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No alternatives to ELTIFs

The commercial impact of the updated
ELTIF 2.0 regulation



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Key takeaways

1.

European Long-Term Investment Funds (ELTIFs) are the only wrapper that permits the distribution of private markets investment strategies to all investor types across Europe.

2.

The new ELTIF regulation (ELTIF 2.0) is making waves in the investment world and creating the potential for ELTIFs to become the vehicle of choice for private market investments.

3.

The ELTIF market is estimated to have reached EUR 13.6bn by end of 2023,¹ and the Alternative Investment Management Association estimates in flows of around EUR 100bn in the next few years.²

4.

The evergreen structure made possible by ELTIF 2.0 may drive the inclusion of private markets in discretionary portfolio management.

5.

The operational complexity of private markets has meant that digital distributors have historically shied away from offering these types of strategies, but the ELTIF may challenge the status quo.

Source: 1. Scope, Solid growth in ELTIF market; new regulation to drive further expansion, 15 May 2024. 2. Alternative Investment Management Association (AIMA), ELTIF 2.0: Reforms set to drive significant growth in European private markets, 19 June 2023.

ELTIF 2.0: What's new

Designed to overcome some of the key operational and structural barriers that hindered a broader adoption of private markets in recent years, including:



Improving access

Introduces an evergreen, open-ended (“semi-liquid”) structure, which offers liquidity at periodic intervals removing long-term lock up periods.



Harmonizing suitability

Simplifies the distribution process as the ELTIF suitability check is now fully aligned with MiFID II suitability (Markets in Financial Instruments Directive)



Broadening the investable universe

Expands the investment opportunity set available to managers, allowing for globally diversified investment strategies in an ELTIF wrapper.

In combination with the well-known UCI Part II SICAV as the underlying structure, the ELTIF 2.0 wrapper unlocks the broadest addressable client base for private market products in Europe and Asia. So, in summary, the ELTIF 2.0 has many potential upsides, with limited downside compared to legacy non-ELTIF structures.

Implications for investors

In combination, we expect these changes to significantly broaden the commercial use case for ELTIFs and accelerate the adoption of private markets across the European Wealth market. In particular we will explore:

- How evergreen structures improve access to private markets
- How to position private markets within traditional fund advisory, as well as discretionary model portfolios
- How digital distribution is unlocking new access routes



Evergreen structures

The ability to use evergreen structures within ELTIF 2.0 (i.e. open-ended strategies) will have a profound impact on the accessibility of private markets.

Three main characteristics of evergreen structures make them more attractive for a broader adoption in wealth:

Reducing operational complexity

While the popularity of open-ended strategies is a relatively recent phenomenon in the private markets' world, they have been long-established for mutual funds. This means that open-ended ELTIFs will be able to draw on some of the key operational features that make mutual funds so scalable, including: clearly-defined dealing cycle for subscriptions and redemptions, straight-through-processing of orders that remove most manual intervention, and not requiring complex capital call management.

Simplifying the product shelf

In addition, evergreen funds are typically continuously offered. This means that distributors are not required to onboard new funds every 12- to 18-months, as it is the case in the traditional closed-ended world. Instead, fund selectors can design their product offering to include core exposures across each private markets' asset class, streamlining their existing recurring due diligence process. Additionally, distributing the same fund can build adviser expertise and enhance their private markets' knowledge overtime.

Managing the liquidity bias

Historically, a key barrier to entry has been the perceived liquidity risk posed by the asset class.

Closed-ended strategies often command long lock ups and risk-averse investors are typically unwilling to give up the flexibility offered by traditional mutual funds, ETFs and savings accounts. This liquidity bias means that investors have historically been materially under-allocated to private markets. By 2030 millennials are set to inherit \$66tn,³ and a survey of young investors (ages 21-42) found that 75% believe it is not possible to achieve above-average returns with traditional stocks and bonds.⁴

Despite these funds designed to be part of a long-term asset allocation, open-ended evergreen strategies offer investors the ability to enter and exit their positions (typically quarterly) based on their personal risk appetite and investment horizon. This will be important to risk-adverse investors who will often hold these strategies for many years, but don't want to run the (perceived) associated liquidity risk of traditional private markets.

Historically only possible for institutions, investors can now also benefit from constant exposure to private markets over a long time. They can simply stay invested in the same fund and hold it for 15 years, rather than continuously having to find new funds to invest in.

Source: 3. 2022 Bank of America Private Bank Study of Wealthy Americans. Independent survey included 1052 people with household investable assets of more than \$3m and who were over the age of 21. Comprehensive study of high-net-worth and ultra-high-net-worth individuals in the U.S.

4. Cerulli U.S. High-Net-Worth and Ultra-High-Net-Worth Markets 2020. Federal Reserve, "Distribution of Household Wealth in the U.S. since 1989," Baby Boomer assets as of Q4 2020. Millennials are individuals born from 1981 to 1996. Most recent available data to BlackRock. Forecasts are not guaranteed and subject to change.

Education on liquidity management is a must

Operational innovation aside, investors and distributors will need to be mindful of how fund managers approach liquidity management in this inherently illiquid asset class. Investor education needs to be at the core of every distribution strategy, and robust liquidity management need to be at the core of every product design to ensure a positive investor experience. Evergreen strategies:

- Are designed for long-term strategic asset allocation. For example, they're not designed to express tactical views, such as an overweight of real estate for a 3m period.
- May have to limit redemptions available in periods of exceptional circumstances
- Need to employ a holistic liquidity strategy looking at flows, allocation to liquid assets, redemption terms, and more, which will affect target returns.



Positioning private markets within Wealth

Advisory distribution remains the backbone

of the European Wealth industry (covering 60% of the assets)⁵, representing most current revenues.

Familiar, relatable investments

A key component of a successful financial advisory relationship is that the end-investor understands what they are putting their money into. It remains critical that advisers can clearly communicate to their clients what the benefits of a potential investment are. We see client-friendly case studies of deals at the core of a successful distribution strategy.

For example, the revenue drivers of private infrastructure are readily understandable. It's easy to see how investments into the infrastructure supporting the energy transition will serve an essential need that, over time, has the potential to generate outsized returns.

Differentiated service

Increasing competition is forcing distributors to constantly rethink and differentiate their offering. Expanding their private markets offering with innovative solutions for Wealth has meant:

- **Reengagement:** ELTIF 2.0 broadens the client base and provides an “easier” access point for first time investors to discuss new investment opportunities compared to the traditional closed-ended fund.
- **Retention:** by nature, private markets strategies are designed as long-term holdings and as such can increase the stickiness of client assets.
- **Commercials:** as a new offering, distributors can also use private markets to rethink their pricing structure, to generate a more diversified revenue stream for distributors.

Source: 5. McKinsey data as of Dec 2023, Broadridge data as of Dec 2023, Global Business intelligence data as of Dec 2023, EFAMA report as of Dec 2023, BlackRock analysis as of Dec 2023



Looking ahead: policy tailwinds for ELTIFs

Recent policy discussions have shown a clear resurgence of the momentum behind Europe's Capital Markets Union (CMU) project, with commitments to boost initiatives aimed at unlocking private capital taken by EU Heads of States and Governments at an April 2024 Summit. In a recent high-profile report to the European Commission on the future of the EU Single Market, former Italian Prime Minister Enrico Letta identified the uptake of ELTIF as a key success factor towards the completion of the CMU and the financing of Europe's economy.

The report notably recommended the introduction of national tax incentives to encourage retail investments in ELTIFs under a new EU-wide scheme (leaving the exact amount of the tax benefit to each EU country, but going as far as suggesting an EU-wide minimum threshold of tax break) to ensure ELTIF's success. While it should be noted that such a European tax scheme for ELTIFs is only a hypothesis now and would take several years to materialise if implemented, this shows the importance the success of the vehicle has taken in Europe's highest policymaking circles.

Discretionary portfolio management (DPM)

Centralised and fee-based propositions are growing to represent over half (~55%) of total Wealth AUM by 2027¹. Demand for simpler fee structures and demonstrable “value for money” has resulted in a widespread shift to fee-based advisory and discretionary models. Fee-based models focus on delivery of outcomes, and therefore place more emphasis on robust and standardised portfolio construction and risk management

processes. Traditional closed-ended private markets funds have been difficult to integrate in this setup, given the inherent lack of standardisation.

Whilst DPM propositions are steadily growing, the lack of private markets exposure has potentially meant that investors have missed out on the return and diversification benefits of private markets, putting pressure on distributors to evolve their DPM offering. ELTIF 2.0 is set to bridge this gap:

1.

The regular liquidity allows granular, and even tactical, asset allocation across private markets exposures, with DPM being able to increase and decrease exposure over time. DPMs can generate alpha through private markets asset allocation.

2.

DPMs that combine public and private allocations in a single portfolio can manage it based on an investor’s overall liquidity requirements, not on an individual fund-by-fund level.

3.

As DPMs thrive on standardisation, by being perpetually offered, evergreen strategies can be used to offer core exposure to private markets across both existing and potential future investors. This is not possible with closed-ended funds, as exact timing of fundraising is not guaranteed.

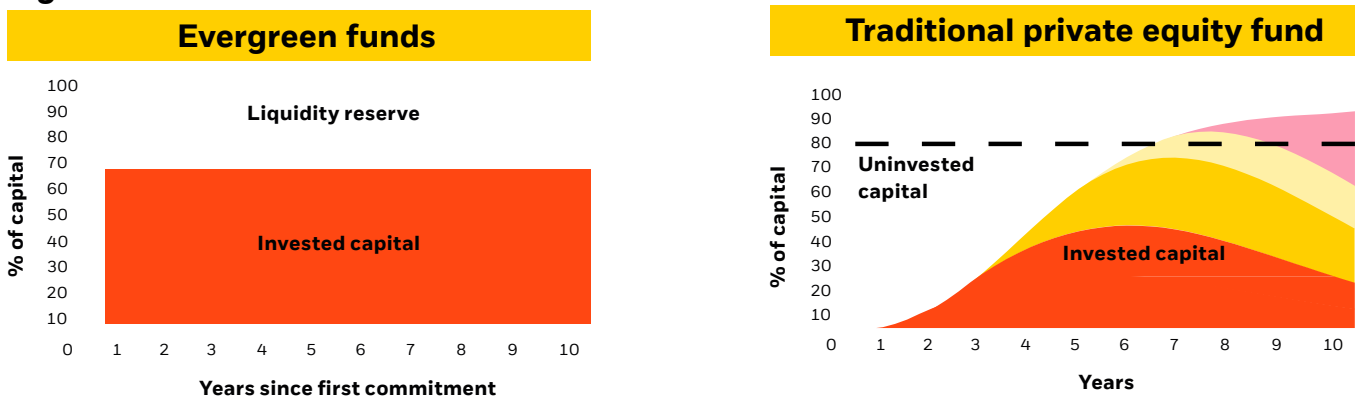
While ELTIF 2.0 will offer significant benefits in DPM, a key consideration when designing a private markets DPM is whether or not this should sit within the traditional liquid DPM, or separately. Whilst there is no right or wrong approach on this matter distributors should consider investor preferences, sophistication as well as how they currently contract with their investors.

Unlocking access

Traditional private funds have a defined life span and managed liquidity window. In this type of structure, fundraising occurs when a new fund is launched, and capital is committed with limited to no ability to withdraw. Institutional investors will typically ensure they meet their target allocation to private markets by running sophisticated commitment strategies across multiple funds and vintages. This complex approach is not possible for Wealth investors, and so evergreen structures offer material benefits of ensuring they maintain a constant allocation to the asset class.

The difference in exposure to private markets via a mature evergreen fund with a well-diversified underlying portfolio versus building the traditional flywheel by constructing a program through multiple generations of traditional private funds and the resulting net asset value (NAV) build-up is best illustrated in Figure 1.

Figure 1.



Source: BlackRock as of 31 December 2023. For illustrative purposes only and is not meant to depict the actual characteristics of any BlackRock fund or any fund in particular. All simulations are net and underlying as well as providers management and performance fees are included.

As depicted, in steady-state once an evergreen portfolio has been ramped up, one can nearly instantly achieve the desired allocation. By contrast, in a program of traditional private fund commitments it takes several years to build-up to that target allocation or NAV. Also, note the annual commitment amount can vary considerably, resulting in concentration risks to individual vintage years.

At an underlying investment level, evergreen funds may offer diversification across regions, sponsors, sectors, and size of the companies whereas with traditional private funds, investors may seek targeted exposure to sectors, regions or themes. In addition, evergreen funds can solve for exposure to directs, secondaries, and primaries depending on the manager and strategy – or be more single solution oriented.



Digital: The next frontier for ELTIFs

Much like we believe the ELTIF is the future of private markets product offering, digital is emerging as one of the fastest growing distribution segments in the region (now 11% of market AUM)⁶. Whilst historically the complexity of private markets has meant that digital distributors have shied away from offering these types of products, the simplicity of the ELTIF is challenging the status quo.

Opening up to new audiences

Initially designed for both institutional and individual investors, the ELTIF structure is now accessible to a wider range of investor types.

While a suitability test will have to be performed before marketing an ELTIF to a retail investor, we are seeing innovative ways to support the distribution of these products through Digital channels:

- Educational videos and events directly accessible to end investors to learn about the benefits of private markets.
- Tailormade suitability and appropriateness assessments leveraging a digital subscription process.
- Investor-level portfolio construction analysis showing how a portfolio would evolve with the inclusion of private markets.

Source: 6. McKinsey data as of Dec 2023, Broadridge data as of Dec 2023, Global Business intelligence data as of Dec 2023, EFAMA report as of Dec 2023, BlackRock analysis as of Dec 2023

Private markets saving plans

Individual investors are increasingly relying on savings plans to build up their investment portfolio. The appeal of savings plans is their simplicity, enabling investors to “set and forget” how much they would like to invest into a given exposure each month. While investments may be small in the short-term, cumulatively savings plans have the potential to be a dominant force for fundraising. It is only now with the advent of the ELTIF 2.0 that we expect private markets savings plans to become mainstream:

1.

By offering regular subscriptions, e.g. monthly, investors can now save into a private markets fund as if it were a mutual fund or an ETF. This is not possible with closed-ended strategies.

2.

Through the lower minimum investments facilitated through the ELTIF 2.0 regime, investors can start with an initial investment of say EUR 10,000 and then look to slowly build up additional exposure over time. For example an investor may look to increase their private markets exposure from 0 to 5% in the short term, and to 10% over the coming years. Prohibitively high initial investment requirements would prohibit the ability to save over time.

3.

Vintage diversification, i.e. allocating to private markets across multiple “vintage years”, is a key aspect of a successful private markets programme. Evergreen strategies already have this vintage diversification implicitly embedded into them, as they will allocate to deals on an ongoing basis, meaning investors buying the fund today will receive exposure to multiple years’ worth of deal flow. However, the savings plan approach adds an additional layer of diversification as investors will smooth their purchase price over a long period, allowing them to avoid the (perceived) risk of buying a fund at the potentially wrong point in time.



Why BlackRock for ELTIFs

BlackRock was one of the first movers to offer ELTIFs to retail and institutional investors in Europe, successfully launching several ELTIFs and raising \$1.4bn as of June this year across private equity and private infrastructure.⁷

It is our vision to offer our distribution partners world class institutional quality investments as well as outstanding client experience across legal and operational matters.

Building on our market leading position, we intend to grow our ELTIF platform, leveraging the new ELTIF 2.0 regulation, and launch a suite of open-ended, evergreen strategies across a range of private assets.

Source: 7. BlackRock as of 01 June 2024.

Want to know more?

If you are interested in learning more on how we can help you, please reach out to your BlackRock Relationship Manager or contact us via our website to discuss your specific needs in greater detail.

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