

ELTIFs and LTAFs: Are Long-Term Fund Structures a Good Fit for Insurance Portfolios?



Austin Brady



Daniel Forbes

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Insurance managers are increasingly exploring longer-term fund structures, yet their adoption has been slower than anticipated. This article analyses the alignment of UK Long-Term Asset Funds (LTAFs) and European Long-Term Investment Funds (ELTIFs) with insurance portfolios, and the mitigants that insurance managers venturing into this area can take to overcome the barriers hindering adoption.

The Shift to Long-Term Strategies in Insurance Portfolios

Insurance investors prioritise capital preservation and asset-liability matching. Life insurers typically engage in longer-term investments to align with their long-term liabilities, while non-life insurers tend to favour shorter-term, more liquid assets due to frequent premium payments. The LTAF and ELTIF structures cater to long-term strategies, offering illiquid assets that can yield higher returns.

In the wake of low interest rates following the global financial crisis, insurance investments shifted from sovereign bonds to higher-yielding corporate fixed-income positions. Recently, the focus has further shifted towards private assets as insurance managers seek enhanced yield amid rising volatility, driven by geopolitical tensions and inflation.

Evolving Regulatory Landscape

The European Union's updated Solvency II framework emphasises a risk-based approach, reducing capital charges for longer-term assets. Key changes include risk margin reductions and mechanisms to mitigate pro-cyclicality, encouraging insurance investors to allocate resources to stable, long-term investments through capital relief measures. Instruments such as the Matching Adjustment and Volatility Adjustment allow insurers to lower capital requirements by demonstrating stable, long-term cash flows.

Exploring Alternative Investments

Increasingly, insurance managers are turning to alternative investments—such as private equity, private credit, infrastructure, and real estate—to enhance risk-adjusted returns. These assets provide smoother valuations and less volatility, along with inflation hedges through floating-rate notes. The diversification benefits of alternative assets are significant, as they typically exhibit low correlation with traditional liquid strategies.

Investment-grade Collateralised Loan Obligations (CLOs) are particularly attractive, offering strong yields and diversification while matching various liability timelines. Insurance-linked securities, like catastrophe bonds, also provide additional diversification by shifting the risk of extreme events.

Challenges for Insurance Managers

Despite the regulatory shift favouring alternative investments, several barriers remain. The LTAF and ELTIF structures may introduce complexities, including potentially higher capital charges associated with riskier assets. Additionally, the opaque nature of private assets poses liquidity challenges, which can complicate balancing long-term liabilities against immediate cash flow needs.

Many insurance managers may lack experience with the governance and operational aspects of LTAF and ELTIF structures. Furthermore, clarity on investor classifications is crucial as it impacts regulatory focus on fund distribution.

However, these barriers and associated risks can be mitigated. Below we outline five key areas:

- 1. Addressing Liquidity Mismatches:** There are several mitigants to illiquidity. Private assets, held within an LTAF or ELTIF structure, can be held alongside liquid assets subject to certain restrictions like money market instruments, which can be sold quickly. The issue with the illiquidity of the asset classes can be circumvented when blended with more liquid strategies that can enter the LTAF or ELTIF. A robust private asset valuation platform will also facilitate quicker liquidation of assets (see area 5 below). In addition, the fund structures should have a sufficient liquidity management tool embedded in the documentation to avert liquidity constraints within an environment where redemption requests are high (e.g. redemption limits, minimum of quarterly redemption periods with notice and ability to introduce side-pockets if needed).
- 2. Managing Capital Charges:** Navigating capital charges associated with the Matching Adjustment and Volatility Adjustment is essential. The ability for the fund administrator to project stable cash flows from long-term investments is critical to minimising capital requirements. Insurance managers and their administrators should focus on thorough due diligence and continuous monitoring of asset performance to ensure compliance with regulatory frameworks.
- 3. Navigating Inexperience:** The LTAF and ELTIF structures and their requirements can be complex, particularly in relation to governance and operational oversight. Given the additional demands placed on illiquid assets, there is an expectation for managers to conduct stress tests on the liquidity of the portfolio. Developing a clear governance framework and understanding the specific requirements of these fund structures will be crucial in mitigating risks associated with inexperience. Continuous education and training in alternative asset management can also enhance operational capabilities. Specialist expertise to conduct liquidity stress testing is also essential.
- 4. Investor Classification and Distribution:** Understanding investor classifications is vital for effective fund distribution and regulatory compliance. Misclassification can lead to increased scrutiny and potential regulatory challenges. Insurance managers should implement robust systems for identifying investor types and tailoring fund structures accordingly to ensure alignment with regulatory requirements.
- 5. Ensuring Accurate Valuation:** The importance of a well-structured accurate valuation platform that produces high frequency valuations to smooth the portfolio marks and to circumvent any volatility issues, is paramount for long-term funds structures and for insurance managers entering the Alternatives space. The lack of transparency in private assets can hinder timely decision-making and impact liquidity. Establishing a reliable valuation framework that incorporates regular assessments and stress testing will be essential for managing potential risks and ensuring informed investment decisions, as well as helps manages to manage costs and improve efficiencies.

How Waystone Can Assist

As insurance managers consider the potential of LTAFs and ELTIFs, addressing the associated challenges is crucial for successful adoption. By partnering with an experienced advisor, such as Waystone, insurance managers can effectively navigate the complexities of alternative investments and fund structures.

Waystone's expertise in governance, distribution, valuation, and capital management supports insurance portfolios to harness the benefits of long-term investment strategies, ensuring sustainable growth in a dynamic market. Areas where we can assist include:

- Fund structuring and institutional governance, including [Management Company](#) and [Authorised Corporate Director](#) (ACD) services
- Independent [fund administration](#) solutions
- Valuation of private assets at a high frequency
- Liquidity stress testing of the portfolio
- Guidance on the oversight of the fund's underlying investors
- [Regulatory authorisation and ongoing compliance support and advice](#)

For further information, please reach out to your usual Waystone contact or contact us via the below.

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