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Recent NCOIL Resolution Looks To Stop Enhanced Cash Surrender Value Offers

Contents

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Editor's Letter
Volume 1 Issue 5 September 2022

Chris Wells
Managing Editor
Life Risk News

NCOIL, the United States' National Council of Insurance Legislators, issued a resolution in the summer, stating that insurance companies who are offering enhanced cash surrender values to life insurance policy holders are in breach of the country's standard non-forfeiture law. The resolution is seen as good news for life settlement fund managers, and for this month's cover story, Life Risk News spoke to **Tom Considine**, CEO at **NCOIL** and **Nat Shapo**, Partner at **Katten Muchin Rosenman** to find out more about what the impact of the resolution might be in *As Recent NCOIL Resolution Looks To Stop Enhanced Cash Surrender Value Offers.*

We're pleased to welcome a new team member to the Life Risk News stable this month; **James Norris** will be picking up the Life ILS beat going forward. Norris' first feature is a roundtable piece, *State of the Life ILS Market*, featuring insights from **Scott Mitchell**, Portfolio Manager and Head, Life ILS, at **Schroders**; **Niklaus Hilti**, Head, Insurance Linked Strategies at **Credit Suisse**; **Adam Robinson**, Head of Life and Chief Underwriting Officer (Life) at **Securis Investment Partners**; and **Craig Gillespie**, Head of Life and Alternative Credit Portfolio Management at **Leadenhall Capital Partners**.

The Insurance & Reinsurance Practice Group at law firm **ArentFox Schiff** are back this month with another litigation bulletin. This time, it's Geronta Funding v. Brighthouse Life Insurance Company, commonly known as *Seck*.

Our second commentary article this month sees **Jay Olshanksy**, Chief Scientist at **Lapetus Solutions** and **Wealthspan Financial Partners** and Professor of Public Health at the **University of Illinois at Chicago** offer his views on longevity and why some live longer than others in *How Time Reveals the Secrets to Longevity.*

This month's poll asked Life Risk News readers, *'Will Blockchain Technology Ever Be Truly Embraced by the Life Settlement Market?'* The results are not as cut and dried as some might think.

Our third commentary piece this month comes from **David Naughton**, Partner, and **David Williams**, Partner at **LK Shields Solicitors LLP.** Naughton and Williams look at the implications of a recent regulatory change to Ireland's QIAIF regime in *A Welcome Development for Life Settlement QIAIFs.*

Our *Q&A* this month features **WL Consulting**'s Managing Director **Roger Lawrence**. Lawrence is a veteran of the U.K.'s Traded Endowment Policy market, and he gives his thoughts on the market's demise and what other options – if any – investors have of accessing U.K.-based longevity risk.

Our final feature this month looks at the funded reinsurance market and it outlook for growth. *Life Risk News* spoke to **Douglas Anderson**, CEO at **Club Vita**, and **Rohit Mathur**, Head of International Reinsurance Business at **Prudential Retirement Strategies**, to learn more about what's happening in this corner of the risk transfer world in *Competition in Funded Reinsurance Market Heating Up.*

If you're interested in getting in touch, whether that's with an idea for a topic that you'd like to see covered, or just to offer some feedback, please drop the team a line at editor@liferisk.news. In the meantime, on behalf of ELSA, we hope you enjoy this new issue of *Life Risk News*.

Recent NCOIL Resolution Looks To Stop Enhanced Cash Surrender Value

Author:
Greg Winterton
Senior
Contributing Editor
Life Risk News

In the United States life insurance market, a standard, non-forfeiture law exists, adopted in every state based on a model from the National Association for Insurance Commissioners (NAIC), which stipulates that should a cash value life policy lapse, the policy holder will not forfeit the policy value because of missed premium payments. It's a consumer protection clause, designed to ensure that Americans don't miss out on the cash surrender value of the policy due to being unable to pay the premiums for a couple of months (or just forgetting to do it).

A certain part of the law was the subject of a recent resolution passed by the USA's National Council of Insurance Legislators (NCOIL) at its summer national meeting in June this year. Specifically, NCOIL felt that certain life insurance companies were violating the standard non forfeiture law's 'smoothness requirement', which was added in 1980, and prohibits sharp, temporary increases in cash surrender value offers; ergo, NCOIL felt that these 'enhanced cash surrender value offers' (ECSVOs), from life insurance companies were illegal.

"The legislators believe that these new enhanced cash surrender offers don't comply with the standard non-forfeiture law," said NCOIL CEO Tom Considine. "We think these offers violate that law and regulators shouldn't be approving any endorsements that take that approach because they are in violation of the law."

> **"The legislators believe that these new enhanced cash surrender offers don't comply with the standard non-forfeiture law."**

Industry says that the issue at hand is one of fairness. The smoothness requirement of the standard non-forfeiture law is designed to ensure that a consumer doesn't miss out on a potential windfall by selling their policy before they might receive a higher offer, or that they don't have the time to make an informed decision before the offer expires.

Nat Shapo, a Partner at law firm Katten Muchin Rosenman, who represented the Life Insurance Settlement Association at the NCOIL summer meeting, says that the ECSVOs from life insurance companies didn't come close to adhering to the letter of the law.

"It would be hard to intentionally design a product less compliant, or with a less smooth progression of cash surrender values," he said.

The NCOIL resolution is not a law; the individual states make their laws. Often, changing legislation can take months, if not years, with millions of dollars spent by both sides of the debate trying to get the lawmakers to see their point of view. This situation is not that, however; the law exists, so the next step is getting the state insurance departments to simply tell life insurance companies to stop issuing ECSVOs and withdraw the ones that have been made.

"Withdrawing an approval generally follows the same standard as denying an approval in the first place: if the form violates the insurance code, its use is prohibited. What NCOIL has called for can be done at any time in any state," said Shapo.

Regardless of how quickly state regulators withdraw the approvals for ESCVOs, the life settlement industry is a particular beneficiary. In life settlements, the sale process from policy owner to investor is heavily intermediated, where policy owners go through brokers, and investors go through providers. Other firms providing services such as life expectancy modelling, legal services, and tax and accounting services, contribute to the overall ecosystem. The process exists to ensure that the broker or insurance agent representing the policy owner, and the investor who purchases the life settlement, are adhering to their fiduciary duty to their clients. Trade body the Life Insurance Settlement Association lobbied NCOIL to take action regarding ECSVOs and is naturally pleased at the outcome.

"The Life Insurance Settlement Association (LISA) and its members applaud NCOIL's recent resolution which identified certain ECSV endorsements as illegal and in violation of standard nonforfeiture law," said John Welcom, the CEO of Welcome Funds and LISA's Chair.

"NCOIL's leadership on this issue will ensure that in-force consumer protections are conveyed to policy holders."

Life insurance companies have only been offering ESCVOs since around 2018, and even then, only a few companies have made these offers to policyholders.

The policies that have been the recipient of an ECSVO are those that would typically qualify for a life settlement transaction – higher maturity value universal life policies. But whilst the life settlement industry does benefit from the ruling, it argues that the consumer does, too.

> **"NCOIL would hope and expect that regulatory approvals would come to an almost immediate end."**

"In life settlements, the policy owner has recission rights, which usually lasts for a minimum of 15 days, which enables them to remedy seller's remorse. Brokers have a fiduciary duty to get the best price for their clients, and doctors are required to provide a certificate of competence, declaring the policy seller competent enough to enter into the transaction," said Shapo.

But one argument goes the other way. Assuming the states do follow NCOIL's resolution and withdraw approvals for ECSVs, isn't that both anti-competitive and bad news for the consumer? Surely, for the American consumer, isn't the opportunity to realise a higher sale price for their life insurance policy a positive?

According to Considine, it's not that clear cut.

"It's necessary for all consumers who have the same type of policy to be treated equally. If you and I have the same policy and you get a letter saying for the next 3 weeks, you can take advantage of this enhanced cash surrender deal, but I don't, that's not fair. It's the job of legislators in state insurance departments to protect fairness for everyone," he said.

The life insurance industry isn't giving up. A spokesperson for the American Council of Life Insurers, Whit Coleman, said in an emailed statement to Life Risk News:

"During the March 2022 NCOIL meeting, Oklahoma Insurance Commissioner Glen Mulready suggested that a request be sent to the NAIC Life Actuarial Task Force to revisit this issue and determine if clarifications are necessary. We believe that is the appropriate place to continue discussion of this issue, and we hope it will result in a clear path forward."

Still, NCOIL expects swift action.

"NCOIL would hope and expect that regulatory approvals would come to an almost immediate end. We also think that the industry is well on notice of this, that insurance companies will be far more hesitant about filing these things. By NCOIL taking this action, we're saying that regulators shouldn't approve this and if need be, we'll tighten the legislation around this," said Considine.

Roundtable
The State of the Life ILS Market

Author:
James Norris
Contributing Editor
Life Risk News

The life ILS market has evolved in the past twenty years from what was a niche market to a fully-fledged asset class. Life Risk News' James Norris spoke to four leaders in the life ILS market to get their views on a range of topics affecting their market in our inaugural life ILS roundtable.

JN: What is the main issue or development from a macro perspective in the past twelve months that has had the biggest impact on the life ILS sector, and why?

SM: Covid-19 has naturally been a focal point over the past few years, especially in the context of extreme mortality risk transferred to the ILS market. While no longer the headline that it was, mortality at working ages remains higher than pre-Covid levels in some countries, notably the US and the UK. That ongoing uncertainty continues to impact the relative attractiveness of mortality risk for investors.

> "Covid-19 has naturally been a focal point over the past few years, especially in the context of extreme mortality risk transferred to the ILS market. While no longer the headline that it was, mortality at working ages remains higher than pre-Covid levels in some countries, notably the US and the UK."

AR: In the last twelve months, there have really been two main macro events that have impacted the Life ILS sector. The first is the 'exit' from Covid as a global pandemic state, the second (and more recently) has been the global hike in rates. The exit from the pandemic allows ILS participants – and crucially investors in the sector – to consider a more 'normal' mortality experience (i.e., a baseline level of mortality, though defining this remains a challenge).

This is important for trade pricing by ILS participants (more stable mortality means pricing is not so wide on risk-bearing trades, increasing the chance of transacting) and it allows investors to invest without any hanging concern of investing in Life in the midst of the largest Life shock event since the start of this sector.

On the rates side, how this will impact the sector is still unclear. It will require ILS participants to seek higher absolute returns as investors require a certain spread above risk-free. A consequence of this is that longer-dated cash flows become relatively less valuable. This may mean there are fewer attractive long dated trades to participate in as the value in longer dated cash flows reduce much more than the shorter dated, as rates go up. There will also be an angle allowing Life ILS funds to 'pick' the best opportunities. Rates have risen alongside inflation and a cost-of-living squeeze.

This may mean existing insurance policies become less affordable, pushing up lapse rates in the future. However, choosing to transact with counterparties who have 'stickier' insurance products (think of an individual buying a product as a necessity rather than a luxury) can counter a lot of this risk and allow Life ILS funds to demonstrate relative expertise compared to peers.

CG: The major development from a macro perspective emerging in 2022 is a scarcity of capital driven by investor's reaction to geopolitical conflict and an aggressive rate tightening cycle being implemented in unison by central banks in developed countries.

Prior to these shock events over the last 12 months, financial markets and their participants had become accustomed to operating in a stable environment where capital was plentiful. This period of equilibrium had operated for over a decade with only minor short-lived disruptions being experienced (for example the initial emergence of Covid in early 2020 which was quickly addressed via government and central bank action).

Niklaus Hilti
Head of Insurance Linked Strategies
Credit Suisse

The large disruptive macroeconomic events we are currently experiencing are unlikely to be so easily remedied as other shocks over the last 10 years, and so consequently it is likely that this scarcity of capital may persist for some time.

The Life ILS sector provides capital to the life and health insurance markets, and these businesses are by nature capital consumptive. A broader scarcity of capital in financial markets therefore changes the dynamic in which the Life ILS sector works with these insurance markets to continue providing the capital necessary for these businesses to continue growing and fulfilling their business plans. This backdrop of uncertainty and volatility provides attractive investment opportunities for managers that are well positioned to provide capital solutions to the life and health insurance markets.

JN: What, in your view, is the biggest misconception that end investors have about the Life ILS market, and what is the impact of this misconception on the Life ILS market?

NH: I'd like to highlight two points from our experience: The first and most important one is that investors believe Life ILS is synonymous with the US life settlement market. However, Life ILS is much broader, and the variety of risks is much greater than just longevity risk in the US life settlement market.

The second misconception held by some institutional investors, particularly pension plan investors, is that by allocating to Life ILS they would be taking on significant longevity exposure that is correlated with their own longevity liabilities. In fact, there are many Life ILS transactions that serve as a hedge to their longevity risk or are neutral.

> **"Investors believe Life ILS is synonymous with the US life settlement market. However, Life ILS is much broader, and the variety of risks is much greater than just longevity risk in the US life settlement market."**

CG: Our experience is that institutional investors are in general sophisticated with a good understanding of the portfolio benefits that can be obtained through allocating to alternative assets such as Life ILS. Institutional investors have the option of selecting from many different alternative assets for their portfolios and so it is not always possible for these investors to have sufficient time or resources to fully appreciate the breadth and depth of investment exposures which might be taken on through a Life ILS mandate.

Misconceptions can arise whereby an investor's understanding of a Life ILS allocation is simplified to having just one type of exposure where they have had less favourable experience in the past or have heard negative market sentiment on one specific type of Life ILS investment exposure. For example, some investors immediately connect Life ILS as being Life Settlements whereas the universe of investment opportunities in Life ILS is vast across mortality, lapse, morbidity, and longevity risks.

Life ILS mandates are often offered by an investment manager specialising in both Life and Non-Life ILS, and this may also give rise to a potential misconception whereby an investor may try to understand the Life ILS offering starting from a Non-Life ILS perspective. The Life ILS and Non-Life ILS investment profiles differ significantly, and so to get to the level of understanding necessary for an investor to have conviction to allocate requires the manager to help ensure the investor approaches each product from the right perspective.

Either of these misconceptions can ultimately lead to investors not committing to a Life ILS allocation, and therefore the market not growing to the size it should, given the opportunity set that is available.

JN: What is your view on the capacity for growth in the Life ILS market? Are we only scratching the surface? Is it quite mature, with little capacity remaining?

NH: We see significant growth potential in the life segment. Regulatory developments and in particular the development of more sophisticated risk models for life insurance will continue to drive momentum in ILS for life insurance over the next decade. We also believe that higher financing costs with increased interest rates will play an important role in the further development of the market.

AR: I believe the market has significant growth potential. There has been a shift in the distribution model whereby smaller start-up brokers are trying to find gaps in the market to sell new products to (typically protection products to segments of the market with a 'protection gap'). This contrasts with the older mode of insurers selling more 'one size fits all' products directly. These brokers need capital to grow, and the ILS market is perfectly placed to help with this.

Geographically, most Life ILS investments have been in Europe

Scott Mitchell
Portfolio Manager,
Head of Life ILS
Schroders

and North America. The rest of the world could be thought of as an untapped market, which I am sure will lead to growth.

On risk-bearing trades, reinsurers are again engaging in conversations to see what pure risk trades they can push to the Life ILS market, these are trades which are not motivated by a financing need. This is likely to be a growth area considering most Life ILS trades over the prior years have had more of an underlying financing rather than risk motivation from the counterparties.

JN: Interest rates have been rising recently in developed markets, offering investors a better return on more liquid yield generating products like government bonds. What's the impact of this on the life ILS sector, given that a sizeable chunk of the market is aligned with 'alternative credit'?

NH: We are observing a "pause effect" and currently also recommend prospective investors to wait and see. This is mainly driven by the fact that the more liquid markets are adapting to the new interest rate environment much faster than the illiquid Life ILS market. Once the new pricing has fully filtered through, we believe Life ILS can be as attractive as other asset classes, but with the distinct advantage of being only marginally correlated to financial markets. The recent market turmoil has once again shown investors that most asset classes are highly correlated. Accordingly, we expect to see increased demand for true alternative strategies and uncorrelated asset classes.

> "In our experience, those investors that have actually been allocating to the Life ILS market have done so on the basis of achieving a defined spread relative to an underlying liquid benchmark, such as government bonds, and so from that perspective changes in the underlying liquid benchmarks should be neutral."

SM: We continue to observe strong demand for Life ILS from institutional investors, in particular, those that recognise the relative risk-return profile and diversification offered by Life ILS as part of a broader portfolio. However, for certain investors, the interest rate environment is influencing their overall approach to asset allocation. For example, the funding position of defined benefit pension funds will likely have benefited from recent rate increases, perhaps resulting in less need to allocate to alternative asset classes such as Life ILS.

CG: In our experience, those investors that have actually been allocating to the Life ILS market have done so on the basis of achieving a defined spread relative to an underlying liquid benchmark, such as government bonds, and so from that perspective changes in the underlying liquid benchmarks should be neutral.

There is a section of investors that allocate and invest on an absolute return basis and the changes in more liquid investments have both positive and negative impacts. For those investors with higher absolute return targets, it may become more desirable to allocate to the Life ILS sector as the absolute returns achieved may now be higher and in line with their requirements. For those investors with lower absolute return targets, it may now become less desirable as they are able to achieve their return target through more stable investments.

There is always a place for an allocation to an alternative asset such as Life ILS within an institutional investor's portfolio due to the diversifying investment profile on offer. We would not see liquid fixed income as a competing product, as Life ILS is designed to be a broadly uncorrelated diversifying investment class, which liquid fixed income is not. Life ILS does exhibit certain attractive characteristics (such as cash flow generation) similar to fixed income, and so these in conjunction with the diversification make Life ILS well worthy of allocation to an investor's portfolio.

JN: In which product areas of the broader Life ILS universe have you seen most growth in during the past twelve months – i.e., are there products that you have been investing in more than others, and if so, why?

NH: With the increased risk perception in connection with the pandemic risk, we have seen a reassessment of mortality risks. Multiples have increased by a factor of 4 to 5 compared to before the pandemic. However, we are currently holding back on new investments, as we believe the returns in 2023 will be significantly more attractive. We are also hesitant on longevity risk, at the moment, as the rebound effect after a pandemic is not well understood and we therefore believe that longevity risk cannot be properly assessed towards the end of or after a pandemic.

Adam Robinson
Head of Life and Chief Underwriting Officer (Life)
Securis Investment Partners

SM: Since launching the Life

ILS strategy, Schroders has seen continual growth in its core segment of structured financing, such as embedded value and commission financing arrangements. In recent years, we have also seen increased activity around privately placed debt and other capital instruments.

JN: What are some of the headwinds facing the Life ILS sector in the next twelve months and what's their likely impact?

SM: Structural barriers must be addressed before the life industry can consider meaningful volumes of longevity and mortality risk being transferred to the capital markets.

For the most part, longevity trades are not particularly investor-friendly, in terms of their structure and duration. Most of the risk, therefore, remains with the traditional (re)insurance market, which can leverage the cross-diversification benefits more easily than a Life ILS fund. The traditional (re) insurance market will likely have to hit capacity constraints before we see a forced change in those dynamics.

Despite increased demand for mortality risk transfer, capital markets investors will need to be convinced that residual uncertainty from Covid, both in terms of baseline mortality rates but also future pandemic risk, has been adequately addressed in deal structures and modelling.

> **"Most funds made positive returns, returned cash from closed-ended strategies, and did not suffer the mark-to-market volatility of more liquid strategies. The last few years should be viewed as an acid test for the Life ILS strategy, and I hope it would encourage investors to continue to put money into this sector."**

AR: With rates going up, longer dated cash flows can be less valuable when priced. This would reduce the relative gain in a counterparty choosing to finance with longer term financing compared to short term financing (put simply, counterparties get less money from locking in longer term financing compared to simpler shorter-term financing). I believe the other benefits of Life ILS (it's risk-bearing nature, the bespoke structuring which can give different accounting treatments) can counter some of this but clearly it can create a 'headwind'.

CG: Scarcity of capital is likely to continue be a theme throughout the remainder of 2022 and into 2023. We see this as both a headwind and a tailwind for the Life ILS market.

It presents as a headwind on the basis that investors may be more cautious to allocate or likely to allocate in smaller sizes than in prior years. With mainstream assets (for example equities and fixed income) suffering significant loss of value in 2022, and alternatives such as Life ILS demonstrating their diversifying characteristics by continuing to perform, this has led to some investors becoming overweight to alternatives. Some investors are now having to rebalance their portfolios to meet their strategic asset allocations, and this can lead to a reduced allocation to alternatives such as Life ILS.

From a pure risk standpoint, it is also worth noting that the outlook for mortality risk remains clouded with Covid-19 remaining present and concerning trends emerging in other causes of death in certain countries. Drug-overdose linked deaths in the USA have continued to grow and contribute to excess deaths in working age groups, and cardiac and circulatory disease incidence has also driven excess deaths in the UK during summer 2022. The impact of these events on portfolios has been limited so far, however they present a continuing challenge to the underwriting of mortality exposed investments.

JN: What about the tailwinds and their likely impact?

NH: We believe that the increased financing costs for life insurers will drive growth and reinforce the attractiveness of value-in-force financing transactions as an attractive alternative; a perception of increasing risk related to pandemic risks will require life (re)insurers to buy hedges; and life insurance risk is almost independent of inflation, and unlike non-life insurance, where inflation increases claims, the cost of life insurance is fairly inert.

SM: We currently consider deal flow, rather than investor capital, as being the main constraint of growth for the Life ILS market. However, as industry participants target a more optimal capital structure, they are increasingly recognising the benefits of the Life ILS market as a source of hybrid capital that offers a combination of liquidity and risk absorbing features. That will ultimately drive the growth of the market, in our view.

Craig Gillespie
Head of Life and Alternative Credit Portfolio Management
Leadenhall Capital Partners

AR: The Life ILS market faced what could be considered in simple terms as its first '1 in 100-year event' with Covid.

Despite this, most funds made positive returns, returned cash from closed-ended strategies, and did not suffer the mark-to-market volatility of more liquid strategies. The last few years should be viewed as an acid test for the Life ILS strategy, and I hope it would encourage investors to continue to put money into this sector.

CG: Life and health insurance markets continue to have a need for plentiful capital to meet their ongoing business requirements. Capital being deployed now to meet the needs of the life and health insurance markets is being better rewarded in terms of risk-return profile as a result of the broader scarcity of capital.

The change in macroeconomic environment over 2022 has also had significant effects on life and health insurance balance sheets and this in itself presents opportunity as these businesses look to re-optimise their balance sheet for the new environment.

For those managers who have capital available to deploy, the current environment to structure innovative and impactful investments is favourable, and investors who have made these capital commitments stand to benefit from an improved risk-return profile on their capital.

Litigation Bulletin: Seck

Geronta Funding v. Brighthouse Life Insurance Company

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Insurance & Reinsurance Practice Group
ArentFox Schiff

On August 25, 2022, the Delaware Supreme Court adopted a fault-based analysis framed under the Restatement (Second) of Contracts ("Restatement") to determine if life insurance policy premiums should be returned in a case where the policy is found to be void ab initio for lack of insurable interest. Geronta Funding v. Brighthouse Life Insurance Company, No. 380, 2021 (D. Del. 2022) ("Seck"). In doing so, the Court effectively overruled a number of federal Delaware court decisions that have held that a life insurer is required to return premium to an investor if the policy is void for lack of insurable interests. The Court remanded the case to the Superior Court to determine if the life insurer had inquiry notice that the policy may have lacked insurable interest, and how such a finding may affect the return of premium issue under the new framework provided by the Court. While the Seck decision has provided a general framework for courts applying Delaware to utilize on the return of premium issue, it has left a number of questions unanswered, such as whether a tertiary market owner is entitled to recover premiums paid by prior policy owners, and what specific inquiries should be made as to the carrier's actual and constructive knowledge of red flags, and what inquiries an investor should make before purchasing a policy (and whether industry standards will provide a benchmark).

In July of 2007, Brighthouse Life Insurance Co.'s predecessor received an application in New Jersey to insure the life of one Mansour Seck, identified as a 74-year-old French citizen residing in New Jersey. The Seck Policy amount was $5M; the owner and beneficiary were identified as the "Mansour Seck Irrevocable Life Insurance Trust;" and the applicant's agent was a broker named Pape Seck. The life insurer followed its usual underwriting protocols and issued the policy.

In 2009, after expiration of the 2-year contestability period, the Seck Policy was sold on the secondary market to EEA Life Settlements, Inc. In 2015, the Seck Policy was sold again, this time to Geronta, a hedge fund, as part of a portfolio purchase in a tertiary market transaction.

Shortly after acquiring the Seck Policy, Geronta suspected that the Seck Policy's insured, Mansour Seck, was fictitious. After performing an investigation and determining that the pedigree information for Mansour Seck was incorrect, in April of 2017, Geronta notified Brighthouse of its concerns. Geronta wanted to rescind the policy with the carrier and recover all of the premiums that it and the prior owner had paid for the policy. Brighthouse agreed to rescind the policy but refused to return the premiums. In 2018, Brighthouse commenced a lawsuit in the Delaware Superior Court against Geronta, seeking a declaration that the Seck Policy was void ab initio for lack of insurable interest, and an order that it was allowed to retain all of the premiums that it and its predecessor had paid for the policy. Geronta counterclaimed, seeking to recover the premiums on a theory of restitution. The parties stipulated that the policy was void ab initio for lack of insurable interest. The only issue to be determined was who would get the premiums paid for the policy by the secondary and tertiary market investors.

The Delaware Superior Court held a bench trial and ruled that Brighthouse could keep all premiums paid to keep the policy in force after April 21, 2017, the date that Geronta had told Brighthouse that it suspected that Mansour Seck was not a real insured. But the Superior Court found that Geronta was not entitled to recover any premiums that it or its predecessor had paid prior to the date that it notified Brighthouse of its suspicions. The Superior Court purported to follow the Restatement in its determination. Generally, under Restatement § 197, a party to an agreement that is unenforceable on public policy grounds cannot seek restitution (here, the recovery of premiums) unless that party is able to prove an applicable exception. The Superior Court focused on certain exceptions set forth in Restatement § 198, which may apply if the party seeking restitution proves either (a) it was excusably ignorant of the facts that caused the agreement to be unenforceable, or (b) it was not equally at fault (in pari delicto) with the other party to the contract. The Superior Court concluded that Brighthouse was not at fault because it had followed its underwriting guidelines in issuing the policy and did not have actual knowledge that the policy lacked insurable interest. The Superior Court determined that Geronta was not excusably ignorant of the problems with the policy, or equally at fault with the insurer, primarily because it had made a strategic decision not to review information that it had received regarding the policy before purchasing it, which information would, according to the Superior Court, have indicated red flags.

Because this was a matter of first impression for the Delaware Supreme Court, it surveyed what other courts across the nation have done in similar situations and found that the courts generally have adopted one of the following approaches: (1) rescission and automatic disgorgement of premiums; (2) restitution under a fault-based analysis grounded in considerations specific to insurance policies declared void ab initio for lack of insurable interest; and (3) restitution under the Restatement. The Court specifically noted that the majority of the courts that it surveyed determined that the premiums should be returned to the investor after undertaking a fault-based analysis.

The Court adopted restitution under a fault-based analysis as framed by the Restatement as the test to determine whether premiums should be returned when a party presents a viable legal theory, such as unjust enrichment, and seeks the return of paid premiums as remedy. It instructed Delaware courts to analyze the exceptions outlined in Sections 197, 198, and 199 of the Restatement, including whether: (1) there would be a disproportionate forfeiture if the premiums are not returned; (2) the claimant is excusably ignorant; (3) the parties are not equally at fault; (4) the party seeking restitution did not engage in serious misconduct and withdrew before the invalid nature of the policy becomes effective; or (5) the party seeking restitution did not engage in serious misconduct, and restitution would put an end to the situation that is contrary to the public interest.

While the Superior Court had concluded that Brighthouse did not have actual notice that the policy lacked insurable interest, it failed to determine whether Brighthouse had inquiry notice of the same. The Court remanded the case to the Superior Court for a determination on this issue in light of the framework that it had adopted and articulated in its decision, and identified a number of facts either stipulated to by the parties or found by the Superior Court, some dating back to December of 2009, that could support a finding that Brighthouse was on inquiry notice of facts tending to suggest that the policy was void.

The Delaware Supreme Court's decision in Seck requires courts applying Delaware law to take a balanced approach and consider the carrier's actual and constructive knowledge in addition to the conduct and red flags that may have been available to the investor that seeks to recover premiums paid on a void policy.

As the Court stated, in addition to incentivizing investors to actually and thoroughly investigate all policies to avoid the risk of losing their premiums, "[a] fault-based analysis also incentivizes insurers to speak up when the circumstances suggest that a policy is void for lack of insurable interest because they will not be able to retain premiums if they stay silent after being put on inquiry notice, and they might also be responsible for interest payments. In other words, our test incentivizes each player along the chain of these insurance policies to behave in good faith."

But the Seck decision did not address which premiums an investor may be entitled to recover (all premiums paid for the policy by the current owner and prior investors, or just premiums that the current owner paid either directly or via a securities intermediary). And the decision did not explain the inquiries that carriers and investors should make in their respective capacities as they may pertain to the fault-based analysis under the Restatement.

Unfortunately, the Seck decision will likely increase litigation and its related costs on the return of premium issue—a subject that was fairly straightforward, at least with the Delaware federal courts which had predominantly ordered life insurers to automatically return premium in whole or in part if the policy was found to be void for lack of insurable interest.

How Time Reveals the Secrets to Longevity

Author:
S. Jay Olshansky, Ph.D., Chief Scientist at **Lapetus Solutions** and **Wealthspan Financial Partners** and Professor of Public Health **University of Illinois at Chicago**

"The passage of time uncovers subgroups of the population with unique attributes that enable them to live long."

Many years ago, my 85-year-old mother and 90-year-old father were at dinner with my wife and I. When the meal was over, the time arrived to decide whether to have dessert. Mom looked down at her pudgy self and declared, as she had every night for the previous seven decades, that she needed to begin watching what she was eating in order to lose weight.

As a professor of public health, you might expect my first reaction would have been to agree with her. Decades ago, yes, but at her age my reaction was the exact opposite. I said Mom, if carrying excess weight was a harmful risk factor for you – you'd be dead already. Go ahead and enjoy dessert, just not in excess. She did just that, with a sense of relief I might add.

This paradox is an example of a public health phenomenon known as "selective survival". That is, the passage of time uncovers subgroups of the population with unique attributes that enable them to live long. Selective survival is also the reason why some now suggest that Covid-19 culled the weaker and more frail members of humanity with pre-existing health conditions – leaving behind a more robust population that could yield a post-Covid life expectancy rebound.

These unusual and often rare survivors are interesting because they're somehow protected from a relentless and well-established lethal risk factor, such as smoking. The documented longest-lived person in history – Jeanne Calment from France. She died in 1997 at the age of 122, and she smoked for more than a century.

For the same reasons, this is also why many researchers in the field of aging like to study the genetics of centenarians – because time shines a spotlight on them as beacons of hope as researchers scramble to understand what's different about these people, and whether it's possible for science and medicine to discover and then find a way to confer their survival advantage on the rest of us.

Consider a hypothetical experiment where we start out with 1 million babies born in a given year, and half of them are required to begin smoking by age 10 while the other half remain non-smokers throughout life. The average duration of life for the smokers would be many years shorter than the non-smokers. However, 100 years after this otherwise fateful experiment, time would reveal a small percentage of the original half million smokers still alive 90 years later, for whom smoking was never a risk factor to begin with.

This is how selective survival operates. Ironically, this is also how evolution works. Differences in survival (and fertility) reveal population subgroups with different risk factors and survival prospects.

Some people survive to extreme old age carrying with them a lifetime of behavioral risk factor baggage that tends to kill everyone else at a much earlier age. These folks smoke cigarettes, drink excessively, eat large amounts of fat; etc. Basically, everything your doctor and mother tell you that you shouldn't be doing. Yet they survive anyway. This is the main reason why a generic approach to survival analysis where people with certain risk factors are all treated exactly the same – using a common mortality multiplier – will often lead to grossly incorrect estimates of survival. The bottom line is that people experiencing exceptional longevity often do not exhibit healthy lifestyles, whichtells you there are other reasons why they live so long. Genetics!

> **"Somescientists suggest that highly efficient DNA repair can be an acquired trait – but researchers are still working out the details."**

This brings me to a recent scientific discovery: "We may finally know why so many lifelong smokers never get lung cancer". The secret is in their genes. There is a group of cells in our lungs known as bronchial epithelial cells that accumulate genetic damage every time they divide. These are the cells most likely to transform into cancer cells within the lungs and they're the primary cells involved in lung cancer. The process of transforming bronchial epithelial cells into cancer cells is determined by the amount of abuse we exact on our lungs during the course of life (either on purpose or by accident), and the level of DNA repair that operates within those cells.

In a study of exceptionally long-lived lifelong smokers compared with younger people – including both smokers and non-smokers; it was discovered that the long-term smokers that survived to extreme old age experienced genetic mutations that slowed considerably after about 23 years of tobacco abuse. That is, they had exceptionally powerful DNA repair mechanisms that were so effective, they eliminated or dramatically delayed the risk of lung cancer – even in the presence of decades of self-inflicted tobacco abuse.

It is believed that these highly efficient DNA repair mechanisms are inherited, although some scientists suggest that highly efficient DNA repair can be an acquired trait – but researchers are still working out the details.

Either way, we now think we know how some people can live so long after decades of inhaling toxic substances that kill the rest of the population at a much younger age. Although we're nowhere near determining in advance, at younger ages, whether you're a member of the population subgroup that has superman DNA repair in bronchial epithelial cells, that time might not be far off.

September 2022 Poll Results

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Will Blockchain Technology Ever Be Truly Embraced by the Life Settlement Market?

Blockchain technology is all the rage, especially in the start-up and venture capital world, it's apparent industry-agnostic applicability leading to billions of dollars of investment. In the life insurance and life settlement world, proponents argue that it can put all of the details about a life insurance policy in one place, eliminating the vast amounts of paperwork, both physical and digital, that prevail in the market today.

So, this month, we asked Life Risk News' readers their thoughts on whether blockchain technology will be fully embraced by the life settlement market in the United States.

The results aren't conclusive. Only a quarter – 26.5% - said that they thought it was inevitable and only 11.8% said that no, there are too many headwinds. That leaves approximately two thirds of survey respondents unsure. 23.5% say that adoption by carriers will be a driving force in terms of more widespread adoption, and 38.2% say that adoption by the wider financial markets will be the main driver.

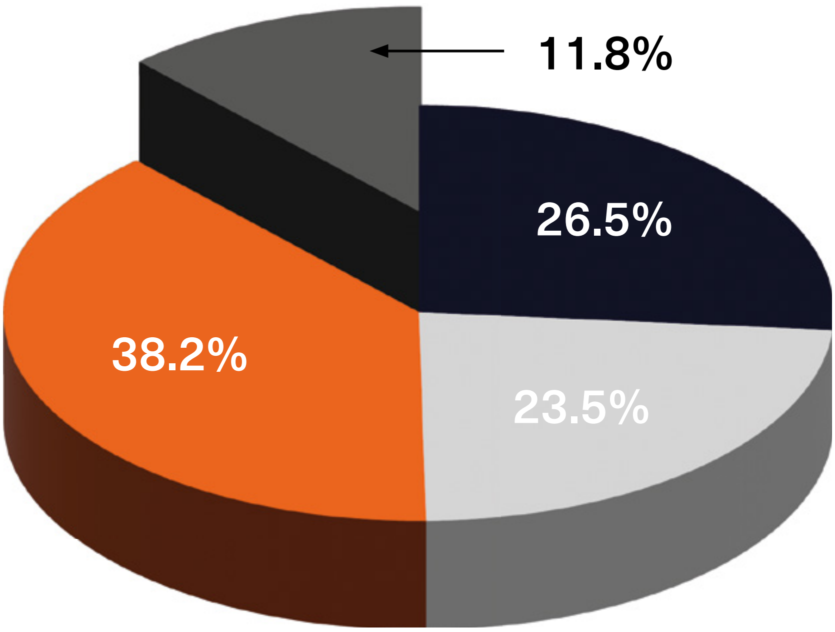
The results perhaps speak to the still nascent state of blockchain technology and the comparative lack of adoption in business and industry generally. Who is right remains to be seen, but a recent development in the industry may well provide a kick start. In July, Abacus Life and Longevity Market Assets announced a partnership with BlockCerts Web 4.0 which will see Abacus Life transact a policy entirely on the blockchain. Those who care about such things will be keeping a keen eye on whether this is indeed the beginning of a new paradigm for the life settlement market.

Unsure, it depends on wider adoption in the financial markets

Yes, it's inevitable

Unsure, it depends on wider adoption from carriers

No, there are too many headwinds



A Welcome Development for Life Settlement QAIFs

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> "The success of the QIAIF regime has been reliant on its speed to market due to the Fast-Track Authorisation Process"

In a welcome move, the Central Bank of Ireland ("CBI") has simplified the authorisation requirements for Qualifying Investor Alternative Investment Funds ("QIAIFs") that invest in life settlements by confirming that pre-submissions are no longer required in connection with their applications for authorisation. These QIAIFs are once again included in the categories of QIAIFs that may avail of the CBI's 24-hour fast-track authorisation process ("Fast-Track Authorisation Process").

Fast-Track Authorisation Process for QIAIFs

A QIAIF is an alternative investment fund ("AIF") authorised by the CBI, under the European Union (Alternative Investment Fund Managers) Regulations 2013 and its AIF rulebook, marketed to professional investors and other high net worth individuals and catering to the widest range of investment strategies in a robustly regulated environment.

The success of the QIAIF regime has been reliant on its speed to market due to the Fast-Track Authorisation Process, which was introduced in 2007 to facilitate the authorisation of QIAIFs within a 24-hour period by the CBI.

In 2020, however, the CBI introduced a pre-submission process for certain types of QIAIFs, including life settlement QIAIFs.

The requirements of the pre-submission regime allows the CBI to raise queries and request additional information. Only once this process has completed and the application is cleared of comment may the QIAIF proceed to the Fast-Track Authorisation Process.

For those QIAIFs required to make a pre-submission, this process results in longer launch timeframes and diminishes the key advantage of establishing QIAIFs in Ireland via the Fast-Track Process.

Pre-Submissions No Longer Required for Life Settlement QIAIFs

On 1 July 2022, the CBI updated the guidance on its website (here) regarding the pre-submission process. One of the key changes is that this process is now only required for QIAIFs investing in global crypto assets or property assets situated in Ireland.

A pre-submission is not required for QIAIFs investing in any other asset classes and life settlement QIAIFs can once again avail of the Fast-Track Process. This is a positive reflection of the quality of submissions made in connection with life settlement QIAIFs and industry's engagement with the CBI.

Benefits for Life Settlement QIAIFs

Life settlement QIAIFs are now authorised by the CBI within 24 hours of submission of a complete application including certifications from the proposed legal adviser, alternative investment fund manager and depositary. If submitted by 5 p.m. on a business day, the QIAIF is authorised by the CBI on the following business day.

This encouraging development demonstrates the CBI's openness to its authorisation of life settlement QIAIFs and is of significant benefit to promoters due to the resultant predictability and speed to market. This considerably enhances the attractiveness of establishing these structures in Ireland.

The CBI will carry out periodic quality assurance reviews of authorised QIAIFs and may in the future update the list of QIAIFs on its website that are required to make a pre-submission. Managers of life settlement QIAIFs should continue to ensure that submissions are of a high quality and to engage positively with the CBI, were deem necessary.

ELSA

Secondary Life Markets Conference 2022

TUESDAY 20TH SEPTEMBER 2022
CANARY WHARF, LONDON, UK

For more information please reach out to ELSA Executive Director Chris Wells on info@elsa-sls.org

Q&A

Roger Lawrence

WL Consulting

The Traded Endowment Policy Market in the United Kingdom is slowly coming to an end. Changes to taxation of these policies means that investors shied away and coupled with insurance companies writing less of these policies over time, means that what was once a robust secondary life market in the U.K. is no more. Life Risk News spoke to Roger Lawrence, Managing Director of WL Consulting, to learn more about the industry's demise.

LRN: Roger, 2022 marks the maturity of endowment policies sold in 1997, the final year that these policies were written; it spells the end of a market that dates back to the middle of the 19th century. How have we got here?

RL: Yes, the market dates back to 1843 when auctioneers H E Foster & Cranfield started auctioning pure life risk policies alongside esoterica. This expanded into other assets with an element of life risk, such as will trusts that might have a life tenant, usually a spouse of the deceased, living in a property or receiving an income form an investment portfolio for life before reversion to the children. This developed into the endowment assurance market in the mid-1980s when the levels of new policy origination suddenly boomed in 1983 as a tax-efficient means to repay house purchase mortgages.

A staged reduction in those tax breaks from 1988 through to final abolition in 2000 put paid to all of that. However, as you say, by 1997 the small tax benefits that were left and an increasingly difficult task to generate a positive return spread over mortgage interest costs put paid to policy sales.

At that time most mortgages were for a 25 year term, meaning this year marks a sad moment for me, having worked in the policy trading industry for 27 years. There remain a small population of longer termed policies still to run off and a few small mutuals do continue to offer new policies as savings vehicles but this will never be enough to sustain a Traded Endowment Policy or TEP market going forward. All we have left now is a small mainly intra-fund tertiary market.

LRN: Has the tontine effect occurred in practice as many predicted it would?

RL: The rapid contraction in both the number of open insurance funds over the last 20 years to barely a handful has meant a lot of closures, consolidations and run offs. For many, their endowment business was huge and during the 2000s many commentators were predicting a sort of tontine effect occurring. Insurers carry substantial surpluses, for their own and regulatory purposes and as the liabilities run off the surplus mushrooms as a percentage of the remaining liabilities.

There were a few cases of early fund closures reaching this point, notably Phoenix Assurance, National Employers Liability and Reliance Mutual and in a belated attempt to distribute the surplus, policy payouts were enhanced by two, five and even ten times the basic policy asset share. This was good evidence of a tontine effect in the making. However the UK regulator (the FSA at the time) was becoming much more pro-active and was determined that some of these extreme distortions should not be repeated. Their guidance was for life offices to distribute surplus as evenly and early as practical and this began being implemented in the early 2010s.

Having bought policies before the start of this distribution process would mean secondary policyholders got to enjoy enhancements of 10%-40% equating to a 1%-4%pa kicker to annual returns. If one were to buy a policy around 2010 through to 2012 and maturing 6 or 7 years later, the life offices' underlying return on assets of 5%pa or so would have been boosted so that TEP investors would be generating 9%pa or more. Against a backdrop of interest rates at near zero and inflation around 2% that would have been pretty good.

LRN: The United States has the life settlement market, and Germany has a traded life policy market. Is there any kind of appetite for something similar to return to the U.K., or do you think that it is the end, at least for the foreseeable future?

RL: Ironically our retail investment arm is experiencing record interest from investors scratching around looking for alpha just at a time when there is nothing to satisfy them. For insurance, there has always been a very small market in Whole of Life policies, very much on the same terms as the US market. Lives assured need to be elderly, typically 75+, or need to be viatical cases with a doctor certified terminal disease in order to attract investors. Investors themselves tend to be retail because the market size is far too small to attract institutional money.

Otherwise, we have pretty much reached the end game over here. For pure life risk, the UK is very under-insured compared to the US and most cover tends to be term which carries a lot more investor risk. Many of the larger Whole of Life policies were established for estate planning for the landed gentry but increasingly these families are setting up family offices and using decreasing term assurance to top up the build-up of their own asset pools.

Roger Lawrence
Managing Director
WL Consulting

Regulatory aversion to insurance concepts like guarantees which require such substantial levels of capital is making issuance of new products unattractively expensive. Regulatory requirements for insurers not to charge penalties to customers for breaking long term contracts has removed most of the margin for secondary market arbitrage and you can see the UK is a difficult place for secondary markets to operate. In Germany, by contrast, there remains a margin in which to operate, though not through surrender penalties but through mitigatable tax penalties. Even there, the reductions in guaranteed interest rates on new products is going to be a market constricting factor moving forward.

LRN: Are there any other opportunities for investors to access U.K.-based longevity risk secondary market investments? If so, what are they and how attractive (or not) are they when compared to the TEP market in its heyday?

RL: Who knows what the further future may bring. Increasingly complex taxation may open doors. But in the here and now, the UK longevity markets are fairly confined to pension annuity risk, which is set to become bigger than ever, and equity release products. However, regulatory caution is unlikely to allow these markets to spill over into the retail investment sector as the TEP market once did. It may be conceptually possible to package equity release mortgages into a collective and sell that on to fund managers seeking diversification. Annuity business is currently all about the reinsurance market as investor, but for capacity's sake that must spread to capital markets.

Both assets are a natural partial hedge for pension funds, but the correlation is far too tenuous to ever turn them into a retail product to help individuals protect against their own longevity.

LRN: Finally, Roger, what's the message to investors who are looking for secondary market opportunities in the U.K? Is there anything to get excited about at all?

RL: I said earlier that I thought it would be difficult to find opportunities in the future as we had in the past. Certainly not in the small-time retail space which the TEP market served. The regulatory mood is against providing alternatives and following some very recent non-mainstream investment failures that have used the "sophisticated investor" exemptions there may be an attempt at further rule tightening. However, it is hard to see how any open society can forbid the wealthy from doing what they like with their money.

There may still be some opportunity for intermediated offerings such as being part of a fund of funds structure.

Ironically all this ramp up in regulation over decades has coincided with the biggest risk transfer of them all – individual longevity risk parked onto the shoulders of the individual. Pension provision has never been so frightening for consumers – not a great result for government and regulators. Hybridised annuity and drawdown solutions are being sought and if way can be found to provide deferred annuities for later life without the current intensity of capital there would be an opportunity for investors to take on this longevity risk.

Funded Reinsurance Market Heating Up

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The pension risk transfer sector is heating up; according to Risk Transfer Report 2022, from consulting firm Hymans Robertson, the past four years have provided the biggest years yet for buy-in and buy-out volumes in the United Kingdom, the space's largest market.

Where insurance companies lead, reinsurance companies follow. Consequently, the funded reinsurance market – where insurance companies turn to manage risk they absorb on completion of these pension risk transfer deals – is on a similar tear.

"Demand from the U.K. pension risk transfer market in particular is driving growth in funded reinsurance," said Rohit Mathur, Head of International Reinsurance Business at Prudential Financial in Newark, NJ. "Insurers are looking for reinsurance partners to meet that demand."

The reinsurance sector is taking note; Prudential Financial has been active in the space for a few years, and Pacific Life Re launched a new team, Global Funded Solutions, in April 2021, to enter this market, completing its first deal the following month.

The growth in the funded reinsurance sector has attracted the eyeballs of the private equity industry. Apollo, KKR, Centerbridge and Blackstone all have ties to the sector, and according to Douglas Anderson, Founder at Club Vita, the attraction for these firms makes sense.

> **"The growth in the funded reinsurance sector has attracted the eyeballs of the private equity industry. Apollo, KRR, Centerbridge and Blackstone all have ties to the sector."**

"There is a multi-level business model here. PE firms can make money on the profit delivered by the funded reinsurance entity, and they can allocate the assets of the reinsurance companies into one of the parent's pooled funds as a limited partner. They can create and issue private corporate bonds and have their own funds buy them. There is a lot of synergy here."

All this doesn't mean that there will be a rush of buyout shops launching reinsurance arms to compete in the space. Deals take a long time to complete, and they are very large and complex; a typical middle-market private equity or credit manager isn't big enough and doesn't have the capacity to deploy all of a reinsurance firm's capital.

A feature of the UK market is that there are only a few insurance companies active in the space; the aforementioned Risk Transfer Report 2022 shows just eight insurance companies involved in either buy-in or buy-out deals in 2021; Aviva, Canada Life, Just, Legal & General, Pension Insurance Corporation; Rothesay, Scottish Widows, and Standard Life. According to Mathur, when these firms elect to use the reinsurance market to transfer some of their newly onboarded longevity risk, there is a natural hedge that reinsurance companies can provide.

"Insurance and reinsurers are natural holders of longevity risks because they have the offset by way of mortality risk; that's important because there is an in-built safety mechanism on the balance sheet," he said.

The natural hedge provided by mortality risk helps in the mortality stress testing element of the capital calculations required by regulators. However, reinsurers also get credit for having a massive pool of all sorts of different low or non-correlated risks, so having marine, aviation and catastrophe risks on the books also helps them when it comes to taking on longevity risk. This isn't always the case with private equity-backed reinsurance, however.

"Because they tend to lack the offset, they have greater risk. If longevity improvements turn out to be higher than they have assumed, they take a profit hit in the future. If they want to pitch the most certain prospective returns to investors, they need to de-risk it by taking out insurance against the most expensive longevity outcomes," said Anderson.

That said, part of private equity's pitch is the access to higher yield-generating assets, and the expertise and scale to take advantage of the opportunities that those assets can generate, that isn't always the case in a pure-play biometric reinsurer. Additionally, it's almost inevitable that these larger buyout firms will continue to be a player in the space because of capacity constraints in the reinsurance market, particularly in Europe.

All this is encouraging for the defined benefit pension funds looking to enter into a pension risk transfer transaction, but Mathur offers a word of caution.

> **"it's almost inevitable that these larger buyout firms will continue to be a player in the space because of capacity constraints in the reinsurance market, particularly in Europe."**

"From the point of view of a defined benefit pension, the more reinsurance companies that are active in the space, the merrier, due to access to different kinds of assets and better pricing from the increased competition. More players supports overall market growth," he said.

"But these are long dated transactions – 30 to 40 years. Insurance companies need to carefully choose a partner that's going to be there for the long run that has a similar risk management philosophy and alignment."

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