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Life Insurance and Private Equity: challenges and opportunities

Aurélie BIECHE
Wealth planner
Frédéric SAUVAGE
Directeur Commercial France
www.baloise-international.lu/contact
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The economic news in the life insurance industry is constantly reminding us that the traditional life insurance model with a guaranteed rate - widely adopted in countries such as France - is gradually reaching its limits with the decline, indeed with the announced end, of euro funds in the near future. From now on, the lump sums paid in by policyholders must be channelled into new investment vehicles which are sustainable over the long term and are a source of performance, something which traditional bond vehicles do not offer. Insurance companies now have to respond to policyholders' requests for protection and remuneration of the assets entrusted to them, by offering alternatives which have the potential to generate profits. The growth of Private Equity funds over the past 10 years, and the ability to incorporate them into life insurance policies, is part of the answer to investors in search of returns.

We do not naturally associate insurance policies with Private Equity. So, how is it that these two worlds, which seem so different from each other, are today working together?

For the purposes of this article, we exclude own-account investments made by insurance companies, such as Bâloise, which allocates CHF 50 million every year to a venture capital fund specialising in 'insurtech' (as broadly defined). We also exclude any mention of the various projects undertaken by insurance companies to create or support start-ups whose activity or business model is complementary to, or even - strictly speaking – in competition with their own business.

Today, when we mention the advantages and objectives of taking out a life insurance policy, we think about its benefits in terms of assets transfer to the next generation, or to chosen beneficiaries. But life insurance is also a savings product in its own right. It enables to invest and grow a capital with a view to bequeathing it, but also to achieving other objectives during a lifetime, such as financing one's retirement, the children's education or a real estate project, etc., and also, for some people, to grow and bequeath assets created by previous generations.

This is the point at which the worlds of life insurance and Private Equity meet. Indeed, the long-term investment horizon of Private Equity funds is perfectly aligned with the life insurance policy's objective of enhancing the value of assets in order to fund future projects, where long-term investment periods are also recommended.

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Why are Luxembourg life insurance policies increasingly favoured by clients wishing to invest in Private Equity?

Private Equity investment is increasingly favoured by wealthy clients in search of performance, novelty and sophistication. Moreover, investment in - and the financing of - the real economy are frequently expressed wishes. However, these clients are also concerned about legal certainty and the preservation of their assets over the long term, particularly when faced with future political and economic uncertainties.

Faced with this demand, insurance companies in the Luxembourg financial centre, and particularly those companies which offer only unit-linked policies, have understood the advantages of enabling access to Private Equity funds within their policies.

In this area, the Luxembourg life insurance finds it way thanks toits flexibility and a protective legal framework. Indeed, Luxembourg's regulations make it possible for some clients to include Private Equity funds in life insurance policies. Some Luxembourg companies have already built up wide-ranging experience in these areas. The inclusion of PE Funds in the Luxembourg insurance package enables policyholders to benefit both from all the legal, tax and inheritance advantages of the policy, as well as from the financial performance of these funds, without forgetting the protection of the subscribers' assets thanks to the Triangle of Security.

What obstacles do Luxembourg companies have to resolve in order to include Private Equity in their policies?

In terms of accessibility within their policies, insurance companies are able offer such investments to a wide public, in the sense that both individuals and legal entities may invest in Private Equity funds via their policies. In the same way, they can access these funds both in their life insurance policies and in their capitalisation policies. However, in all cases, access is limited to Type D policyholders, i.e. those who invest at least €1 million in their policies and declare ownership of a portfolio of securities worth more than €2.5million[1]. Policyholders must have specific risk and asset illiquidity parameters included in their profiles as 'dynamic' or 'aggressive' investors.

[1]These limitations have been set by Bâloise Vie Luxembourg. For the general limitations, please refer to Circular 15/3 of the Commissariat aux Assurances.

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Nevertheless, providing access for policyholders to their Private Equity funds represents a challenge for Luxembourg insurance companies at several levels. First, competence, i.e. to have the expertise required in order to understand, analyse and monitor this type of investment. Second, the ability to react quickly in order to introduce these assets into policies within the deadlines for closing set by the investment funds.

Finally, the biggest problem facing companies is liquidity risk. By definition, Private Equity funds are illiquid before their maturity date and insurance companies have no satisfactory secondary market available to them. However, various events may occur during the life of the insurance policy itself which render its benefits payable, such as a request for surrender by the policyholder, or the death of the insured. The approval of a new fund by the company therefore involves exchanges with the Private Equity fund in order to adapt the conditions for exit from these securities. In general, a payment of benefits will therefore be made in kind, by transfer of the securities to the beneficiaries. Luxembourg regulations already offer this service which it is also favoured by certain national regulations, such as in France which - for example, first with the Macron Law in 2015 and later with the Pacte Law in 2019 - now offer a mechanism for making the payment of benefits in the form of securities.

Which is the best vehicle for an insurance fund investment in Private Equity?

Within our policies, Private Equity funds are eligible for inclusion in Internal Dedicated Funds ('IDF') with a discretionary manager, and Specialised Insurance Funds ('SIF') where the choice of vehicles is left to the policyholder.

In order to meet the needs of our partners who often do not have the approvals enabling them to manage PE funds, we offer SIFs specifically dedicated to holding assets with reduced liquidity. Unlisted bonds and PE funds are generally tied up for long periods of time, often without an available secondary market. Such funds do not require day-to-day discretionary management. On the other hand, they require specific administrative management for which the company must develop specific know-how. In this sense, Private Equity SIFs are holding tools perfectly adapted to an asset class which has become indispensable when allocating high yielding assets.

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| Bâloise Vie Luxembourg S.A. | 23, rue du Puits Romain | L-8070 Bertrange |
| Tél. +352 290 190-1 | Fax: +352 290 190 462 | www.baloise-international.lu |