Interest in the LTAF and ELTIF soars: How retail investors can get comfort in these fund structures

Long-term funds, such as the UK's Long-Term Asset Fund (LTAF) and the European Long-Term Investment Fund (ELTIF), are widening the scope for retail investors, offering access to private credit, private equity, infrastructure and real estate investments without restricting liquidity.

However, regulators and investors are applying scrutiny on areas including valuation expertise, liquidity and asset level transparency. In this article, we explore both fund types, common pain points, and how Waystone can help retail investors address these challenges and gain comfort with investing in these structures.

LTAF and ELTIF: Benefits for retail, UHNW and professional investors

The UK LTAF and European ELTIF offer an entry point for retail and professional investors to gain exposure to the illiquid alternative investment space, to capture additional pick-up in the long term and to offer diversification to their portfolios.

In the UK, the LTAF regime was created in 2021 by the Financial Conduct Authority (FCA) to boost investor appetite in illiquid products for professional investors, including pension funds. The European ELTIF model is a collective investment scheme and similarly focuses on longer term assets. In particular, the focus on the investment lies within companies requiring capital to allocate to longer term projects (e.g. infrastructure), provided by institutional and retail investors.

The ELTIF and LTAF regimes offer an easier entry point and a more secure path for retail investors looking to invest in, for example, private credit and private equity investments. Rather than investing in a pure private credit or private equity investment fund, retail investors can gain exposure to this asset class within a well-diversified structure away from the core asset base of many retail investors. Investors are insulated from volatility within the closed-ended structure of the ELTIF, which has a longer-term objective – an appealing trait for pension managers for example.

In addition, other investors may be attracted by the flexibility to have a structure that is an open-ended LTAF structure or a longer timeframe replicating some open-ended fund with the ELTIF regime, albeit at a longer timeframe.[1] The ELTIF regime also offers a passport into Europe to access professional and retail investor distribution channels. As we discuss later in this article, recent developments in both LTAF and ELTIF regimes make the fund structure more appealing to a wider pool of investors, such as fund managers, pension funds, municipalities, insurance firms and smaller retail investors/savers.

Further LTAF Insights and Features

Learn more about the LTAF in our other recent insights here:

- Table 1 below – Key features of the LTAF
- Article – **Engagement with the new UK LTAF**
- Webinar – **Charting a course in support of the UK LTAF webinar**

Table 1: Key features of the LTAF

Structure	LTAF Feature
Fund Structure	Open-Ended, Feeder, non-LTAF, Non-UK all Allowed*
Investors	Retail and Professional*
Target Assets	PE, PC, Loan-Origination, VC, Infra, RE***
Dealing Frequency	At Least Monthly (90 day Notice)
Restrictions	Must Invest >50% in Longer-Term Assets
Collective Schemes	Investments into Collective Scheme is Permitted
Leverage	30% used as borrowing (Investment or Liquidity)

* The LTAF fund can be structures as an Authorised Contractual Scheme (ACS), an Authorised Unit Trust Scheme (AUT) or an Investment Company with Variable Capital (ICVC).

** Retail investors are restricted to allocating 10% into LTAF's but if retail investors receive advice or recommendation, they may sidestep the 10% restriction. Overall, the following can invest into LTAF's: UK professional investors; UK Defined Contribution pension schemes; Self-Invested Pension Schemes; High Net Worth Investors and retail investors.

*** Interestingly, the LTAF can participate in or originate loans (not to individuals or connected parties) one the basis that the fund adheres to "Prudent Spead of Risk", or PSOR. This spread must account for the liquidity of the asset, counterparty risk, credit risks and market risks. The inclusion of loan origination within the LTAF regime is an appealing feature for many investors and managers active in this space.

Further ELTIF Insights and Features

Learn more about the ELTIF in our other recent insights here:

- Article – **ELTIF 2.0: The key to democratised private markets**
- Webinar – **Successfully distributing private funds to retail investors in Europe – lessons learned from ELTIF**

[1] The ELTIF structure can be structured as a de-facto Evergreen fund with long end date with permitted pre-determined redemptions.

ELTIF regulatory changes have widened the scope

The Central Bank of Ireland (CBI) in Ireland and the Commission de Surveillence du Secteur Financier (CSSF) in Luxembourg have also addressed several pain-points[2] raised by fund managers to change various aspect of the structure. The key changes include:

- Abolishing the minimum investment of €10m
- Widening the scope of eligible investments using a broader definition
- Permitting co-investments, master-feeders, Fund of Funds
- Permitting Simple and Transparent Securitisations
- A reduction in eligible securities holding (now 55%)
- More flexibility on open-ended structure within ELTIF and matching mechanism to offset redemptions with new subscriptions

Find out More on These Key ELTIF Changes Here

- ELTIF 2.0 has broadened the definition of what is deemed a real asset or incorporating any asset that has “intrinsic value due to its substance and properties”
- The minimum investment amount is no longer set at €10m
- The market capitalisation threshold has increased from €500m to €1.5bn, for what is termed Qualified Portfolio Undertakings (or QPU’s)[3]
- ELTIF 2.0 now permits the investment in non-EU QPU’s[4]
- Co-investments are now permitted (minority), ELTIF’s can be used within a master-feeder structure once both are set up as an ELTIF (and 85% is invested into the Master ELTIF) and ELTIF’s can now invest in Fund of Fund strategies
- Securitisations are permitted and must adhere to Simple and Transparent Securitisations (STS) methodology
- The requirement to hold 70% of eligible assets has been reduced to 55%, thereby allowing some liquidity flexibility for managers
- Crucially, Redemption requests can be offset by matching new subscriptions as an additional measure to offer investor
- Less onerous diversification criteria reducing the number of distinct investments from 10 – managers can now invest in more concentrated strategies
- ELTIFs offered to retail investors can use up to 50% leverage, with ELTIFs offered to professional investors availing of up to 100% leverage. The €10,000 investment threshold for retail investors was also removed
- The fund structure may not need to be a pure closed-ended fund with ability to set up longer term funds that replicate an open structure

[2] The uptake in the ELTIF applications was relatively low due to the number of restrictions facing managers. ELTIF 2.0 seeks to make the process more appealing to retail investors and private fund managers by reducing the regulatory burden and widening the pool of eligible assets.

[3] QPU’s are specific companies created to provide financing to infrastructure projects or acquiring or financing or constructing real assets.

[4] Note, this excludes high-risk AML countries or non-cooperative tax regions.

What are the pain points?

Valuation

In the UK, the FCA expects firms to have appropriate valuation expertise. Some retail managers lack this knowledge and experience in alternatives as it is a non-core investment strategy. LTAF or ELTIF assets must be valued by an external valuer if the fund manager lacks the experience to do so. If the fund manager or AIFM maintains the valuation function, the entity providing the valuation service must be completely independent from the portfolio management of the fund (to avoid conflict of interest) from the portfolio management of the fund.[5]

Liquidity

There are general liquidity concerns from ESMA, associated with redemption requests relative to the illiquid nature of the underlying asset classes. The valuation frequency must be able to match the liquidity profile of the asset, taking into consideration the investor base.

Reporting and Asset-Level Transparency

Alternatives are widely considered opaque, with the CBI and CSSF pointing to lack of (borrower level) reporting offered to investors, thus limiting investor understanding of the asset class.

Stress Testing

The CBI and the CSSF have raised concerns regarding the appropriate use of stress tests within the alternatives space. More specifically, the CSSF noted the lack of integration between asset liquidity and the borrower-specific stress test. A high-level stress test encompassing interest rate or stock market shifts is not deemed appropriate for alternative investments and a more granular approach at borrower level is a preferred approach to stress testing.

How Waystone can assist investors

Waystone specialises in the alternatives asset class and can assist investors addressing these challenges above.

Alternatives and LTAF/ELTIF experience

We have deep experience and are well positioned across the alternatives asset class, with clients globally across private credit, private equity, infrastructure and real estate. Waystone also recently became the first ACD to have an LTAF approved in the UK, has four ELTIF's launched on the ELTIF register at the date of publication (the most out of any 3rd Party AIFM to date), and has number of ELTIFs in the pipeline.

We guide managers and offer risk solutions including asset-level modelling and isolating key risks within portfolios or funds. This requires detailed understanding of the associated risks for each alternative asset class from the outset.

Waystone also offers a comprehensive product suite encompassing AIFM/ACD and Distribution solutions, expert fund administration, and regulatory compliance solutions. We assist fund manager clients seeking to launch U.S., UK, Irish or Luxembourg structures, and access investors globally.

[5] The fund depositary will evaluation independence, resources etc on annual basis. The valuation frequency must match the fund dealing frequency agreed by investors. Dealing must be at least monthly, accounting for company and macro events that drive a fair and accurate valuation.

Valuation

Retail investors, HNW investors and DC pensions require high frequency valuations, often more than one month. Waystone has deep valuation expertise to meet the demands of all investors. The objective is to facilitate retail investors in gaining exposure to alternative assets and obtain regular asset valuation that improves the liquidity profile. This is an important consideration for retail and professional investors seeking to improve Liquidity Risk Management processes for ELTIFs and LTAFs.

From a valuation perspective, monthly valuations are a prerequisite for ELTIFs/LTAFs, however Waystone can offer daily or weekly valuations to cater for retail and professional investors.

Liquidity

As discussed above, many concerns have been somewhat alleviated within the ELTIF regime, as the eligible asset requirement was reduced to 55%.[6] European regulators are also looking to implement a matching mechanism which will look to offset full or partial redemption requests with new subscriptions within the ELTIF structure.

The valuation offering from Waystone serves to improve daily NAV production/liquidity at asset level. Managers have daily marks to exit illiquid positions if required.

Risk analysis, stress testing and transparency

Waystone has built a risk suite which models assets at borrower level to gauge changes in company risk profile. LTAF's require the use of PSOR's within Loan Originations for example, an area where Waystone specialises.

The modelling and valuation of such asset relies on various credit risk parameters that account for market, credit, liquidity, and counterparty risk, to derive accurate credit spreads for such loans. We leverage off our technology to provide frequent risk analysis and valuations, both improving liquidity management. This enables managers, and investors alike, to obtain a regular report showing a snapshot of the key risks within the portfolio in real time.

Stress testing

Waystone offers an element of transparency to the market by conducting borrower specific and fund-level Credit Risk Analysis across all alternatives asset classes (private equity, infrastructure, private credit, real estate). The stress testing highlights the key risks faced by each borrower and traces the evolution of such metrics to provide managers with a comprehensive view of the credit risk profile of borrowers and at fund level. The ability to conduct either borrower-specific or fund-level stress tests will also put investors' minds at ease.

If you have any questions or would like to sign-up to receive our communications, please contact your usual Waystone representative directly or reach us via the below.

Contact Us →

[6] In addition, as we discussed above, a variety of measures are available to fund managers to reduce or limit redemption risk within the open-ended LTAF and de-facto open-end ELTIF.

Further insights: Waystone's credit and alternatives series

You can find other insights we have recently published in relation to credit, alternatives and other relevant topical themes **here on our website** or you can subscribe to our communications above.

As part of our private credit and alternatives series, we will be sharing insights and research to assist fund managers and industry participants to navigate complexity effectively in the global private credit market. Upcoming pieces include:

- The different factors that investment managers must consider when selecting an ELTIF jurisdiction in Ireland and Luxembourg. Waystone has a strong presence in both jurisdictions and can facilitate our clients' needs accordingly
- Key issues faced by investment managers on the ELTIF/LTAF distribution
- The operational challenges and solutions for administering of Evergreen private credit funds in North America
- The specific challenges and solutions for European Evergreen private credit funds including AIF oversight, administration, valuation and depositary considerations