



Life Board and Life Research Sub-committee

Equity Release Mortgages 2020 Working Party

Overview

Equity release mortgages (ERMs) have emerged as an increasingly material asset class for some UK insurance firms. This trend can be viewed as part of a wider shift by UK insurers into private debt asset classes. As with private debt assets more generally, ERMs tend to be used to back illiquid liabilities such as long-term annuity business.

ERMs have numerous features that make their valuation and risk assessment complex. They are, like other private asset classes, highly illiquid. They are exposed to the long-term price behaviour of individual residential properties, which have idiosyncratic risks and are also illiquid. The long-term behaviour of the mortgage borrower (their longevity, transition to long-term health care and prepayment tendencies) all impact on the ERM's cashflows and hence its value and risk profile.

UK insurers often securitise their ERM asset portfolios so as to create asset structures that may be eligible for use in Matching Adjustment portfolios. This can create another layer of complexity in the valuation, risk and capital modelling and assessment of insurers' ERM exposures. The PRA has issued PS31/18 and PS 19/19 which, among other matters, introduces a diagnostic test, the Effective Value Test (EVT), that is used to monitor and limit the amount of Matching Adjustment benefit that insurers claim in respect of their MA-eligible ERM assets.

A number of research papers on ERMs and their treatment in actuarial work have been released in 2018 and 2019. The IFoA's Actuarial Research Centre published a report on "*UK Equity Release Mortgages: a review of the No Negative Equity Guarantee*" by R. Tunaru in March 2019. Other papers, such as the paper by Jeffery & Smith that was presented to the Society of Actuaries of Ireland in March 2019, are also notable for their discussion of the technical topics that can arise in the consideration of the actuarial work related to ERMs. The analysis and recommendations of these research papers, taken in aggregate, highlight that there is not yet a clear consensus in some important theoretical and practical topics relating to the actuarial treatment of ERM assets. Nor do any of these papers suggest they have attempted to answer all relevant questions relating to the actuarial treatment of equity release mortgages. An ongoing program of actuarial and academic research is anticipated and welcomed.

Working party objective / aims:

1. To assist the Life Board, Life Research Sub-committee and Finance and Investment Research Sub-committee in any matter relating to ERMs.
2. Preparation for any future consultation responses in relation to ERMs to the PRA and FCA.
3. To stay abreast of relevant ERM research produced by the global actuarial and academic research communities and to support future research efforts in areas deemed most important to the IFoA actuarial community.
4. To discuss and appraise possible approaches to actuarial work related to ERMs in areas such as:
 - a. Economic valuation, including possible consideration of different issues that arise in different valuation contexts such as PRA EVT, SII and IFRS. Topics may include valuation modelling approaches; parameter calibration; the choice of reference assets for use in valuation; the effects of illiquidity (of both the mortgage asset and its residential property collateral) on valuation; and the modelling of borrower behaviour.

- b. Implementation of specific regulatory requirements, such as the PRA's EVT and the calculation of the EVT under stress.
 - c. Risk and capital assessment and risk management, including topics such as the treatment of securitisations and the assessment of ERM's long-term cashflow risks.
5. The output of 4. may be disseminated in a variety of forms such as papers for publication in the British Actuarial Journal, articles in The Actuary magazine, and presentations at relevant IFoA events such as sessional meetings, Life Conferences and regional society meetings.

Anticipated 2020 outputs and timeframes as at Jan 2020 (to be updated quarterly):

1. Discussion paper on the assessment of ERM economic valuation in the specific context of the PRA's EVT. Publication planned for February 2020.
2. Presentation of the content of the EVT economic valuation paper at IFoA events. TBD.
3. A range of other potential outputs will be determined as feedback is received on outputs 1 and 2, and as a result of the currently ongoing WP activity relating to its objectives listed above.

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