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ELTIFs: The quiet boom in EU wealth management

Introduction

In the nearly six years since its introduction to the European private markets, the ELTIF (European Long Term Investment Fund) has demonstrated its value and versatility to investors, and we expect rapid growth in the coming years. The ELTIF market is estimated to have reached 10bn EUR[1] by end of 2022 and the Alternative Investment Management Association is expecting additional 100bn[2] EUR AuM over the course of the next five years.

The ELTIF regulation was introduced by the EU in 2015 with the aim of supporting the long-term financing of the European economy and a path of smart, sustainable and inclusive growth. This is in line with the Europe 2020 strategy for creating high employment and competitiveness for building tomorrow's economy in a way that is less prone to systemic risks and becoming more resilient.[3]

This positive development coincides with European investors seeking access to the benefits of private markets and wealth managers that are looking for scalable and efficient methods to deliver the asset class to their clients. While there is more than one way to meet this growing demand, the ELTIF is quickly becoming the vehicle of choice in Europe. As an early mover in the ELTIF space and having successfully funded and closed both a private equity and an infrastructure ELTIF, BlackRock has gained insights about this new investment vehicle and how best to position it as part of a client’s portfolio.

1 Source: Citywire Amplify, The amplify ELTIF study, 1 February 2023. **2** Source: Delano, 26 October 2022, ELTIF 'explosion’ anticipated in Luxembourg: industry view. **3** Source: Regulation of the European Parliament and of the Council of 29 April 2015 on European long-term investment funds (ELTIF).

Why are ELTIFs growing?

01. Diversification and portfolio resilience

2022 delivered stomach-churning volatility for many European investors. Not only did many experience losses in equities but also in their bond portfolios. Against this backdrop of higher inflation, lower growth and higher interest rates, more investors are asking how they can further diversify their portfolio and add resilience.

While private markets are not immune to market corrections and dislocations, the attractive returns delivered by private markets have led investors to increase their allocations in recent years. In France, for example, 64% of private bankers anticipate increasing their private-markets allocations to a new clients' base, the so called 'mass affluent' investors, according to a 2022 survey by Cerulli.[4] For high-net-worth clients, 61% of their private bankers expect to increase private-market investments.[5]

The story is similar in other big wealth markets – Italy, the UK, Germany, and Switzerland - where industry professionals expect private equity and infrastructure to see the biggest net increases in allocations. Infrastructure in particular has come into focus both because of the counter-cyclical nature of the asset class and the inflation-hedging qualities which are increasingly important today.[4]

4 Source: Cerulli Report, European Alternative Investments 2022. **5** High-net-worth individuals: People or households who own liquid assets valued between $1 million and $5 million. Source: Forbes Advisor, 26 July 2022.

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02. Scalability

From the perspective of European wealth managers, ELTIFs provide virtually the only scalable vehicle capable of distributing private markets to retail investors across borders within Europe. This efficiency of the ELTIF structure has been publicly praised by a number of leading German-, French- and Italian-headquartered banks, who have begun to distribute the funds to their customers. We believe that in the same way that UCITS established itself as the go to vehicle for wealth managers distributing public markets, so may ELTIF become the preferred vehicle for the distribution of private markets.

03. New developments supporting growth

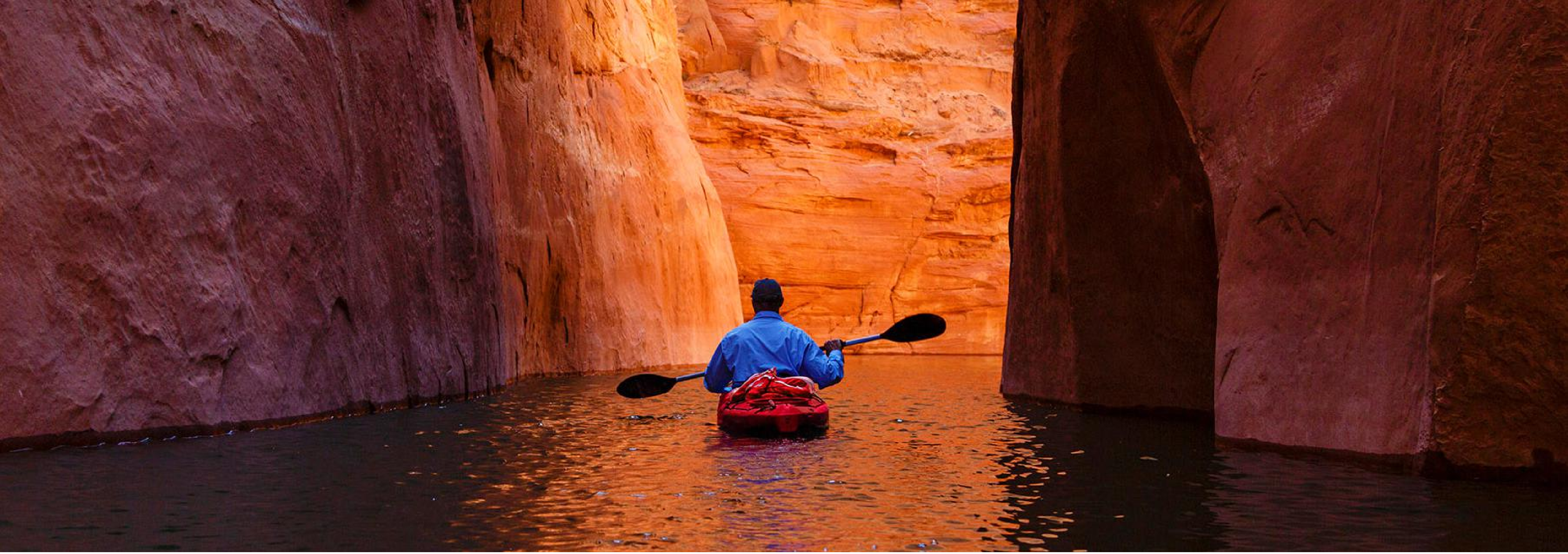
The European Council and the European Parliament has voted in favour of new rules for ELTIFs. The revised ELTIF Regulation is expected to be published in the Official Journal of the EU in March 2023 and enter into application in Q1 2024.

Changes in the agreement include:

- Simplifying distribution by fully aligning the ELTIF suitability test with MIFID II requirements for selling complex products.
- Relaxing the constraints of eligible assets for example green bonds, fintech equity, and more types of real assets.
- Increasing investment flexibility to allow ELTIFs to allocate to funds.

Source: EFAMA (European Fund and Asset Management Association), ELTIF review What is needed to make ELTIF 2.0 successful? 25 February 2022. Source: EFAMA, Press Release - New ELTIF 2.0 regulation will facilitate retail investor access to long-term investment opportunities in Europe. 15 February 2023.

Taken together, we believe these enhancements will provide material improvements to portfolio construction, provide a positive investor protection framework, and will contribute to growth in the category as more investors embrace the vehicle.



The Bottom Line on ELTIFs' main advantages

01. ELTIFs are available to retail investors across Europe at low minimum investment levels, and with an EU marketing passport, allowing for broader distribution. This lower minimum investment, compared to traditional institutional private equity funds, is one main driver of the increased demand we see, and it allows new clients to gain alternatives exposure as part of their whole portfolio. We also note that this comes with a corresponding obligation to be sure that clients understand the risks of alternative investments, and particularly liquidity risk.

02. There are two main structures ELTIF investors can select: with capital calls or as fully funded vehicles. The advantage of the fully funded vehicle is that it allows clients to avoid receiving a series of capital calls, as is the case during an investment period with traditional closed-end funds. The fully funded model comes with shorter investment periods, and potentially shorter J-curves. But there can be a trade-off in the form of lower returns due to cash (or other liquid securities) being held in the fund until the capital can be entirely deployed. Clients need to consider these attributes carefully.

Figure 1: ELTIFs: The fully funded vs. the capital-call model

Fully funded model	Capital-call model
• One single capital call upfront	• Multiple capital calls as needed
• Typically shorter investment period and J-curve	• Typically longer investment period and J-curve
• May lead to slightly lower internal rate of returns (IRR)	• Potential for cash drag to effect internal rate of returns (IRR)
• Reduced operational burden on headquarters and private bankers	• Requires headquarters and private bankers to manage capital calls

Source: BlackRock. 31 January 2023.

03. ELTIFs can be marketed in key non-EU countries under private placement rules. This can potentially expand the addressable market for wealth managers, although the majority of demand today is still expected in Europe.

04. The EU is taking steps to promote the ELTIF structure as a way to boost investment in infrastructure and other long-term projects and businesses within the European Union.

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These benefits are generating a substantial uptick in overall interest. And there are new ELTIFs being launched on a regular basis. Since 2015, the market has grown to 84 registered and marketed ELTIFs.[6]

6 Source: ESMA, Register of authorised European long-term investment funds, as of January 2023.

Key lessons for European wealth managers

Through our partnerships with leading wealth managers, we have learned several important lessons about using ELTIFs in client portfolios.

These include:

01. Education

If the age-old expression in real estate investing is location, location, location, then the corresponding maxim for ELTIF distributors is education, education and education. Many wealth managers significantly underestimate the level of education and training needed for advisors and retail clients to make private markets part of an overall portfolio.

Advisors need much more information, portfolio analytics and guidance on how private markets products fit into client portfolios, and how best to position them. They also need to better understand the role that private markets play in terms of risk and return in client portfolios. To underscore this point, we are making BlackRock's Alternatives Academy available to our clients to support this very important process.

02. Broad view

Wealth managers need to look at private-markets investments through the lens of a whole portfolio. This means thinking about the allocation to private markets in the context of the client's overall portfolio, not as a single product based on its own merits.

This is fundamentally about changing the dialogue. We have invested in the portfolio analytics capabilities to help our clients put this into practice today. In an environment of increasing complexity, regulatory pressure, market uncertainty and an ever-evolving investment universe, building a portfolio that continues to meet the needs of clients over time has become more important than ever.

03. Sourcing, crucial for performance

Limited Partners (LPs) should really question their General Partners (GPs) on the ability to source quality assets either bilaterally, off-market and through deeply established networks of sponsors. This is typically important for delivering performance across asset classes and vintages.

04. Private Markets lifecycle management

Wealth Managers need to manage the entire the private-market fund lifecycle, from onboarding all the way through to the distribution of proceeds. While a number of wealth managers have experience with this, others make a point of working with a partner who understands the operational complexities and reporting needs of these vehicles and can offer the proper client support. We believe each step in the lifespan of these investments demands careful preparation at the outset.

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05. Liquidity and clarity

Liquidity always matters. While ELTIFs have offered limited liquidity, the vehicle is evolving and becoming more flexible. Nonetheless, we believe it's critical to properly position the topic of liquidity with clients to provide transparency and avoid potential misunderstandings of how much liquidity clients can expect from their ELTIF investments.

06. Patience is a virtue

Distributing an ELTIF is not like simply putting the next mutual fund on the recommendation list of a wealth manager and waiting for it to "roll" off the shelf. Given the required time for the due diligence process, setting up the operational model, finalizing the distribution agreement, partnering on marketing material and advisor education, the preparation for an ELTIF distribution can take up to six months. Furthermore, this needs to be aligned with the fund-raising period of the ELTIF which can take more than one year.

From our vantage point, we see many encouraging signs that the obstacles that ELTIFs have faced in the past are being addressed. With new features and political support, along with increased training, education, and overall comfort levels, ELTIF adoption should accelerate in the coming years.

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To learn more about BlackRock's ELTIF offerings, our country specific experience, our whole portfolio solutions, and our advisors' alternatives academy, please reach out to your BlackRock Manager or visit our website.

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