

AVIVA'S EQUITY RELEASE SECURITISATION SIGNALS A NEW ERA FOR LONG-TERM RMBS

The word “mortgage” comes from the Old French words “mort” meaning “death” and “gage” meaning “pledge”. Whilst we now think of a mortgage as a loan secured over real property with a pledge to repay over a long time period, there is an area of the market where the term mortgage is somewhat more literal: equity release.

EQUITY RELEASE PRODUCTS

Equity release mortgages (“Equity Release Products”) (UK, Ireland), reverse mortgages (Australia, Canada, New Zealand) or home equity conversion mortgages (“HECM”) (USA) (together, “Equity Release Products”) allow borrowers above or nearing retirement to borrow money with their home as security, with repayment over a period when they are unlikely to have employment income. Unlike most other non-equity release mortgage products, principal on the loan is not paid back periodically, rather, the principal is paid back in full when the borrower dies or goes into long term care. Some Equity Release Products provide for the periodic repayment of interest (e.g. a Retirement Interest Only Mortgage), whereas other Equity Release Products provide for interest to be capitalised and added to the principal loan balance.

Other than the mandatory prepayment on death or entry into long term care, the other main differences between Equity Release Products and other residential mortgage products are:

- (A) the no negative equity guarantee (“NNEG”). The effect of the NNEG is that the borrower is not liable for any undischarged portion of the mortgage loan following the repayment date as a result of the relevant property being sold for an amount less than the amount outstanding under the mortgage loan; and
- (B) longevity risk in repayment profile - homeowners outliving expectations can mean delayed expected cashflows.

Equity Release Products are an increasingly attractive proposition for funding later life expenses, as homeowners may find that their pension provisions may be under performing, or inadequate, in the context of unanticipated increased costs of living.

REGULATORY FOCUS

Despite the NNEG feature of Equity Release Products, there are regulatory sensitivities around offering Equity Release Products to consumers due to their complex nature. Firms advising on or selling Equity Release Products or reverse mortgages are regulated by (e.g.) the Australian Securities and Investments Commission in Australia, the Reserve Bank of New Zealand in New Zealand, the Financial Conduct Authority in the UK and the Central Bank of Ireland in the Republic of Ireland. In addition, various industry bodies have been established to set guidance for best practice for lending Equity Release Products, such as the Equity Release Council in the UK (which has Irish affiliate members).

INSURER CAPITAL REQUIREMENTS

Insurers typically purchase or advance Equity Release Products to improve liability matching and manage longevity risk, since the repayment profile of a portfolio of Equity Release Products can be a good fit for the corresponding liability profile of a portfolio of life insurance policies. While many life insurers hold Equity Release Products on their balance sheet, other originators often seek to fund them through forward flows, warehouse facilities or portfolio sales. In addition, owners of Equity Release Products may be incentivised to securitise them in order to transfer economic risk and manage liquidity. In the case of insurers that hold Equity Release Products, there is often an additional reason for securitising, which is to issue matching adjustment eligible securities. The vast majority of such securitisations to date by EU and UK insurance firms have been internal or on-balance sheet securitisations, where fixed and variable notes are issued with the fixed cashflows on the senior notes allowing the insurer to obtain favourable ‘matching adjustment’ treatment under the relevant solvency capital regime.

The drawback to funding through internal securitisations is that the Insurer is also required to hold the junior, variable tranches which absorb payment volatility alongside the matching adjustment eligible senior tranches. In the past this has been seen as a necessary evil, but a slow but emerging public securitisation market for Equity Release Products, since Heartland Bank's aggregate of AU \$1.7 billion reverse mortgages securitisations in 2020 and 2022, Household Capital's AU\$263m 2024 reverse mortgages securitisation and LiveMore's £208m 2024 securitisation of Retirement Interest Only Mortgages, is starting to change the picture.

LIFETIME MORTGAGE FUNDING 1 PLC (LMF1) SECURITISATION

Slaughter and May advised Aviva as original lender, servicer and Class A Noteholder on the c. £1 billion LMF1 securitisation which closed in December 2024.

This transaction marks a significant development in the UK and European securitisation markets, proving that it is possible to achieve a public securitisation of Equity Release Products at scale, and showcasing innovative deal features to make the junior and mezzanine tranches attractive to third party investors.

The LMF1 transaction involved the sale of a portfolio of Equity Release Products by Aviva to Aira Force Capital Optimization Strategies, LLC ("Aira"), which subsequently sold the portfolio to LMF1. LMF1 then issued £1,059,450,000 in Equity Release Mortgage Backed Fixed Rate Notes due December 2090. The notes were structured across various classes, with ratings ranging from Aa2 to Baa3 by Moody's and AA+ to BBB+ by ARC Ratings. Aviva was appointed as servicer and legal title holder of the portfolio. Aira as risk retention holder is required to hold the 5% net economic interest in the stack for the life of the deal.

Aviva retained 100% of the Class A1 and A2 matching adjustment eligible notes, demonstrating confidence in

the underlying asset pool and achieving its capital efficiency objective. Aira acquired the subordinated Class B3 and C Notes, while the remaining tranches were offered to the market. Citigroup Global Markets Limited acted as the arranger and lead manager for the transaction.

In order to make the junior and mezzanine notes attractive to third party investors, the majority Class C noteholders hold and may exercise a refinancing option to direct the Issuer to redeem and re-issue all of the Class B Notes and the Class C Notes on and from the Interest Payment Date falling in March 2028. This means that whilst the Class A Notes were structured to be suitable as buy-to-hold instruments, the mezzanine and junior noteholders are not required to take such a long position.

This transaction, alongside other public deals in the market, represents a notable step in revitalising the UK equity release securitisation market, which had seen limited activity in recent years. The success of LMF1 may pave the way for further transactions, providing liquidity and funding options for Equity Release Product originators and owners.

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