concerns from market players and adopt the final ELTIF 2.0 RTS by means of a Commission Delegated Regulation in a fashion that takes into account current concerns and answers these in a pragmatic manner.

Going forward, we hope that the European Commission will choose to remove the unpragmatic ties between redemption notice periods and liquidity pockets in its entirety. In our view, the suitability test, as well as the product governance framework would already provide sufficient protection for retail investors such that they would not disproportionally allocate their investments in such products. Hence, the ELTIF 2.0 framework should not necessarily assume, in terms of investor protection, that the product in itself should offer liquidity based upon the assumption that retail investors would fully or almost fully invest their funds in a single ELTIF. Instead, the basic presumption should be that the ELTIF would be part of a sufficiently diversified investment portfolio, which new initiatives, such as the pending Retail Investment Strategy proposal, even seek to reinforce.

Furthermore, the current draft of the ELTIF 2.0 RTS seems to overlook that ELTIFs may invest in a large spectrum of asset classes and, in our view, it is inappropriate to allow for proportionality, in terms of redemption frequency and minimum holding periods, for various types of ELTIFs, but to push for a "one-size fits all" solution for ELTIFs with respect to LMTs, such as notice periods, redemption gates, as well as liquidity pockets. This mechanism is, thus, not aligned with AIFMD 2.0 and with the broad spectrum of asset classes with different characteristics and liquidity profiles in which ELTIFs may invest in.

In addition, the rigid liquidity pocket standards that are based upon the length of the notice period seem to heavily intervene into the types of LMTs that are allowed to be employed by AIFMs for ELTIFs under AIFMD 2. The ELTIF 2.0 RTS already require, contrary to the flexibility provided under AIFMD 2, a mandatory mix of LMTs that consist of (i) notice periods, (ii) anti-dilution LMTs, such as anti-dilution levies, swing pricing or redemption fees and (iii) redemption gates. Furthermore, matching mechanisms are also allowed to be employed and could offer additional liquidity options.

In our view, requiring rigid liquidity pocket standards that do not observe the liquidity profiles of individual ELTIFs and the asset-classes they invest in on top of the "mandatory LMT mix" is off-market and would deter managers from offering open-ended ELTIFs altogether. Instead, we would expect an acceleration of the resurgent success of Part II UCIs (without the ELTIF label) for (semi-)open ended strategies. In addition, in the context of closed-ended retail ELTIFs, we believe the matching of transfer requests with or without "liquidity windows" in which (affiliated) continuation funds would be willing to step in on the basis of the NAV of the ELTIF in that specific window might over time develop into an innovative alternative to a (semi-)open ended ELTIF without being subject to the same restrictive LMT and other rules that apply to those latter.

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Que se passe-t-il après le boom des actions ?

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L'Euro STOXX 50 a augmenté de 19,4% en 2023

L'année boursière 2023 a été caractérisée par un mouvement haussier étonnamment fort. Toutefois, tous les secteurs n'ont pas contribué de la même manière à ce boom.

Les actions à forte capitalisation du secteur technologique, en particulier, ont fait grimper les niveaux de l'indice. En ce début d'année, il s'agit pour beaucoup d'un signal d'alarme indiquant qu'une hausse trop importante a été anticipée à court terme.

Dans d'autres secteurs, cependant, de nombreux titres se négocient encore loin de leurs plus hauts, parfois en raison de l'évolution hétérogène de l'année précédente.

Opportunités dans les secteurs défensifs de la consommation et de la santé

Deux secteurs défensifs n'ont pas pu suivre le rythme des grands indices l'année dernière. Il s'agit tout d'abord du secteur de la consommation, qui a souffert des craintes que les taux d'intérêt élevés et les prix de l'énergie ne pèsent sur l'appétit des consommateurs pour les dépenses. Coca-Cola, Nestlé et Co. n'ont pas non plus pu tirer parti de leurs qualités défensives, car la récession ne s'est pas matérialisée.

Deuxièmement, il convient de mentionner le secteur des soins de santé. Hormis des développements particuliers chez Novo Nordisk et Eli Lilly, qui bénéficient d'une forte demande de médicaments contre l'obésité, la plupart des valeurs pharmaceutiques et des fournisseurs tels que les fournisseurs d'équipements de laboratoire Thermo Fisher et Danaher n'ont pas été en mesure d'enregistrer des gains de prix significatifs.

Ces deux secteurs ont en commun d'avoir connu une sorte de boom pendant la période du coronavirus (en raison des tests de dépistage du coronavirus et de la production de vaccins, ainsi que de la tendance à rester à la maison, qui a notamment accru la consommation en ligne) et de traverser à présent une phase de normalisation.

Par conséquent, les valorisations de nombreuses valeurs défensives ont de nouveau chuté de manière significative à la fin de 2023.

Les actions des petites entreprises restent à la traîne

De nombreuses actions de second rang se sont également redressées de manière beaucoup moins dynamique après les pertes de 2022 et se situent toujours bien en deçà de leurs anciens sommets.

D'une part, il y a de bonnes raisons à cette évolution : jusqu'à la mi-2021, les moyennes capitalisations ont longtemps surpassé les grands indices et les valorisations étaient donc ambitieuses. En outre, les leaders technologiques dans de nombreux domaines innovants sont pour la plupart de grandes entreprises.

Néanmoins, en raison des ratios d'évaluation désormais plus attrayants, il peut être intéressant de s'intéresser au deuxième niveau, par exemple aux entreprises actives dans une niche, qui disposent des avantages concurrentiels d'un "gros poisson dans une petite mare" et qui consolident leur marché grâce à des acquisitions habiles.

Conclusion : les secteurs à la traîne offrent encore des opportunités

Après une année faste pour les principaux indices boursiers, notre analyse suggère qu'il pourrait être intéressant de s'intéresser à des secteurs et segments récemment délaissés.

À notre avis, les actions du segment des moyennes capitalisations ainsi que les actions des secteurs de la santé et de la consommation offrent potentiellement de bonnes opportunités d'entrée.