

Diversification Isn't Just an Investing-Related Free Lunch



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Editor's Letter

Volume 2, Issue 4, April 2023

Chris Wells
Managing Editor
Life Risk News

The recent challenges in the banking system have brought added scrutiny on the topic of counterparty risk. For this month's cover story, *Greg Winterton* spoke to **Chris Conway**, Chief Development Officer at **ISC Services**, **Roger Lawrence**, Managing Director of **WL Consulting**, and **Scott Willkomm**, CEO at **Life Equity**, to get their thoughts on life insurance companies, most significant counterparty in the life risk investing space, in *Diversification Isn't Just an Investing-Related Free Lunch*.

The full impact of the Covid-19 pandemic won't be felt for decades, but already, signs are there that mortality data is changing. *Aaron Woolner* spoke to **Stephen Caine**, Director at **WTW**, and **Corwin Zass**, Founder of **Actuarial Risk Management**, for their thoughts on what they're seeing in the pensions and life settlements space, in *Excess Mortality Impact Very Different for Life Settlements, Pension Funds*.

This month's Roundtable sees Life Risk News' first foray into the life-contingent structured settlement market. *Greg Winterton* spoke to **Mike Fasano**, Founder at **Fasano Associates**; **Fred Love**, President and General Counsel at **SuttonPark Capital**; and **Jason Sutherland**, CEO at **DRB Capital** to learn more about the current state of this market.

Our first commentary piece this month comes courtesy of **Richard Morris**, an Actuary and Independent Consultant, who digs deep into the various investment risks in the life settlement market in *What Investment Risks Impact a Life Settlement Fund Manager's Returns and How Can These Be Mitigated?*

April is the two-year anniversary of the **World Bank** closing its Pandemic Emergency Financing Facility. So, for this month's issue, our poll asked our readers, *Will Pandemic Bonds Ever Return?*

We continue to learn more about the long-term risks of Covid-19, but more is still unknown than known. **Mike Fasano**, Founder of **Fasano Associates'** *Long COVID and Reinfection Risk* piece is our second commentary article this month.

Life settlements asset manager **Ress Capital** manages a publicly listed product in the space. *Greg Winterton* spoke to **Hanna Persson**, Head of Sales at Ress Capital, to learn more about the firm and its approach in this month's Q&A.

Pandemic bonds received significant negative media coverage during the Covid-19 pandemic. *Greg Winterton* spoke to **John Kiff**, who was a Senior Financial Sector Expert at the **International Monetary Fund** from 2005 to 2021, to get his thoughts on why investors might not be interested if the initiative is ever resurrected in *Difficulty in Modelling Pandemic Risk a Main Reason Why Pandemic Bonds Won't Return*.

I hope you enjoy the latest issue of Life Risk News!

Chris Wells
Managing Editor
Life Risk News

Diversification Isn't Just an Investing-Related Free Lunch

Author:
Greg Winterton
Senior
Contributing Editor
Life Risk News

The recent banking crisis on both sides of the Atlantic has shone a light in asset management circles on the due diligence process undertaken by end investors on their counterparties. A significant percentage of the venture capital industry faced a potential liquidity crisis, and consequently, investors are looking more closely at counterparty risks of all types, not only at the asset manager level, but through to the underlying fund or managed account portfolio level as well.

Just like many other asset classes in the private markets, counterparty risk in the life risk investing world comes in many forms. In markets such as life settlements and life ILS, the most significant of these is the life insurance company which has issued the insurance policy.

If a life insurance company were to fail, the first losses would, in theory, be borne by the shareholders and the regulatory surplus capital. But

diversifying counterparty risk is a natural place to start for a simple risk mitigation strategy. Limiting your exposure to a single carrier, regardless of its financial strength, is a prudent approach."

The main driver of SVB's troubles was its investments in longer-dated securities, which presented it with a classic asset/liability duration mismatch. Fortunately for capital markets participants in life risk, there are few similarities between bank and life insurance company balance sheets. Aside from mortality risk, which is hedged differently to assets, economic risks do exist, but rarely in isolation, as they can be within a bank.

Consequently, the likelihood of an 'insurance company run' is improbable. Even if a situation were to occur where every single US universal life insurance policy holder wanted to sell their policy back to the insurance company at the same time - and therefore the insurance company would need to pay out the cash surrender value - this would be a manageable process, as there is no requirement to pay out policy holders the same day and there may be all sorts of management tools to slow the process down or to apply disincentives and penalties.

Aside from mortality/longevity risks that they themselves run within their pricing, the main day-to-day insurance-related risk, at least in the life settlement market, is the Cost of Insurance risk - the risk that the insurance company increases the COI rates on certain types of policies, the consequence being that these additional costs eat into the eventual investment return. But this is an investment due diligence risk, not an operational one, and certainly with policies funded on a minimum basis, there is little direct asset market risk. Perhaps the closest equivalent of a 'bank run' for insurance companies would be an extreme mortality event.

"The SVB scenario equivalent for a life insurance company could be the onset of a huge pandemic or epidemic - one that would be significantly worse than the recent Covid-19 one," said Roger Lawrence, Managing Director at consulting firm WL Consulting. "If there was a pandemic which had a much higher mortality rate, insurance companies would be on the hook for a rising rate of pay-outs which would not only threaten solvency with worse mortality than they planned for, but a need to meet the cash flow of

"Most life insurance companies are highly rated, have conservative balance sheets, and benefit from a strong regulatory infrastructure. But diversifying counterparty risk is a natural place to start for a simple risk mitigation strategy. Limiting your exposure to a single carrier, regardless of its financial strength, is a prudent approach."

many safeguards exist in the insurance industry at the insurance company level - more so than in the banking industry, where most of the protections are at the consumer level. So, even if there was a technical failure, the assets backing the liabilities should mostly or wholly remain, and policyholders would still be in good standing. Scott Willkomm, Chief Executive Officer at Life Equity LLC, says that, whilst the likelihood of a life insurance company default is low, an obvious first line of defence against this risk presents itself.

"Most life insurance companies are highly rated, have conservative balance sheets, and benefit from a strong regulatory infrastructure," he said. "But

more claims, and every insurer will have a severity threshold at which they couldn't access the capital to pay the death benefits they are liable for."

Pandemic risk is, however, arguably akin to a black swan event and is something outside of the insurance company's control, whereas the decision to invest in certain illiquid securities, or not, is something that is within a bank's control. Indeed, the life risk investing industry has long pointed to life insurance companies being robust counterparties, not weak ones. Many have excellent credit ratings, and even tick ESG boxes given the societal benefit of insuring lives and livelihoods.

"There have been some insolvencies of some small life insurers during the last 7 or 8 years, but the last big company one was about 35 years ago, before the first introduction of risk-based capital regulatory regimes in the 1990s."

"There have been some insolvencies of some small life insurers during the last 7 or 8 years, but the last big company one was about 35 years ago, before the first introduction of risk-based capital regulatory regimes in the 1990s," said Chris Conway, Chief Development Officer at ISC Services. "Yes, they are different types of businesses serving different purposes. But from a counterparty risk perspective, life-based investors have it pretty good."

Bank failures do and will have some impact everywhere, especially if nations refuse to underwrite them. Insurers will suffer within their operational division, losing assets held in cash which may slow claims payments down and at the simplest level, they may not be able to access deposits to pay staff, as was the case with the recent turmoil in venture capital circles. In the life settlement space, another impact of a bank failure is that a bank can also be the securities

intermediary and/or custodian. Although custodial roles played by banks should not be a long run counterparty risk, in the short term, there could be a messy hiatus where access to assets is not possible.

"Ideally, a life settlement fund should not bank with the same firm that it uses as its custodian or securities intermediary for the policies it owns. It's again a simple case of diversifying risks – if a bank were to go under, then having different firms would at least not stop the operation of the fund even if there are delays in getting access to the policies," said Lawrence.

The venture capital industry endured a difficult few days as the SVB debacle unfolded, but ultimately, the US government guaranteed all deposits at those banks, even those above the published \$250,000 guarantee. Add to this the bail outs of many banks in many countries during the Global Financial Crisis and it's easy to succumb to the idea that governments will now guarantee deposits ad infinitum. But you never know, and Lawrence says that for life risk investors, diversification is the name of the game.

"We might always live in hope for a free lunch, but you are wise to be prepared to buy your own," he said. "Ensure you do as much due diligence on your operational risk as for your investment risk."

Excess Mortality Impact Very Different for Life Settlements, Pension Funds

Author:
Aaron Woolner
Contributing Editor
Life Risk News

More than three years after the start of the Covid-19 pandemic, excess mortality may finally be declining in Europe, but it remains at elevated levels compared to a 2019 baseline. That is the latest observation from EuroMOMO, a pan-European mortality monitoring group which measures excess deaths among public health threats such as pandemics and seasonal influenza.

In its tenth weekly 2023 bulletin, the group, which draws on data from 28 European countries and subregions, said that while the recent trend of elevated all-cause mortality was receding, the exclusion of post-2020 data means its analysis could be unreliable: in other words, the baseline itself could be wrong.

“Due to the exclusion of data from the Covid-19 pandemic, the trends incorporated in the statistical estimation of the baseline are presently forecasted beyond the intended duration. This prolonged forecast has introduced an increasing bias over time, which can cause incorrect estimations of the excess mortality, particularly when the numbers are cumulated.”

“Due to the exclusion of data from the Covid-19 pandemic, the trends incorporated in the statistical estimation of the baseline are presently forecasted beyond the intended duration. This prolonged forecast has introduced an increasing bias over time, which can cause incorrect estimations of the excess mortality, particularly when the numbers are cumulated.”

The EuroMOMO figures are based on general population data and while the long-established principle that insured lives have a greater life expectancy than their uninsured peers has been borne out by Covid-19, that does not mean the former group has been unaffected by the pandemic.

Indeed, according to Stephen Caine, Manchester-based director at actuarial consultants WTW, the signs are the baseline for life expectancy has been changed permanently across all cohorts. Caine says that WTW's view of Covid-19's long-term impact on mortality, and consequently pension schemes, has evolved through the pandemic.

“Certainly, when Covid-19 first hit, and into 2021, schemes were assessing the situation and didn't make any knee-jerk reactions; nobody knew if the pandemic was going to be a blip, which wouldn't affect the existing life expectancy path. What has changed is that during 2022 it became clear that the elevated level of mortality has continued.”

Caine says that the higher levels of mortality are not just directly related to the virus. The UK experienced between 500 and 1000 Covid-19 deaths a week through 2022 with numbers generally lower in the latter half of the year but still at a significant level.

“But there were also excess deaths that weren't directly from Covid-19, due to a number of reasons; some known, such as the heat waves, flu and pressure on the health care system, but also less well proven sources, for example the link between Covid and an elevated risk of death from other causes. So, in terms of general mortality, 2022 was over and above what we would normally expect.”

This continuation of this trend has led to pension schemes reassessing their existing life expectancy projections in response to what Caine says is, “the sad truth” that these expectations now need to be downgraded and that Covid-19 will have a long-tail effect on mortality.

“That has changed the thinking. Everyone now appreciates that there are both long and short-term factors in play and the ongoing disruption from Covid-19 will not disappear overnight.”

Actuaries in Europe may be reassessing their baseline longevity assumptions but Corwin Zass, founder of Texas-based Actuarial Risk Management (ARM), says that the US is moving more slowly on this issue. He points to the UK's Institute and Faculty of Actuaries' Continuous Mortality Investigation working group which has added a feature allowing for Covid-19 and lockdown factors to be incorporated into life expectancy projections, contrasting that with statements made by the US Society of Actuaries (SOA).

"There has been some conversation in the US, over the long-term impact of Covid-19, and long Covid during the mortality assumption setting stage. The SOA here in the US has stated correctly that it is too early to evaluate its impact. Obviously, these statements do not cover every US pension plan actuary's perspective."

In the life settlement industry, Zass says that his firm is not making alterations to its mortality assumptions, but that could change, a move which would in turn increase the value of existing life settlement investments.

"I say this as an explicit statement, yet I would caveat the impact of Covid-19 and long-Covid as I suspect life expectancy underwriters are seeing some insureds with greater impairments, which in turn implies higher values, all things equal."

"There has been some conversation in the US, over the long-term impact of Covid-19, and long Covid during the mortality assumption setting stage. The SOA here in the US has stated correctly that it is too early to evaluate its impact. Obviously, these statements do not cover every US pension plan actuary's perspective."

While life settlement investors may see a higher return as a result of Covid-19 impacting the mortality expectations of the underlying pool of lives, pension funds are now faced with a quandary, according to Caine. He says that the realisation that their members' life expectancy has been negatively affected, albeit at a lower level than the general population, has implications for their funding levels.

The UK Pensions Regulator's 2022 analysis of funding levels, based on the triennial funding results, conducted between December 2020 and December 2021, showed that schemes in deficit had an average funding ratio of 82%, with recovery plans that forecast 5.9 years to eliminate this shortfall.

Putting Covid-19 aside, Caine says the subsequent increase in interest rates since the start of the pandemic, and complicated by the UK's recent highly publicised LDI crisis, has led scheme trustees to realise that they are better funded than they expected to be.

"The implications of that will be different for every pension scheme but ones in deficit could be further along their de-risking journey plan than expected and can therefore take risk out of their investment strategy sooner than expected," he said. "We have seen a lot of schemes de-risk recently, because as a result of dramatic change in financial market conditions they found they're much better funded on an insurance basis than they expected."

According to Zass, this appears to already be happening in the US, with 2022 seeing a record level of 560 buyouts, worth a collective \$50bn dollars - this includes some major schemes, such as IBM which offloaded \$16bn worth of pension liabilities to US insurers last September - a trend he expects to continue into 2023.

As with Caine, however, he points to the broader macroeconomic picture as being a more important driver of pension buy-out than a revised view of longevity.

"While the longevity component is an important assumption, I wouldn't say it is the most significant factor. In my view, one of the more important assumptions relates to investments, the yields that are available and the supporting hedging against financial stresses."

Despite data currently pointing to a likely long-term fall in life expectancy, Caine cautions that there is still such a high level of uncertainty of the future path of longevity that pension schemes which now find themselves in position to offload their liabilities could be making a mistake in waiting for even lower life expectancy projections that would make the cost of de-risking even cheaper in the future. Citing previous pandemic scares such as avian and swine flu, which were relatively contained, he says that Covid-19 pandemic is not a new risk, simply one which had not manifested itself before.

"While we might now be making a judgement that Covid-19 has caused a long-term impact on life expectancy, what if instead life expectancy jumps right back up again," says Caine.

Roundtable

Life Contingent Structured Settlements



Mike Fasano
Founder
Fasano Associates



Fred Love
President &
General Counsel
SuttonPark Capital



Jason Sutherland
CEO
DRB Capital

The life contingent structured settlement (LCSS) market in the United States began in the early 1980s with the enactment of the Periodic Payment Act of 1982 but it remains a niche investment opportunity, despite the potential size of the market. Greg Winterton spoke with **Mike Fasano**, Founder, **Fasano & Associates**; **Fred Love**, President and General Counsel at **SuttonPark Capital**; and **Jason Sutherland**, CEO at **DRB Capital**, to get their views on the current state of the LCSS market.

GW: Let's begin with the size of the market, and market penetration in terms of existing deal flow compared to potential deal flow. Where are we at in 2023?

JS: I remember a memo from Willis Towers Watson more than a decade ago that said that at any given time, there is around \$250bn outstanding in structured settlements and our industry factors approximately around \$1bn each year. Market penetration is quite low in our space, despite some firms spending enormous amounts on TV advertising.

FL: We talk to people all the time and they still have no idea that this market exists. Overall, this is a very niche industry and advertising, especially on TV, can be very expensive and only the largest companies can afford that expenditure. Smaller companies are forced to advertise on Google searches or through direct mail campaigns. So, unless you have a structured settlement and are in need of immediate cash, it's not something that people are generally searching for.

MF: It's important to note the motivation factor here when analysing the market size. The percentage of the market that sells their structured settlement is small; the people who tend to take this option often can't get a credit card, so the settlement option that provides them with cash now is an attractive one to this group. The potential size of the secondary market in this space is not the same as the overall size of the market. Those that don't need the cash quickly won't sell their policy.

GW: What about the outlook for growth in your space in the coming 12-24 months? Are there any structural changes coming that might contribute to an increase in sales of consumer policies? Any technology-related developments that might impact your market?

JS: The space has had only minimal growth in the past two decades. As we've discussed, our market sees activity when there is some sort of need – that could be anything from buying a car, to college tuition, even child support payments. If someone doesn't need to access a cash lump sum, they'll keep their policy and continue to receive the payments themselves because they will receive their undiscounted payments over the long term.

MF: In terms of technology, one thing I'd mention is that an area where there is significant potential – but will take years to play out – is in the spinal cord injuries arena. Progress is being made in reversing spinal cord injuries in laboratory mice. If that gets traction in people, that could significantly affect mortality in the structured settlement space. We're talking years here, but the potential is substantial.

GW: Following on from Mike's earlier point, another consumer life-linked secondary market, the life settlement market, consistently claims that it's an ESG-friendly space – certainly, in terms of the 'S' leg of the stool. Your space can also make that claim, right?

FL: That's right. We provide a service that benefits those who can't access money. Many of the consumers we work with are lower income consumers with poor credit scores, so they can't get credit cards to help them manage their spending and cash flows, or they are stuck with 30% interest credit cards which makes it more difficult to pay off. Our market gives them access to cash, with no obligation to repay it.

GW: Mike - the profile of the consumer selling their structured settlement, when compared to the consumer selling their universal life policy, is very different, as has been noted. How does that impact underwriting in the LCSS space?

MF: There's a huge difference in the profile. The life settlement space tends to be populated by above average income consumers whereas the structured settlement demographic, with a few exceptions, is the lower end of the socio-economic spectrum as we've already discussed. The life settlement types, partly because they're older, go to the doctors much more frequently, and consequently have more medical records. Whereas you have a large percentage of the structured settlement market who don't go to the doctors because they can't afford it – sometimes they might not have health insurance, for example. The life expectancies tend to be much shorter in the LCSS space, and they're harder to underwrite because of a wider range of ages and lack of medical records.

We did a study where we compared anti-selection in structured settlements vs life settlements. We found a strong anti-selection bias in life settlements, as people who sold their life insurance policies knew more about themselves and lived longer than the underwriting suggested. People in the secondary structured settlement market selling their settlement annuities, on the other hand, died as predicted and didn't live shorter lives, as you would expect if they were gaming the system. That's a function of the relative lack of financial and medical sophistication of the structured settlement seller vs the life settlement seller. The former cohort don't have financial planners, for example.

GW: Finishing up with the bigger picture in terms of the current macroeconomic environment. The LCSS space is a fixed income product, with the vehicles created by the intermediary firms rated by the agencies. What's been the impact of the recent slew of interest rate rises by the Fed and the higher inflationary environment on your space and what are the medium-term consequences here?

JS: In terms of the impact on the firms that structure these deals, it's obviously not helpful. We have consumers asking us 'why is it that my payments I sold a year and a half ago were discounted at 4.5% and 10% now? We're trying to re-educate the consumer because when rates jumped up, we had to honor the existing contracts, but many don't understand the mechanics of the impact of rate rises on the market.

FL: I agree with Jason. In the short term, it's about re-educating sellers and judges. However, we have been through this type of interest environment before, and the market will adjust. When rates are low, people want money to take vacations, purchase homes, etc. When rates are high, people need money just to survive. At the end of the day, people are always going to need money and historically, the demand has been very consistent.



What Investment Risks Impact a Life Settlement Fund Manager's Returns and How Can These Be Mitigated?



Author:

Richard Morris

Independent Consultant

"If there is an external lender, it's important to know the details of when they can intervene, how they would respond to further extension requests, and what the loan terms are. Managers should keep valuation parameters regularly updated and monitor marketability; their liquidity profile should be made part of their regular communication to their investors."

It's not unrealistic for institutional, end investors to expect – and receive – double digit IRRs from their allocations to third party life settlement fund managers; there are a range of stochastic probability curves that support this view. In addition, these investors are not only receiving additive gains to their broader portfolio, but they're getting uncorrelated returns to traditional economic asset classes, something which is attractive in bull or bear markets, in the short or long term.

But where might it go wrong? As someone who has spent more than a decade in the life settlement market, I've seen many reasons why a fund manager might not deliver what they are capable of delivering, but I also think it's contingent on the investor to ask more cerebral questions during the due diligence process to help them determine whether those double-digit returns are realistic or not.

Longevity Risk

Longevity risk is the key valuation risk and can be split between mis-estimation risk – a systematic issue with the calculation of the insureds life expectancy (LE); volatility risk – this naturally emerges from the nature of a probabilistic cashflow calculation with a single event pay-out; and mortality development risk, something that impacts the LE or mortality curve, like unforeseen medical developments, or more recently, the Covid-19 pandemic.

Longevity risk can be mitigated by avoiding LE providers who are unwilling to give transparency on modelling or won't partake in due diligence. Make your own judgement on LE providers and get as much information as possible from them. Don't be swayed from a particular one because market sentiment is that "their LE's are too long".

Liquidity Risk

This is the risk of insufficient cash being available to pay premiums. Cashflows in the life settlement market are volatile, which may lead to distressed sales, or even surrenders and lapses.

The fund manager should be able to demonstrate the liquidity stresses that the fund can withstand. This can be very simple, for example the number of months liquidity with no cash inflow from claims. A documented plan of steps to manage liquidity breaches' defined limits is key here.

If there is an external lender, it's important to know the details of when they can intervene, how they would respond to further extension requests, and what the loan terms are. Managers should keep valuation parameters regularly updated, monitor marketability, and their liquidity profile should be made part of their regular communication to their investors.

Legal Risk

Legal Risk is a multi-faceted one, which includes potential issues with the purchase and sale of policies, claim payment and ownership litigation, cost of insurance increases, and retrospective litigation.

The fund manager needs to be able to show the documentation, review and auditing process needed to support a purchase. There is a considerable amount of transaction documentation needed, but there is substantial information publicly available on standard requirements. Investors need to ask what the fund manager's approach to premium finance policies is. If they are part of the purchase criteria, has the premium finance programme been legally reviewed?

“How is past and on-going litigation monitored against the portfolio, and how is this information used by the fund manager? For example, is there an impact on selection criteria, are there policies currently held that are impacted positively or negatively. Which policies fall under jurisdictions with the highest likelihood of a legal challenge that negatively impacts the fund, and how is this reflected in purchase criteria. How diversified is the portfolio against actions?”

How is past and on-going litigation monitored (e.g., external and/or in-house US lawyer) against the portfolio, and how is this information used by the fund manager? For example, is there an impact on policy selection criteria, are there policies currently held that are impacted positively or negatively. Which policies fall under jurisdictions with the highest likelihood of a legal challenge that negatively impacts the fund, and how is this reflected in purchase criteria. How diversified is the portfolio against actions?

Is there a risk of challenge by the carrier or seller after a claim has been paid to the fund? Overall, fund management engagement of an external lawyer for on-going updates is strongly encouraged.

Concentration Risk

Concentration risk is another multi-faceted risk.

In terms of the range of face values of policies in the portfolio, how were these limits derived, and, if there is a particular focus, what are the drivers? For example, funds may target smaller face value as a proxy for an insured's net worth and socio-economic status. This also increases the policy count for a given fund size, hence reducing volatility.

What is the number of years between policy inception and first sale? The risk of challenge is expected to reduce further, the greater the period. It also increases the time since the policy was underwritten. Although the VBT select curve addresses this, there will be more smoothing of the curve for older ages. Ideally, the portfolio will not be concentrated on 2-5 years since policy issue.

What is the minimum age at purchase, targeted average age, and targeted gender diversification (this is likely be similar to the insured market, approximately 70% male / 30% female)?

What is the range of insurance carriers and credit ratings? This diversification helps to reduce risks from cost of insurance increases, carrier litigation risk, carriers that may have been anticipating the likelihood of policies moving to the secondary market.) What is the LE at purchase? They need to be a minimum of two years to avoid viatical settlements. What are the mortality factors and conditions? Is the manager targeting a range of conditions and impairment levels?

The bottom line with regards to concentration risk is that diversification is the key.

Cost of Insurance Risk

Cost of insurance (Col) is the part of the premium covering the mortality costs. However the fund should have assessed the specific conditions for reviewing premium costs, which can vary by policy.

When I first became involved in the life settlement industry, and asked to prepare a summary of potential risks, the risk of premium charges being increased by carriers was sometimes questioned. There were a range of responses: “In theory the premiums can be increased but only if mortality experience is worse than expected, and so highly unlikely”; “Insurance companies won't do that as it will damage their future sales”, “They won't because they'd be admitting to mispricing the policies”; “They're not allowed to do that”, ...

For investors new to life settlements and not experienced with universal life policies, this feature may be a new one. Cost of insurance increases were emerging at a time of risk-free rates being much lower than the guaranteed rate on cash in the policy. If these increases are justified by the policy conditions, they can't be avoided. The fund manager will need to monitor the observed changes and ensure diversification by insurer and anticipate further increases. It's important to note that some carrier's Col changes do seem to impact the age range typical for the life settlement market.

“Managers should maintain a buffer of cash to cover, for example, an approximate future three months cost of insurance. The precise premium needed to keep the policy in-force is not known and is derived by the fund manager from the policy contract details of expense charges and surrender charges, together with an illustration projecting the policy based on a fixed level premium.”

Operational Risk

The most critical operational risk is that of lapse risk; insufficient premiums have been paid, the insurance company has sent a payment reminder, this is not responded to, and the policy lapses.

Managers should maintain a buffer of cash to cover, for example, an approximate future three months cost of insurance. The precise premium needed to keep the policy in-force is not known and is derived by the fund manager from the policy contract details of expense charges and surrender charges, together with an illustration projecting the policy based on a fixed level premium. One issue for the fund manager is that the illustration may not be complete, as the carrier is unable to provide a full projection if it would trigger tax status changes for the policy. They should have methods developed to develop a proxy for the future Col's, for example based on past Col increases, taken from account statements, and the Col's from the partial illustration. If the premium is not enough to cover the months Col and costs, the policy owner will receive a “grace notice” informing the amount and deadline for payment to keep the policy in-force. The fund manager will be able to detail the response procedure. The critical part is to follow each stage of the chain from receipt of the notice, communication to the policy servicer, fund manager, and if applicable investment advisor. Importantly, the process should ensure all relevant parties are informed, but also that this does not allow an assumption that another party is addressing the issue.

Communicating to the investor why the fund's longevity experience is not precisely as expected is a natural part of risk communication. Informing them that a policy has accidentally lapsed is not so easy.

Conclusion

Life settlements, like any other asset class, has nuances that can affect the alpha that an asset manager generates. One of the key differences between our market, and traditional ones, however, is that more investors are less familiar with these, which leads to a less effective due diligence process. All life settlements asset managers should have plans in place to mitigate these six key investment-related risks. Investors should be asking related questions, not only in the initial due diligence basis, but on an ongoing one as well.



April 2023 Poll Results

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Life Risk News

Will Pandemic Bonds Ever Return?

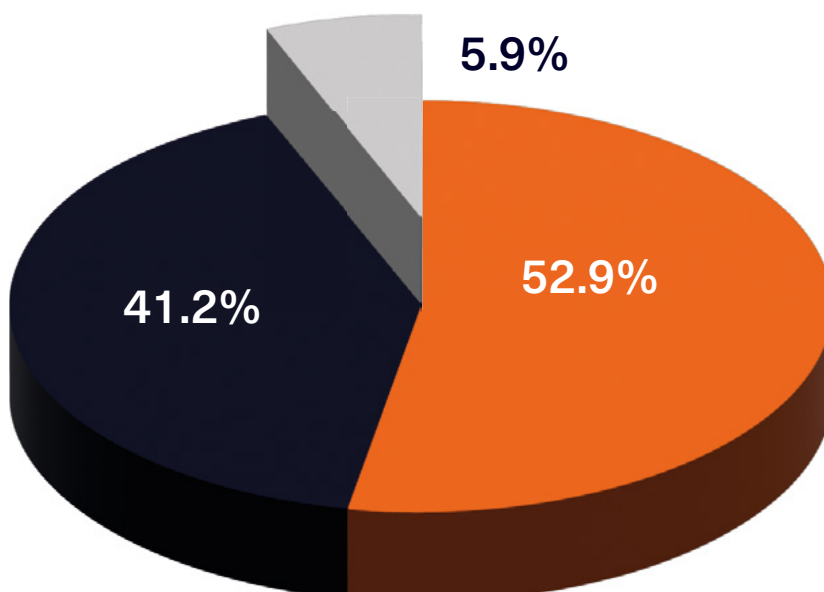
In April 2021, The World Bank announced that it had closed its Pandemic Emergency Financing Facility (PEF) – the program that sold pandemic bonds to capital markets investors.

The program raised a few hundred million dollars and 64 countries received payments to help them with their Covid-19 responses. However, many were critical of the program, and the announcement that the initiative has closed is no surprise to most, but there remains a significant funding gap for developing countries when the next pandemic hits.

So, for our poll in March 2023, we asked Life Risk News readers, “Will Pandemic Bonds Ever Return?”

Very few – only 5.9% - think so. The balance of respondents is split between a firm ‘No’ – 52.9% - and ‘Unsure’ – 41.2%.

Arguably, the return of pandemic bonds is unlikely in the short term – last year, the World Bank announced a new Pandemic Fund which has received \$715m in contributions from governments at the time of writing. But a large funding gap remains, and pandemic bonds are one way to provide access to capital for developing countries that need support to fight future pandemics. Time will tell whether they ever return.



Long COVID and Reinfection Risk



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“Those infected more than once with SARS-CoV-2 have a higher risk of experiencing diseases associated with long COVID. However, the severity of disease in reinfected people appears to be relatively mild in comparison to those infected only once.”

As we enter the 4th year of the COVID-19 pandemic and as the number of infected survivors grows ever larger, attention is increasingly turning to the risks of long COVID and reinfection.

Characteristics of Long COVID

Most patients totally recover from acute COVID within 3 to 4 weeks after onset of infection. Long COVID has been reported in 10% to 30% of those with COVID-19,¹ and in some studies, even more. It is more common in women, non-whites, hospitalized patients and those with a COPD and/or smoking history. The World Health Organization characterizes Long COVID, or Post COVID-19 Syndrome, as being associated with:

- Individuals with a history of probable or confirmed SARS-CoV-2 infection (the virus that causes COVID-19) who experience symptoms impacting everyday life, such as fatigue, shortness of breath and cognitive dysfunction; and
- Symptoms that usually are present 3 months from the onset of acute COVID-19, that last for at least 2 months and can't be explained by an alternative diagnosis.

Interestingly, most with post-COVID syndrome are PCR negative, i.e., they have biologically recovered from acute COVID.² Approximately 25% of Americans with long COVID report significant activity limitations.³

Reinfection Risk

Those infected more than once with SARS-CoV-2 have a higher risk of experiencing diseases associated with long COVID. However, the severity of disease in reinfected people appears to be relatively mild in comparison to those infected only once. A recent V.A. study compared 40,947 people with 2 or more SARS-CoV-2 infections with 443,588 people with only one infection, measuring excess burden and hazard ratios 6 months after reinfection.⁴

Excess Burden and Hazard Ratios in reinfected versus singly infected people was as follows:

	Excess Burden Per 1,000 people	Hazard Ratio
Mortality	19.33 (1.9%)	2.17
Hospitalization	100.19(10.0%)	3.32
≥1 Sequela	235.91(23.6%)	2.1

“Although people with multiple SARS-CoV-2 infections clearly have a higher incidence of respiratory, cardiovascular and neurologic impairments, the severity of the reinfection related impairments is less than that associated with primary infection.”

Excess Burden and Hazard Ratios for specific impairment groupings measured were as follows:

	Excess Burden Per 1,000 people	Hazard Ratio
Respiratory	75.64(7.6%)	3.54
Cardiovascular	62.80(6.3%)	3.02
Neurologic	52.91(5.3)%	1.6

Although people with multiple SARS-CoV-2 infections clearly have a higher incidence of respiratory, cardiovascular and neurologic impairments, the severity of the reinfection related impairments is less than that associated with primary infection. A study published in the New England Journal of Medicine (NEJM) found that people experiencing a single infection only experienced severe, critical or fatal disease at more than 10 times the rate of those experiencing multiple infections.⁵

The NEJM study was based on a younger, healthier cohort of subjects and therefore not entirely representative of the larger COVID positive population. Nevertheless, the comparative data is directionally instructive:

Severity of Reinfection versus Primary Infection⁵

Number with Disease Outcome/Total in Study:

Disease Outcome	Reinfection	Primary Infection
Severe (Hospitalized)	4/1300 (0.3%)	158/6095 (2.6%)
Critical (ICU Required)	0/1300 (0.0%)	28/6095 (0.5%)
Fatal	0/1300 (0.0%)	7/6095 (0.1)%
Severe, Critical or Fatal	4/1300 (0.3%)	193/6095 (3.2%)

Conclusions

We continue to learn more about the long-term risks of COVID-19, but more is still unknown than known. We know that the risk for hospitalized patients is greater, more so for ICU patients. Comorbidities matter and increase risk, particularly COPD and other respiratory impairments. Reinfection increases the risk of impairments, but with diminished potency. We will continue to follow and report on the evolving research.

¹ Nashville Chest, 2022, Oct 16-19

² Clinical Research & Reviews, 15(3), 869-875

³ CDC Survey, Sep. 14-26, 2022

⁴ <https://news.feinberg.northwestern.edu/2020/12/04/new-drug-connects-dots-that-cause-clots-in-covid-19-patients/>

⁵ New England Journal of Medicine 2021; 385:2487-24-89

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Q&A

Hanna Persson

Head of Sales, Ress Capital



Stockholm-based asset manager Ress Capital is a specialist investor in life settlements and runs one of the few listed vehicles active in the space. Greg Winterton spoke to Hanna Persson, Head of Sales at Ress Capital, to learn more about the firm itself and its approach to the space.

GW: Hanna, Ress Capital's investment vehicle is publicly listed, on the Nasdaq Nordic exchange. Why did the firm decide to go that route?

HP: The open-ended structure enables gradual growth, and policies can be gradually sourced. It also allows the fund to buy longer life expectancies which a closed-end fund could not do with a buy and hold strategy. We wanted to make this very interesting asset class more accessible to investors that would not necessarily be able to invest in the life settlement market otherwise. Being listed allows different type of investors from all over the world to buy shares easily through their local bank/broker.

GW: Tell us about your approach to policy selection. What are some of the features that you look for in policies that make it into your portfolio, and why?

HP: In the end, using correct mortality assumptions will of course be most important and we tend to be on the conservative side there. But for policy selection, our investment team focuses on limiting the tail risk of the portfolio both at an individual policy as well as portfolio level. This is achieved by reviewing large numbers of policies and then buying single, high-quality policies. We are very selective and buy only 3-4% of the policies we look at.

In general, we look for wealthier and relatively healthy individuals with long life expectancies (average life expectancy at purchase is 12 years) which we believe are more accurate. Then, by looking for stable future premium streams, the negative effect of any individual substantially outliving their life expectancy is reduced.

At a portfolio level, we then always strive to have high level of diversification in terms of age, gender, size and life expectancy which should reduce the systemic risk of medical underwriters estimating longevity for sub-groups.

GW: Ress Capital is a signatory to the United Nations' Principles for Responsible Investments. Why did you decide to pursue this credential and what's been the main benefit so far?

HP: Being a responsible investor is an integral part of how we operate. Our clients should feel confident that we prioritise sustainability in our daily activities and that we always strive to improve our sustainability efforts. Being an alternative investment manager active in the secondary market for US life insurance policies, ethics is a key aspect.

At Ress Capital, we are convinced that the future challenges we face will place new demands on us as managers of our clients' capital. Through our work with responsible investments, we want to contribute to a more long-term and sustainable investment climate where environmental, social, and corporate governance (ESG) factors are included in the investment process. Responsible investments thus become an important prerequisite for achieving our goal of generating good long-term returns.

As an essential part of Ress Capital's commitment to sustainability and responsible investments, we signed the United Nations' Principles of Responsible Investment (UNPRI) in 2017 meaning we supports the work carried out by UNPRI to promote sustainability work in the asset management industry.

Continued on page 18

GW: There is disagreement amongst life settlement-focused investment managers about whether the asset class should be considered more akin to private equity or alternative credit. What's Ress Capital's view and why?

HP: I wouldn't say Ress Capital has taken any official stance on this. However, we believe the asset class potentially has similarities with alternative credit, although we would argue that the credit rating of US life insurance companies is far better and they're also highly regulated. As regards similarities with private equity, since our fund is listed, it has little in common with closed-end PE funds with no liquidity. Also, we would argue that expected return profile is quite different from PE.

GW: Lastly, Hanna, what's your message to institutional, end investors that don't have an allocation to life settlements in their portfolio – what are the main reasons for doing so in your view?

HP: This is an asset class that is fundamentally uncorrelated to majority of other asset classes.

The underlying risk is decoupled from the economic cycle. When done correctly, life settlements as an asset class offers a fixed income alternative with yields comparable to those of an equity portfolio, but with volatility below that of investment grade bonds. In times of high volatility in the market life settlements present a unique, stable and truly uncorrelated return stream.

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Difficulty in Modelling Pandemic Risk a Main Reason Why Pandemic Bonds Won't Return

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The Pandemic Emergency Financing Facility (PEF) was launched in 2016 by the World Bank as a response to the West Africa Ebola Crisis in 2014. It issued 'pandemic bonds', designed to provide immediate funding - that would likely not be available via the capital markets - to poorer countries to help them fight a large-scale outbreak of a virus or disease. Whilst the PEF bonds weren't the first mortality-based bond - Swiss Re issued a few between 2003 and 2015 - they were the first to be sponsored by a supranational body.

At the time, investors seemed bullish on the idea; The World Bank raised \$425mn (\$320mn in bonds and \$100mn in swaps) in an over-subscribed offering.

But it's been two years now since the World Bank closed its Pandemic Emergency Financing Facility (PEF) and the consensus is that there won't be any more pandemic bonds. And according to John Kiff, who was a Senior Financial Sector Expert at the International Monetary Fund (IMF) from 2005 to 2021, that shouldn't be a surprise.

"There are two reasons why mortality-linked bonds, like pandemic bonds, won't work. First, it's incredibly difficult to model them because there is a lack of information, and second, the political flak they [World Bank] got last time makes it just not worth it for them again."

"There are two reasons why mortality-linked bonds, like pandemic bonds, won't work. First, it's incredibly difficult to model them because there is a lack of information, and second, the political flak they [World Bank] got last time makes it just not worth it for them again."

The information issue is a clear roadblock on the route to pandemic bonds ever returning. Pandemics occur infrequently and randomly, and investors, which are used to consuming - in many cases, vast quantities of - data upon which to make an investment decision, can't accurately judge the risk and return profile of pandemic-based investments.

Kiff likens investing in pandemic bonds to a game of chance.

"You're basically building a bond around a coin flip. No-one would buy fixed income on a coin flip operation. Investors are generally smart and only enter markets where they think they have an edge. That's not the case with a coin flip operation."

The public perception issue is the other roadblock. The PEF was criticised in some quarters for being too slow to pay out and criticised in others for seeming to favour investors over the actual beneficiaries of the program. Coupons paid to the bond investors ran at 6.9% for the first tranche and 11.9% for the second, reflecting the risk that investors were taking on (and ultimately lost money on when the criteria for paying out were met). In today's environment, coupons would need to be higher still to persuade investors to take on the risk because of both the higher interest rate environment markets find themselves in and recency bias. Investors won't underwrite a pandemic bond program without being compensated for doing so, but rates that high can come with political and public relations risk.

The transfer of other mortality-based risk to the capital markets is robust, however. The 'life ILS' market, whilst small, is well established, where over the counter, 'value in force' transactions are commonplace between life insurance companies and investment firms. The catastrophe bond market, whilst not a pure-play mortality risk market, has significant overlap, and is similarly well established. But transactions in these sectors are still heavily data-based, and the investors in these two markets are working with data that is known, that occurs with a higher degree of predictability, a higher degree of frequency, and is similar to that which has gone before.

"Natural catastrophe risk goes back decades. There is lots of really good data about wind speeds, where hurricanes land and the damage they do at different levels of intensity," said Kiff. "But a mortality risk bond, for example a pandemic bond, is almost pure speculation."

It does indeed seem like the World Bank has given up on the idea of pandemic bonds.

In November last year, the organisation officially announced The Pandemic Fund, a new initiative designed to provide financing to developing countries to support them in the event of another pandemic. In February, \$300m of financing was

Surely, if the price is right – i.e., the interest rate on the bonds – then some investors would undoubtedly go back in. But ultimately, a resurrection of the PEF can only work if investors can better model the risk – an undertaking that's an extraordinarily difficult one.

"You could make the case that holders of longevity risk might be interested in adding mortality risk because if you're covering someone else's longevity risk, pandemics reduce your risk," said Kiff. "But a pandemic is a tail risk event, and that's where the data problem is. A pandemic isn't something you can predict. You can't say 'here's all the conditions that led to the Covid pandemic and the triggers so we'll repeat this' because the next one will be different."

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approved for the first round of funding, and last month, the Fund issued a Call for Proposals, with a mid-May deadline for eligible countries to get their pitches in (the World Bank declined to comment for this article).

Still, an article from Reuters in early March suggested that, despite \$1.6bn being raised so far, the total amount needed is closer to \$10bn. So, could pandemic bonds still be an option here?

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