

UK Equity Release Market Needs Greater Awareness To Fill the Demand and Supply Gap



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03

Editor's Letter

Chris Wells, Managing Editor, **Life Risk News**

04

UK Equity Release Market Needs Greater Awareness

To Fill the Demand and Supply Gap

Greg Winterton, Snr. Contributing Editor, **Life Risk News**

06

US PRT Market on Course for Record Breaking 2023

Aaron Woolner, Contributing Editor, **Life Risk News**

08

Proposed Rule by U.S. Department of Treasury Seeks to
Clarify Tax Treatment of Life Settlement Exchanges

Jeffrey Davis, Contributing Editor, **Life Risk News**

10

UK Closed Life Funds – A Secret Returns Goldmine?

Roger Lawrence, Managing Director, **WL Consulting**

12

Poll: What Is the Larger of the Challenges Facing the Life ILS
Market at Present?

Greg Winterton, Snr. Contributing Editor, **Life Risk News**

13

LE Mortality Tables and Underwriting

Traci E. Davis, Chief Customer Whisperer,
Chief Underwriter, **Valkyrie Limited**

16

Q&A: Nat Shapo, Partner, Katten Muchin Rosenman

Greg Winterton, Snr. Contributing Editor, **Life Risk News**

18

Change in Approach A Necessity to Combat Human Capital
Challenges In UK Pension Risk Transfer Market

Greg Winterton, Snr. Contributing Editor, **Life Risk News**

Editor's Letter

Volume 2, Issue 7, July 2023

Chris Wells
Managing Editor
Life Risk News

The equity release market in the UK is facing a challenge of awareness similar to that faced by colleagues in the Life Settlement market across the Atlantic. With supply outstripping demand for the past five years looking for new avenues to market growth is a focus. LRN's Greg Winterton talks to **Ben Grainger**, Partner at **EY**, to explain in *UK Equity Release Market Needs Greater Awareness To Fill the Demand and Supply Gap*.

The US pension risk transfer sector has had its busiest year, with a record number of transactions worth \$52bn taking place in 2022. Rising interest rates are a major driver of this growth as **Jake Pringle**, Principal and Consulting Actuary at **Milliman**, explains to LRN's contributing editor Aaron Woolner in *US PRT Market on Course for Record Breaking 2023*.

It would be an understatement to say that the US tax code is complex. Jeffrey Davis spoke to **James Davis**, CPA, of **EC Barrett**, LLC in Atlanta about proposed rule changes by the US Treasury Department in an effort to clarify possible unintended consequences from 2019 IRS regulations in *Proposed Rule by U.S. Department of Treasury Seeks to Clarify Tax Treatment of Life Settlement Exchanges*.

It was the failure of Equitable Life some 20 years ago that led to a tightening of solvency reserving. That, and a number of other factors, turned the tide against with-profits products, leaving a number of so-called 'zombie' or 'orphan' funds. However, with a lot of very careful management, some of these funds have returned to good health and some are even flush with a surplus. **Roger Lawrence**, Managing Director at **WL Consulting**, asks the question in *UK Closed Life Funds – A Secret Returns Goldmine?*

It was always going to be a tough call deciding the larger of the challenges facing the ILS market today. Would it be the rising interest rates, maybe the changing mortality rate, the need for increased levels of deal flow, or maybe there are other factors? We asked our readers and you came back with your verdict in our July Poll: *What Is the Larger of the Challenges Facing the Life ILS Market at Present?*

For as long as there's been a life settlement market, there has been discussion over the best or most appropriate mortality tables to use to determine life expectancy. **Traci E. Davis**, Chief Customer Whisperer, Chief Underwriter at **Valkyrie Limited**, takes a look at the role of underwriters in *LE Mortality Tables and Underwriting*.

Enhanced Cash Surrender Value Offers (ECSVOs) have presented the life settlement market with a new dynamic when buying policies. **Nat Shapo**, Partner, **Katten Muchin Rosenman** explains to Greg Winterton the challenges ahead and why some US states have already taken action in this month's Q&A.

While the significant increase in the number of deals has been a boost to the PRT market as a whole, it's been held back somewhat by a lack of people power to take on the extra work. **Andy McAleese**, MVP, Longevity, Europe at **Pacific Life Re**, and **Pretty Sagoo**, Managing Director of Defined Benefit Solutions and Member of the Group Executive Committee at **Just Group**, reflect in *Change in Approach A Necessity to Combat Human Capital Challenges In UK Pension Risk Transfer Market*.

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

UK Equity Release Market Needs Greater Awareness To Fill the Demand and Supply Gap

Author:
Greg Winterton
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Life Risk News

The life settlement market has undertaken significant efforts in recent years to improve what it considers to be an awareness challenge in terms of the general senior population in the US not always being aware that they can sell their life insurance policy for a lump sum.

The direct-to-consumer market, for example, is proving effective at generating more enquiries not only from the insured, but also from their advisors, like accountants, lawyers, and wealth managers.

The equity release market in the UK has a similar challenge. Unlike life settlements, where the capital comes largely from investment fund managers, the money for equity release mortgages in the UK comes from bulk annuity premiums, itself a market that is undergoing significant growth as more defined benefit pension plans in the country find themselves in a stronger funding position that moves them closer to being able to complete a risk transfer solution.

“Ongoing increases in UK interest rates are resulting in higher interest rates on mortgages and low advances being made available to equity release mortgage customers, impacting consumer demand.”

UK insurers flush with millions of pounds of premiums from bulk annuity deals won't be able to direct much more of this capital towards equity release products than they already do, however, because there isn't enough demand to meet the available capital. According to data from EY, supply has outstripped demand each year since 2018, and recent economic events aren't helping demand either.

“I don't see demand recovering significantly in the short term,” said Ben Grainger, Partner at EY. “Ongoing increases in UK interest rates are resulting in higher interest rates on mortgages and low advances being made available to equity release mortgage customers, impacting consumer demand.”

Time will tell how long the current interest rate environment will persist. Inflation in the UK remains high – 8.7% in May 2023 - and the Bank of England's recent 50bps rise is indicative of the country's efforts to rein in the increase of the cost of living.

When rates do fall, supply should pick up, even if it's only slightly. But for the market to really move, awareness needs to be significantly higher. One seemingly obvious channel is the direct-to-consumer one – ie: television, radio and other media advertising. It's a channel that's delivering dividends in the life settlement market, but unfortunately, in the UK's equity release market, an equity release provider increasing their TV advertising spend won't make much of a difference.

“TV advertising is saturated in the equity release market. If you watch TV during the day, then you'll probably see an ad. But if you don't, you won't. This means that spending more on more TV advertising won't make much of a difference to awareness,” said Mr Grainger.

The market currently remains somewhat subdued. The number of new and returning equity release customers active between January and March this year dipped to 16,691, down 19% from 20,597 in Q4 2022 and down 29% from 23,395 a year earlier.

But still, the awareness issue is a structural one, something that the industry is trying to remedy. The Equity Release Council, the trade association for the industry, has educational initiatives to support financial advisers in their discussions with their clients, and it continues to drive progress in the industry in terms of standards and best practice; in April this year, it appointed independent chair Michelle Highman to its standards committee, and in May, launched new guidance on post-completion communications, a 17-page report for advisers which describes the various triggers for providers to communicate directly with customers.

Other tailwinds to awareness do exist. Martin Lewis, the well-known British consumer finance media personality, recently updated an article in which he encourages British consumers to use a provider that's a member of the equity release council if they do decide to go down that route.

And there are plenty of other personal finance websites which reference equity release, so as the internet-savvy Generation X ages into the range where equity release mortgages are available (age 55+ in the UK), then awareness should concurrently rise.

Regulators are in on the act as well. The UK regulator issued this press release in 2020 criticising the quality of advice issued by financial advisers, suggesting that it will be "undertaking further work to review the suitability of advice in the lifetime mortgage market." Exactly what that work entails is unclear – the FCA declined to comment for this story – but the Equity Release Council is already making efforts to educate IFAs via its 'competency framework' initiative, so work is underway in that corner of the market already.

"In addition to the current economic environment, the key barrier to the growth of the UK equity release market is a lack of consumer awareness, prompting a need to widen distribution channels and inform consumers."

UK insurers add equity release mortgage exposure to their balance sheets because they feel that the product offers solid risk-adjusted returns. But also, there aren't many other options for them in terms of long-term assets to match the long-term liabilities that they onboard during the bulk annuity process, and as has already been stated, they are currently receiving new bulk annuity premiums in record numbers.

But ultimately, the growth of the market in the medium to long term will need to be driven by the industry's efforts in the awareness arena.

"In addition to the current economic environment, the key barrier to the growth of the UK equity release market is a lack of consumer awareness, prompting a need to widen distribution channels and inform consumers," said Mr Grainger. "But the funding model is good, and consumers have better protections now than they have previously. It's now a case of the industry needing to continue to educate."



US PRT Market on Course for Record Breaking 2023

Author:
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Life Risk News

The US pension risk transfer (PRT) market saw its biggest year in 2022, with AON recording a total of 568 transactions, worth \$52bn — a 28% rise on the previous year and a record for the sector.

This heightened level of activity has continued into 2023 with Legal & General Retirement America's (LGRA) Q1 2023 PRT Monitor reporting around \$6bn worth of deals in the first three months of 2023, ahead of the \$5.3bn recorded a year earlier. LGRA said it was likely the first half of 2023 would see a record \$23bn worth of transactions.

Big name US corporates struck PRT deals in 2022, including IBM offloading \$16bn worth of pension risk to a pair of insurers, and aerospace firm Lockheed Martin making a \$4bn group annuity purchase. A significant transaction so far this year was the \$8.1bn PRT deal between telecoms groups AT&T, and private equity-backed insurer Athene, which was announced in April and will see 96,000 retirees change pension provider.

“From our standpoint, 2022 was certainly busier than 2021, and the pipeline for 2023 is as full as it’s ever been, with lots of deals lined up over the next three months.”

The driver for this activity is, of course, rising interest rates: the US Federal Reserve increased its base rate by 425 basis points (bps) over 2022, with another 50bps added each in February and March this year, widening the discount rate used to estimate the net present value of pension scheme funding levels.

“What makes the total premium more impressive is that the significant increase in interest rates reduced the size of plan liabilities, effectively making the premium for individual PRT deals smaller,” AON said in its March report on the Q1 US PRT market.

According to research from actuarial consultants Milliman, the funding status for the 100 largest US private pension schemes increased on average by 12% from fiscal year 2020 to fiscal year 2023. Jake Pringle, Principle and Consulting Actuary at the firm’s pensions arm, says as a result his team are increasingly focussed on PRT deals.

“From our standpoint, 2022 was certainly busier than 2021, and the pipeline for 2023 is as full as it’s ever been, with lots of deals lined up over the next three months. It can be challenging to ensure that things don’t get overscheduled in terms of setting up the calls, performing the financial due diligence and all the other aspects involved in completing a PRT transaction,” he said

According to the Houston-based actuary, the Fed’s interest rate hikes in early 2023 have been a key factor in sustaining PRT demand.

“As interest rates started to rise it felt like plan sponsors were thinking: ‘Maybe this is a limited time opportunity, and these rates are going to come down once inflation gets under control’. Then in 2023, it became clear that high inflation and interest rates are not short-term events and pension plans became more comfortable looking at a PRT.”

Rising interest rates may be the catalyst for the current spurt of US PRT activity but the long-term increase in Pension Benefit Guaranty Corporation (PBGC) — the US pensions lifeboat — premiums has been a secular driver of demand over the last decade.

In 2013 the PBGC charged a flat rate of \$42 per plan member. In 2023 this had increased to \$96 a head, meaning AT&T has saved a significant amount in PBGC premiums by offloading its retiree obligations this year.

“PBGC premiums have always been a bit burdensome in the US because even a fully funded plan has to pay the flat rate per participant and they have been going up at a steady rate over the last decade, so it’s not a minor expense. And for pension plans which are underfunded, a lot of times the plan sponsors are saying: ‘If I’m going to be paying money, I want it to go into the plan’. But if they conduct a PRT transaction it may cost a bit upfront but it’s possible to get a fair portion of that back via PBGC premium savings over the next five to seven years,” Mr Pringle says.

In April the UK’s Pension Regulator warned in its annual funding statement that the domestic buy-out market had limited capacity and schemes could find themselves struggling to secure a provider and end up paying higher premiums.

The picture in the US is different, according to AON's 2022 PRT market report, which said demand remained robust among insurers for taking on pension scheme risk. Last year saw three new entrants entering the US direct writing sector, including Reinsurance Group of America, Global Atlantic and American National, meaning there are now 22 firms active.

Despite this increase, Mr Pringle says that the sheer level of demand from plans means that the number of rejections from insurers is rising, and there has been a slight fall-off in the number of carriers bidding on a PRT transaction. However, he says that this shortage is muted.

“It’s not like we had to implore insurers to do a PRT deal, or that there is only one bid on a placement so we had to follow up to get a second bid so there is a competitive situation.”

“It’s not like we had to implore insurers to do a PRT deal, or that there is only one bid on a placement so we had to follow up to get a second bid so there is a competitive situation. It’s more a case of one or two less firms bidding than we would have previously expected once they start to hit capacity.”

The first quarter numbers are notable given that the US PRT market activity is typically heavily skewed to the second half of the year, particularly the final quarter. Mr Pringle says that US pension schemes receive their evaluation results around August, or September, meaning corporates can estimate their next year pension fund cash contributions and are able to take a decision on whether to de-risk at this point.

Add the January 1 deadline for PBGC contributions to the mix and the result is typically a year-end scramble in the US PRT market. But Mr Pringle says that given the elevated level of activity so far in 2023 the sector could face capacity challenges in the final quarter.

“Insurance companies have a goal in mind in terms of how much business they want to write this year and that could be \$500m, or \$10bn, depending on the size of the firm. My estimate is that with the level of activity we have seen in 2023 so far, most insurance companies are probably ahead of schedule on that metric.”

Secondary Life Markets Conference 2023

Date: September 12th 2023

Location: EY, Canary Wharf, London, UK

Proposed Rule by U.S. Department of Treasury Seeks to Clarify Tax Treatment of Life Settlement Exchanges

Author:
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Contributing Editor
Life Risk News

Tax experts serving the life settlement industry are paying close attention to a proposed rule from the US Treasury Department that addresses unintended tax consequences resulting from Internal Revenue Service regulations issued in 2019 under IRC Sections 101 (death benefit exclusion) and 6050Y (Form 1099 information reporting).

The proposed rule to clarify how life settlement exchanges are taxed, "Information Reporting and Transfer for Valuable Consideration Rules for Section 1035 Exchanges of Life Insurance and Certain Other Life Insurance Contract Transactions," was published in early May 2023 and comments from interested parties were closed on July 10, 2023.

According to the IRS summary, the proposed rule would "provide guidance on the application of the transfer for valuable consideration rules and

101 would correct the mistake in the existing regulations by eliminating the treatment of some Section 1035 exchanges as reportable policy sales and would clarify that Section 1035 exchanges do not result in a taxable transfer-for-value."

At the close of the comment period the American Bankers Association was the single association to post a point of view, noting, in part, how the 2019 final regulations helped clarify what constitutes an RPS, or reportable policy sales.

"The proposed regulations include a new exception from the definition of RPS for certain direct acquisitions of interests in life insurance contracts by C corporations that arise as part of ordinary course mergers and acquisitions where life insurance constitutes a de minimis amount of the total assets being acquired," the ABA wrote.

"With that in mind, however, the De Minimis Exception should be expanded to cover certain taxable transactions between C corporations, including transactions involving one or more holding companies and their subsidiaries.

The proposed changes are still in the early stages, and it is not yet clear when they will be finalised. However, the fact that the IRS is proposing these changes is a positive sign for the life settlement industry. It shows that the IRS is aware of the uncertainty surrounding life settlement exchanges and reorganizations, and is taking steps to address it.

Here are some specific examples of how the proposed changes would affect life settlement exchanges and reorganizations:

Currently, there is some uncertainty about whether the death benefit from a life settlement exchange is taxable.

The proposed changes would clarify that the death benefit from a life settlement exchange is not taxable, as long as the exchange meets certain requirements.

There is some uncertainty about whether reorganizations involving life insurance contracts are subject to the same rules as other types of insurance transactions.

The proposed changes would clarify that reorganizations involving life insurance contracts

"The proposed regulation under Section 101 would correct the mistake in the existing regulations by eliminating the treatment of some Section 1035 exchanges."

associated information reporting requirements for reportable policy sales of interests in life insurance contracts to exchanges of life insurance contracts qualifying for nonrecognition of gain or loss, as well as to certain acquisitions of interests in life insurance contracts in transactions that qualify as corporate reorganizations."

Industry experts say this is good news for the life settlement industry, as it clarifies the tax treatment of Section 1035 exchanges and makes it more likely that these exchanges will be tax-free. This could lead to increased activity in the life settlement market, as more people are able to take advantage of the tax benefits of exchanging their life insurance policies.

"These final regulations had inadvertently treated certain Section 1035 exchanges as reportable policy sales thus subjecting them to the transfer-for-value rules that could limit the Section 101 death benefit exclusion," James Davis, CPA, of EC Barrett, LLC in Atlanta told Life Risk News.

"The proposed regulation under Section

are not subject to the same rules, and that the death benefit from a life insurance contract is not taxable in the event of a reorganization.

The proposed changes would make life settlement exchanges and reorganizations more

“The proposed regulations include a new exception from the definition of RPS for certain direct acquisitions of interests in life insurance contracts.”

attractive to investors and companies. This could lead to increased activity in these markets, as more people are able to take advantage of the tax benefits.

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UK Closed Life Funds – A Secret Returns Goldmine?



Author:

Roger Lawrence
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More than 200 years ago, Equitable Life, the now defunct UK mutual life insurer, realised that they were making excess profits and started distributing them to policyholders via reductions in the following years' premium. This profit distribution evolved into making annual increases to the sums insured; the next evolutionary iteration was to deliberately load premiums to allow for scope to intentionally generate "profits" by diverting the additional margin into riskier but hopefully more profitable assets. Finally, insurers were doing so well, especially from a buoyant stock market, they began adding a further "terminal" bonus to pay-outs funded from the excess returns they achieved that had not already been distributed through annual additions.

This style of product, so-called "with-profits", became a commonplace savings vehicle in the UK and spread around much of the Commonwealth. UK Prime Minister Margaret Thatcher's private personal pensions revolution in the mid-1980s created yet more demand for this form of hybrid investment – guarantees but with equity driven upside – as did a tax relief on mortgage interest in 1983 that created a boom in life assurance-based saving.

However, with-profits was not a perfect panacea in all economic climates. When inflation, and consequently interest rates, began to fall, the cost of providing a guarantee in nominal terms became increasingly expensive. It also got regulators twitchy because high guarantees mean an increased risk of insolvency. So, ironically, it was the failure of Equitable Life in the early 2000s that led to a rapid tightening of solvency reserving. That, the cost of guarantees impairing returns, and the cancellation of tax relief on mortgage interest, all turned against with-profits and by 2004, large funds began closing and consolidating. Today, there are only a handful of funds still writing new business - and those that are, do so at much reduced levels.

Many hands were wrung over the plight of these so-called "zombie" or "orphan" funds – closed to new business and in a state of run-off that nobody loved and nobody seemed to want to manage. Would policyholders' expectations be curtailed by over-cautious investment strategies?

Some funds were undoubtedly in a terrible condition, and no amount of nursing would fully turn them around but, following the end of the dotcom bubble in 2004, and with careful guarantee management, a lot of these funds have not only returned to good health once again, but are now flush with surplus. Some funds may have been required to distribute the surplus to shareholders but most of them are contractually required to distribute the majority of the surplus to policyholders.

There was concern, especially amongst regulators, that a huge inequity would develop: the insurer holding back the surplus for far too long, until just a handful of policyholders would be eligible for a massive payout – the so-called tontine effect. The regulator urged insurers to pay out as much surplus as they could, as soon as possible, to ensure a fairer pay-out to all policyholders that were still in the fund at closure. This has led to the build-up of some substantial additions to policyholders' basic accrued asset shares.

The method and style of distribution was left to insurers and each of the many approaches favours certain policyholders such as long-stayers or those with distant maturity dates. Two of the main methods are to either bulk up the annual investment returns through an annual addition, or to simply divide all the surplus at any time amongst all policyholders and apply an equal share to all policies that become a claim (the so-called "terminal bonus addition").

"When inflation, and consequently interest rates, began to fall, the cost of providing a guarantee in nominal terms became increasingly expensive."

“Compounding the annual performance of these funds leads to some substantial “free” additions from surplus of 63% and 25% of policy assets, respectively.”

Much of this started in or around 2010 and the purchaser of a second-hand policy at that time has achieved a supra-return through these additions. A 30% terminal bonus addition emerging equates to roughly 3% per annum being added to underlying returns over a 10-year period. The table below shows the returns for the past 12 years of two funds which have chosen to go through the annual additions route:

Figure 1:
Guardian, National Mutual Enhancements to Annual Performance, 2010 – 2022

	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Guardian	2.5%	8.0%	3.0%	2.5%	3.0%	3.0%	3.0%	8.0%	3.0%	5.0%	3.0%	3.0%	3.0%
National Mutual	1.8%	1.9%	1.9%	7.0%	0.3%	1.8%	0.0%	1.9%	1.9%	1.4%	1.4%	1.9%	1.9%

Source: W L Consulting (collation from life office's own data)

Compounding the annual performance of these funds leads to some substantial “free” additions from surplus of 63% and 25% of policy assets, respectively. This is on top of the returns achieved on the underlying assets, which are broadly comparable with other mixed asset funds and give total returns of more than 7% or 8% per annum in an era when base rates were nearly zero.

Figure 2 below shows the equivalent additional return represented by the increase in the uplift in the terminal bonus addition between 2014 and 2022. National Mutual of Australasia had, for example, been enhancing pay-outs well before 2014 but by lower amounts than in 2022 and the 2%pa annual return uplift is equivalent to the terminal bonus addition rising from 75% to 105% only.

Figure 2:
Progression of Enhancements to Basic Asset Shares (8 Selected Companies), 2014 – 2022

Life Office	2014	2016	2018	2020	2022	Per annum equivalent
Colonial Mutual	0.0%	0.0%	1.0%	20.0%	25.0%	2.8%
Friends Provident	0.0%	0.0%	8.0%	12.0%	10.0%	1.2%
National Mutual of Australasia	75.0%	85.0%	90.0%	90.0%	105.0%	2.0%
Pearl Assurance*	24.5%	28.8%	34.6%	36.2%	34.1%	0.9%
Royal Life Insurance*	17.0%	33.9%	37.0%	56.4%	57.5%	3.8%
Scottish Mutual	16.8%	20.0%	35.4%	50.4%	44.3%	2.7%
Scottish Provident*	24.3%	33.5%	44.9%	50.0%	49.9%	2.4%
Winterthur Life	0.0%	0.0%	1.0%	20.0%	25.0%	2.8%

*Adjusted for enhanced annual additions also made.

Source: W L Consulting (collation from life office's own data)

Is this of benefit to the ILS investor? Well, yes and no. Clearly, the tontine effect much talked about in the mid-2000s seems to be occurring, albeit much diminished by regulatory guidance. Access to surpluses is also significantly curtailed because of the decline to near zero of policies qualifying for these rewards. There do remain opportunities, but very much on a cottage industry level, unlikely to be of interest to the institutional scale investor. However, it is worth bearing in mind that there may be other pockets of untapped reserves that emerge in other markets, just as they have in the UK.

July 2023 Poll Results

What Is the Larger of the Challenges Facing the Life ILS Market at Present?

Author:**Greg Winterton**

Senior

Contributing Editor

Life Risk News

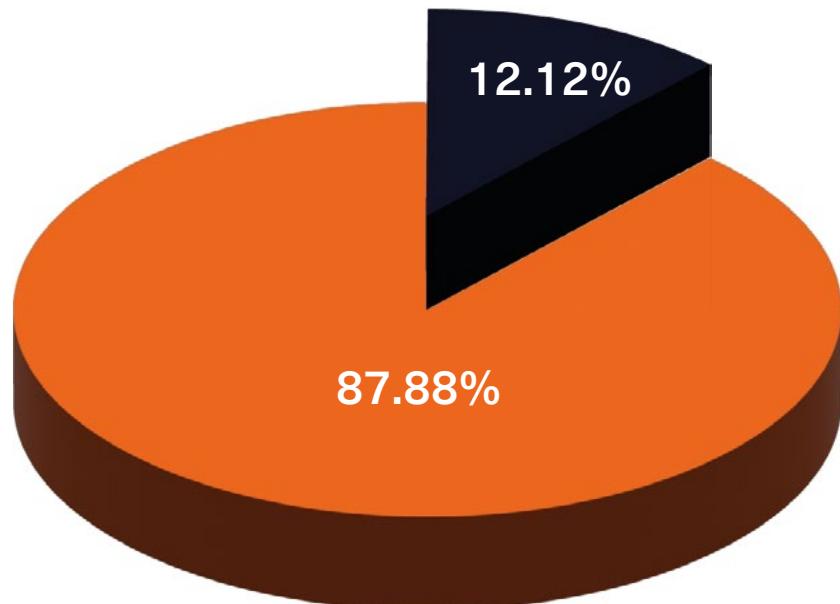
The life ILS market, like many alternative credit strategies, is facing challenges from the rising interest rate environment not only in terms of investor appetite but in terms of deal activity, as higher risk-free rates impact the extent to which life insurers can transfer risk to life ILS investors. But, like other life risk markets, it's also facing challenges from changing mortality trends in terms of modelling that risk.

So, for this month's poll, we asked our readers which of the two was the more prevalent. And the results were clear.

The need for higher deal flow was the landslide opinion; 87.88% of readers felt this was the case. The elevated interest rate environment looks like it will remain for a while yet, which would dampen demand.

But there is significant opportunity in the market in Asia, for example, where the life ILS space remains relatively nascent, and moats exist for life ILS managers which may mean that the current deal flow 'challenge' isn't as pronounced as others in the alternative credit market.

- █ The impact of changes in longevity / mortality trends
- █ The need for higher levels of deal flow



LE Mortality Tables and Underwriting



Author:
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Chief Customer
Whisperer, Chief
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As long as there has been a life settlement market, there has been disagreement over the 'best' or appropriate mortality tables for determining life expectancy. The subject has been the source of countless white papers, articles, and verbal sparring during industry panel discussions between actuaries, underwriters, and researchers representing Life Expectancy Provider (LEP) firms. As an underwriting professional, I always come back to what I have always felt to be a relevant stance, which is: "You can have the best mortality table in the business, but if the risk assessment applied by the underwriter is incorrect, the output from the table is going to be worthless."

Historically, the relationship between actuarial and underwriting professionals has been symbiotic on the life insurance side. We develop our work in the same ecosystem, and both professions' decisions will affect each other's assumptions. However, it is critical to distinguish that actuarial philosophy is based on mathematical theory, based on large homogenous data populations. In contrast, the underwriting philosophy is based on health impairments with unique factors reflected at an individual applicant or insured level. So, when actuarial assumptions do not come to fruition, there is a deep dive into how the individualised risks, with shared components, were underwritten. These typically cause changes reflected in the mortality tables. Essentially, the underwriting process drives mortality table changes and outcomes.

Consider the following: actuaries live in a world of large numbers. They typically relate it to 'if we start with 1,000 lives' when they break down examples. However, underwriters, while understanding that debit and credit methodology takes the law of large numbers into account, we live in a world of assessing the individual in front of us and all of the aspects of the risk that may be relative to the impairment but also unique to that individual.

"In contrast, the underwriting philosophy is based on health impairments with unique factors reflected at an individual applicant or insured level."

For example, when you take the broad category of coronary artery disease, actuarial science (for developing appropriate outcomes relative to the risk) will start with the Framingham heart study out of MA (circa 1948). Framingham has been a serial decade study of individuals and their family members tracking specific cardiac risk factors over generations, starting with over 5,200 original participants. This study works well, from the diversity, population size, and duration (years of study time) for actuarial science, to determine, with reasonable certainty, the mortality impact of specific risk factors for developing disease and stability (or progression) of disease over time. This insight into crucial risk components is incorporated into underwriting manuals that guide the underwriter in capturing all relative risk factors the same way for every cardiac risk. However, the studies, the actuarial science, and the manual do not provide insight into the nuance of each risk. Meaning the data will indicate in broad terms a potential outcome. Still, the information underwriters develop on applicants or insureds is not purely broad-based impairment data; it is very specific to that individual.

What does this intersection of actuarial science versus underwriting do? Suppose you are an underwriter that 'underwrites by the book' and applies what an underwriting manual suggests without considering the unique factors of the individual. In that case, there is a high probability that you will over or under-assess the risk (by applying too many or too few debits or credits). Then, when using that outcome in the actuarial table, which could be the most relevant table for the population of risk being assessed, the estimated life expectancy may be useless in pinpointing the risk.

“Still, the information underwriters develop on applicants or insureds is not purely broad-based impairment data; it is very specific to that individual.”

Based on life settlement-specific information noted in various articles, white papers, and presentations I ingest weekly, I have yet to see anything that focuses on the underwriting of the risk and how it impacts the mortality outcomes. Instead, most of the information is a continued argument over which table is best; Social security population being more relevant than insured lives tables, not sharing mortality tables because it is the ‘secret sauce’ of the process, layers of different tables to fit the risk, etc.

While actuarial science is critical and has a place in developing appropriate tables based on the unique factors of the population being underwritten, underwriting is where the discussion should focus, even if you are working with a LEP that establishes all outcomes on the table. If you do not understand the underwriting methodology or philosophy, and you are not being provided that insight by the LEPs you are working with (assuming you are speaking with someone that is a professional and certified Actuary or a Certified Underwriting Professional), it is to be expected that the outcomes seen in the block of business you are managing will be not what you thought you’d see.

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Secondary Life Markets Conference 2023

Date: **September 12th 2023**

Location: **EY, Canary Wharf, London, UK**

Details to be announced visit **elsa-sls.org**

A large, stylized, white-outlined text spelling "ELSA" is positioned in the lower right area of the image. The letters are designed with sharp, angular edges and varying heights, giving them a modern and dynamic appearance. The background of the entire image is a dark, slightly blurred photograph of a modern skyscraper with a glass and steel facade, showing its complex structural lines and reflections.

Q&A

Nat Shapo

Partner, Katten Muchin Rosenman



The subject of enhanced cash surrender value offers (ECSVOs) made by life insurance companies in the United States during the past few years has caused a great deal of chagrin amongst those in the life settlement industry. Greg Winterton spoke to Nat Shapo, Partner at law firm Katten Muchin Rosenman, to get his views on the issue.

GW: Nat, for those who might not be too familiar with ECSVOs, tell us what they are.

NS: A few life insurers are making limited-time offers, by endorsements created many years after the creation of the policy form and the issuance of the policies, of substantially spiked cash surrender offers which are calculated by radically different methods than the benefit specification in the issued policy. They are being made on specific blocks of universal life policies, usually with secondary guarantees, for the stated purpose of inducing policy terminations.

GW: ECVSOs are a hot topic in life settlement circles, as they essentially put life insurance companies in competition with life settlement investors. Isn't it a little disingenuous for life settlement investors to criticise competition? This is capitalism, after all.

NS: Insurance is a heavily regulated form of capitalism. Life insurers in order to be licensed must not violate the unfair discrimination prohibition and the Standard Nonforfeiture Law smoothness requirement, both of which, like all regulation, impede competition based on the legislature's policy decision that treating like risks alike supersedes insurers' ability to cut side deals which differ from the terms of the policies that everyone followed for years after they were issued.

Life settlement companies are licensed for a very discrete, much different purpose than life insurers. They do not group like risks together and spread and bear their risks. Instead, they pay market value for seasoned policies.

A leading life insurance executive recognized this in testimony where he explained that state insurance code "laws prohibited insurers from giving more money for a policy to a customer over another. This was where life settlements come into the picture. Life settlement companies could discriminate on the market value of the policy."

Life settlement companies follow a slew of consumer protection laws that life insurers evade in their ECSV offers, including rescission rights, intermediary fiduciary duty, verification of consumer competence, and disclosure of competing alternatives. Each licensee should offer their own products and follow their own rules.

GW: Last year, after the NCOIL (National Council of Insurance Legislators) summer meeting, it issued a press release, declaring that 'certain' ECVSO's 'violated the standard non-forfeiture law'. That implies that there are different types of ECVSOs. What are the differences here?

NS: Life insurers have previously offered products with the same label, "enhanced cash surrender." This is a traditional product, offered by many insurers, with completely different characteristics. There is no spike in cash surrender value many years into a seasoned policy never contemplated by the originally issued policy design.

Instead, the traditional enhanced cash surrender product featured higher cash values in earlier years to help with the accounting treatment of employee benefits. This is nothing like the ECSV products which are at issue today, which have only been offered for a few years by a few insurers.

GW: The state of Montana recently issued an Advisory Memorandum to life insurance companies, stating that ECVSOs were not compliant with some provisions of the Montana Insurance Code. Other states have done something similar. Does this mean that the risk that ECVSOs present to the life settlement market is receding?

NS: Nine states have taken some kind of action with respect to ECSVs. This includes two states who recently rescinded all four previous approvals for these products. This is good progress which we hope will spur action in more states.

GW: If you're an end investor in a life settlement fund, what do you need to be asking your manager about the ECVSO issue? Are there any other risks that ECVSOs present to the market that they should be aware of?

NS: Once an investor owns a policy, ECSVs do not pose a direct risk to that investment, since the investor has a contract with the insurer and can pay premiums until the death benefit can be claimed. The issue is a macro one for all stakeholders in the life settlement market—ECSVs may take policies which would be candidates for future life settlements out of commerce before the consumer is made aware that his or her asset might have a secondary market value.

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Change in Approach A Necessity to Combat Human Capital Challenges In UK Pension Risk Transfer Market

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The growth in the UK pension risk transfer (PRT) market in the past few years has been accelerated by the recent rises in interest rates, the effect of which has been an increase in many defined benefit pension funds' balance sheet readiness for a buy-out or buy-in solution.

On the surface, seeing a significant growth in deals is music to the ears of the ecosystem at large; an array of lawyers, salespeople, actuaries and analysts.

But underneath the headline numbers lurks a formidable obstacle – that of a lack of people power to absorb the glut of work.

"The real constraint in terms of the amount of deals we can do is people. PRT is quite a complex world, transactions are quite challenging to price, structure and execute, they involve a lot of parties, and they are time consuming," said Andy McAleese, MVP, Longevity, Europe at Pacific Life Re. "There is quite a limited pool of specialist people that can do this, and we're all looking for the same people, and that's a real impediment to growth." The people challenge to which Mr McAleese refers has been exacerbated by the Covid-19 pandemic and the unforeseen consequences of working from home.

"There is quite a limited pool of specialist people that can do this, and we're all looking for the same people, and that's a real impediment to growth."

During the lockdowns imposed to combat the spread of Covid-19, the lines between home and work became blurred for people in many industries, as the traditional commute – which previously offered some level of segregation of work time and non-work time – was eliminated, a consequence being that the PRT market was already losing people even before the dramatic increase in activity that the market has seen recently.

"You can work on even more deals when you're not spending three hours commuting," said Pretty Sagoo, Managing Director of Defined Benefit Solutions and Member of the Group Executive Committee at Just Group.

"But the result was devastating for a lot of young people who just barely got out of their bedrooms sometimes. Covid led to an exodus of pricing actuaries just as a result of them never seeing the light of day."

The industry has begun attempts to address the people resource challenge. Mr McAleese and Ms Sagoo were part of an initiative that gathered market participants together to discuss some of the mental health challenges in the space back in 2021.

"It started with a roundtable of senior leaders from across the market – lawyers, consultants, reinsurers, insurers - talking about people and wellbeing, including the question about burnout and how could we address that. It was a positive discussion, highlighting the importance of sharing our challenges, such as the difficulties in saying no to clients or handling tight deadlines and late nights. We expanded that to a PRT and Talk event so that broader range of people could share their experiences and ideas about working in the market," said Mr McAleese.

Initiatives like PRT and Talk are welcome developments for many in the industry, but it's not a silver bullet, unfortunately. Implementing a better support system and work environment benefits only those who are currently in it, and the numbers shortage remains. Investment banking has long recruited people with different skill sets and educational backgrounds, and now, the PRT market is also looking further afield to address the numbers gap.

"I'm a non-actuary, but I can do maths," said Ms Sagoo. "I spent ten years on a longevity desk at a bank and we did billions in transactions with only one actuary out of a team of 15 people. Our market has overlooked people because of strict job requirements that, looking back, might not have been necessary. We've put ourselves into a box, but we need to get off the hamster wheel of always doing the same thing recruitment-wise because I think that different skill sets can give a competitive advantage in the long term."

The expansion of the net the PRT market throws to catch new talent should go some way to alleviate the challenge, but it takes time to train new recruits, particularly those that have recently graduated from university.

But other industries are competing for that talent as well, and so Ms Sagoo says that the 'new normal' – not so new anymore, perhaps – of 'hybrid' working is something where, for firms that are willing to implement more flexible working arrangements, it can be a competitive advantage.

"Covid led to an exodus of pricing actuaries just as a result of them never seeing the light of day."

"I've lost talent because they didn't want to come in three days a week. And I've lost talent because they didn't want to come in ever. But I've never lost anyone because they wanted to come in five days a week – so that can't be the only option!" she said. "We have to keep an open mind about this so that we maximise the size of the available talent pool."

The current healthy nature of the funding position of defined benefit pension funds means that scheme trustees will be knocking on the door of consultants for years, as even in the event of a reduction in interest rates, those that implement effective hedging strategies should be able to maintain their fully funded status.

The steps the industry is currently taking to address the talent shortfall would arguably reap rewards, but until these initiatives begin to bear fruit, in the short term, it's about managing what you've got.

"The challenge that we've got now is not just the extent to which the lack of people might impact the growth of the market, it's the risk that the short-term opportunity that exists now starts to burn people out. There could be the temptations to repeat the cycle of late night after late night, quote after quote, because of the situation now," said Mr McAleese. "It's about asking ourselves: 'How can we start to think differently, and protect our people,' because the PRT market is a long-term market and we need this to be sustainable."



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