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Should retail investors consider investing in AIFs and ELTIFs?

The success of the UCITS brand and the establishment of UCITS as the default investment fund for retail investors in Europe has created a strong focus on the most liquid assets classes. Despite the continuing low interest rate environment prompting investors to explore new avenues, retail investors continue to invest through UCITS and the limited range of strategies available in this structure.

Could EU Alternative Investment Funds (AIFs), including European Long-Term Investment Funds (ELTIFs), provide retail investors with access to investments unavailable in UCITS funds? What sets such alternative funds apart from UCITS and what would make AIFs and ELTIFs suitable and attractive to retail investors? Since AIFMD governs fund managers and not the funds, there are many different types of AIFs and a broad spectrum of fund characteristics. Therefore, a differentiated approach to this question is needed.

A number of AIFs have been set up and function very much like UCITS, geared towards the specific needs of retail investors. Their investment strategies usually permit investment in certain assets or a portfolio weighting just outside the scope of the UCITS requirements, creating the opportunity for retail investors to broaden their investment exposure whilst maintaining liquidity as well as the subscription and redemption features UCITS are known for.

Investing in less liquid assets, the purpose of many AIFs and ELTIFs (which provide long-term financing for infrastructure projects, SMEs and unlisted companies), means that early redemption is usually unavailable, restricted, or only possible at a significant cost for the investor. As such, only retail investors who do not need liquidity should consider investing in such funds. Some AIFs maintain a portion of more liquid assets, often reducing potential performance of the fund. Moreover, the liquid assets portion may not suffice to cover an extreme situation in which all investors seek to redeem.

In practice, many AIFs and most ELTIFs are set up for professional investors only. The combination of large unit sizes and initial investment requirements, capital calls and restrictive redemption make such investment funds less suitable for retail investors. Adaptation of such AIFs for investment by retail investors would not make sense as retail interests would inevitably and irreconcilably collide with those features offered to professional investors.

For a well-informed decision to invest in AIFs and ELTIFs, retail investors need additional information from distributors on all features typical to AIFs but not present in UCITS. Retail investment in less liquid strategies will require more extensive customer due diligence, appropriateness and suitability testing, and a clear understanding of the target market. More affluent and financially literate retail investors may then find investments in AIFs and ELTIFs an interesting and attractive investment proposition, allowing them to access asset types and investment strategies that enhance and are complementary to more traditional UCITS investments.