Life Risk News

Volume 2
Issue 10
October 2023

Plenty of Positives for Life Settlement Market Despite Challenging Macro Environment

Life Risk News
ISSN 2753-7374
Volume 2, Issue 10
October 2023

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Editor's Letter, Volume 2, Issue 10, October 2023

Chris Wells
Managing Editor
Life Risk News

The impact of the rising interest rate environment of the past 18 months has had a significant impact on the life settlement industry, as it has with all alternative asset classes. *Greg Winterton* spoke to **Bill Corry**, Founder at **Corry Capital**, **Alejandra Limones**, Partner at **Demeter Capital** and **Jonas Martenson**, Founder and Sales Director at **Ress Capital** to get their thoughts on the state of the life settlement market in *Plenty of Positives for Life Settlement Market Despite Challenging Macro Environment.*

A number of factors determine an individual's likely life expectancy, but there is also evidence to suggest that social contact has an impact on mortality rates. *Aaron Woolner* spoke to **Sacha Dhamani**, Chair of the Mortality and Morbidity Research Steering Committee at the UK's **Institute and Faculty of Actuaries, Rahul Nawander**, Medical Director at **Fasano Associates** and **John Lynch**, Director of **Actuarial and Underwriting Services at Longevity Holdings**, for their thoughts on the topic in *Evidence Mounts That Loneliness Shortens Life Expectancy.*

In life settlement litigation cases, some courts have held in recent years that an insured's use of a non-recourse loan to purchase a policy that they intend to sell amounts to an unlawful wager, which renders the policy void. Not so in North Carolina; *Jeffrey Davis* spoke to **Andrew Dykens**, Senior Associate at **ArentFox Schiff**, to get his views on the Trevathan ruling in *Life Settlement Market Sees Positive News Coming Out of North Carolina.*

The life ILS market is a multi-faceted one, providing an array of opportunities for both institutional investors and asset managers to participate in the space. Greg Winterton spoke to **Craig Gillespie**, Head of Life and Alternative Credit Portfolio Management at **Leadenhall Capital Partners**, **Scott Mitchell**, Head of Life ILS, Portfolio Manager at **Schroders** and **Gokul Sudarsana**, Managing Director, Chief Actuary at **Hudson Structured Capital Management** to get their thoughts on the current state of the market for a roundtable this month.

Macro- and micro-longevity risk don't describe or imply anything about a life expectancy provider's methodology, but as they assess more lives over time, underwriters learn more about the macro and micro implications of their work. **Chris Conway**, Chief Development Officer at **ISC Services**, explains more in a commentary piece, *Deciphering Longevity Assessment: Unveiling Macro-Longevity and Micro-Longevity Perspectives*, this month.

The life settlement industry tends to measure its size based on the US dollar value of policies transacted in the space's secondary market, but the industry's tertiary market is much larger in terms of the total face value of policies transacted. But what about the amount of money that the asset managers in the space run? We wanted to see what our readers thought, so our poll for this month asked, *What Is Your Best Estimate for the Total Value of Life Settlements in Assets Under Management (AUM) Across All Life Settlement Funds?*

Consumer awareness in the secondary life settlement market is a perpetual hot topic in the industry. Greg Winterton spoke with **Michael Freedman**, CEO at life settlements provider **Lighthouse Life**, to get his take on the current state of consumer awareness in the space and what could be done to improve in this month's *Q&A.*

The UK government's plan to reform the country's insurance regulatory regime took its latest step on 28th September with the publication of the Bank of England Prudential Regulatory Authority's Consultation Paper regarding the planned changes to matching adjustment portfolios. One of the key points that British politicians are trying to push here is that they want the insurance sector to be able to invest in a wider range of assets than they currently can – but just changing the rules might not be enough. *Greg Winterton* spoke to **David Burton**, Partner at EY in London, to get his thoughts in *Matching Adjustment Portfolio Reform Unlikely To Open Illiquid Assets Floodgates Just Yet.*

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

Plenty of Positives for Life Settlement Market Despite Challenging Macro Environment

Author:
Greg Winterton
Senior
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Life Risk News

The rising interest rate environment of the past 18 months has had a significant impact on the alternative investment industry, with fundraising across all the main segments – hedge funds, private equity, private debt, real assets – falling in 2022 and then again this year as global capital allocators pivot to assets that are perceived as having lower risk, higher liquidity and now, for the first time in more than a decade, an acceptable yield.

The impact has certainly been felt in the life settlement market.

"You can get a four-week US treasury bill for around 5% at the moment," said Jonas Martenson, Founder and Sales Director at life settlements investor Ress Capital. "It's had a big impact on asset raising in our space."

What's unclear is how long the current macro-economic situation will persist. In September, both the Bank of England and the US Federal Reserve held interest rates steady for the first time in more than a year, providing optimism for certain investors. But for Martenson, the current situation highlights something that he thinks the life settlement space more broadly should be promoting regardless of the prevailing macro-economic and capital markets climate.

> **"The asset class is still very unknown. Most investors in most countries have no idea that an American can sell their life insurance policy. Life settlements is truly uncorrelated so if you take the positive side, there are a lot of investors waiting to be educated who have never heard about the asset class."**

"Investors like the uncorrelated returns. I think we should be pushing that more closely," he said. "The asset class is still very unknown. Most investors in most countries have no idea that an American can sell their life insurance policy. Life settlements is truly uncorrelated so if you take the positive side, there are a lot of investors waiting to be educated who have never heard about the asset class."

The uncorrelated nature of the return profile of life settlements isn't the only benefit that the industry could use in its sales pitch, according to Alejandra Limones, Partner at Demeter Capital. Whilst the ESG topic has taken something of a back seat in recent months to the broader macroeconomic climate – at least, in terms of column inches - many investors are still interested in exploring opportunities that support their own ESG requirements, and she says that communicating the social benefit is something the life settlement market could be better at.

"Correlation is the top bullet point. But ESG isn't played up enough in this asset class – probably due to the negative press life settlements used to get. We need to focus on all the good that this product is doing to fund the retirement gap in the US, and the various social benefits of it. And I think for the big pension funds that are looking at impact investing, this should be a big opportunity and selling point for us and we should focus on publicising that," she said.

The 'negative press' issue that the life settlement industry has received in the past is less of a barrier for managers looking to secure an allocation than it used to be, but there are other challenges that were born many years ago that the industry is still paying off. According to Bill Corry, Founder at Corry Capital, it's important that the space acknowledges that expectation setting could have been better.

"Sometimes I hear stories of disappointment from investors who have invested in the asset class in the past, not just because the returns had been over promised, but also because cash flows weren't what they were hoping. I think it's important for both managers and investors to understand the past to have a better conversation about what it is you're trying to achieve," he said.

A recent good news story in the space came in the summer, when trade publication The Life Settlement Report, part of The Deal published its annual secondary market provider league tables, which showed that around $4.5bn of face value transacted in 2022, a return to growth for the space after a retraction in 2021. Overall, the secondary market has grown four-fold in the past decade or so, from just $1.1bn in 2013.

There is no publicly available data for the tertiary market, however. But it's generally accepted that the space is much larger than the secondary market, as life settlement portfolios contain multiple policies, often many years old, so the sheer number of policies transacted each year is naturally higher than the secondary market, which consists only of new settled policies. Still, while the secondary market is growing, that's not the case in the tertiary space.

"Correlation is the top bullet point. But ESG isn't played up enough in this asset class – probably due to the negative press life settlements used to get. We need to focus on all the good that this product is doing to fund the retirement gap in the US, and the various social benefits of it."

"If I look at opportunities this year in the tertiary market compared to last year, we probably see a 25% decrease of the paper auctions, whether that's liquidity in open ended funds, or funds coming to end of life, or bankruptcy cases. That tells me that buyers and sellers are not quite meeting at the current price expectations," said Limones. "Buyers would like to see a higher yield and sellers are maybe not willing to sell their paper at the current demand. That points to illiquidity and it only takes a couple hundred basis points correction to erode and to get the new capital coming in."

"The opportunity is significant. From a capital raising perspective, it's never looked better, despite higher interest rates. Supply is a challenge, but it always has been. A lot of people don't know a great deal about life settlements, including institutional investors. This makes the opportunity so encouraging."

Whether the pull back in the tertiary market continues also remains to be seen. But these deals are still moving existing policies around different investors. To truly grow, there needs to be more activity in the secondary market, and life settlements participants will have to wait another nine months or so to see if the 2022 upturn in the secondary market continues. But overall, Corry says that the life settlement market is in a good place.

"The opportunity is significant. From a capital raising perspective, it's never looked better, despite higher interest rates. Supply is a challenge, but it always has been. A lot of people don't know a great deal about life settlements, including institutional investors. This makes the opportunity so encouraging."

Evidence Mounts That Loneliness Shortens Life Expectancy

Author:
Aaron Woolner
Contributing Editor
Life Risk News

A number of factors determine an individual's likely life expectancy, but there is also evidence that social contact has an impact on mortality rates. The link between the latter and life expectancy is well documented with a broad range of data to support it.

A 2019 study by Drexel University, for example, found the average life expectancy for the lowest socio-economic groups in the US to be nine to 12 years below that of people the same age in the highest socio-economic cohort.

But according to Sacha Dhamani, chair of the Mortality and Morbidity Research Steering Committee at the UK's Institute and Faculty of Actuaries, as people age the importance of how much social contact they have increases – whereas the impact of socio-economic variation decreases.

"Typically, socio-economic factors are very powerful between the ages of 60 to 75 in terms of predicting life expectancy, but social contact becomes increasingly important between the ages of 75 and 85; and after that mental wellbeing, social interaction, and engagement are much more important than is commonly recognised."

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Dhamani says that this is also true for older people who suffer from some form of physical impairment.

"At which point, how much purpose there is in their life is what matters most. And that will drive their level of social engagement, but if they're physically restricted this becomes very hard."

Rahul Nawander, an Ontario-based medical director at Fasano Associates, which operates in the life, health, and life settlements sectors, agrees with Dhamani on the negative impact of low levels of social contact on life expectancy. But he says there are also other factors at play in the same age group that is most impaired by a lack of human interaction.

"It's true from a research perspective there is an increased risk of mortality linked to loneliness, and social isolation, particularly in relation to elderly lives. But is it magnified to an extent that it trumps the other risk factors? That might not be entirely plausible."

According to Nawander, biological factors also become important at a similar age to when loneliness becomes a risk factor, with mild cognitive impairment typically starting around 75: the age at which the grey matter in a person's brain typically starts shrinking.

"It's a natural process of ageing. Some people still live much longer, such as into their 90s before experiencing cognitive decline, but roughly 16 out of 100 lives will experience this form of brain atrophy, at which point the level of support becomes very important."

The critical issue is that while loneliness is a simple concept to explain it is a difficult one to measure, and Dhamani says a lack of publicly available data on the issue makes it hard for UK life insurers to incorporate it into their underwriting.

This may change. In the UK, people typically annuitise at around 65, however, as part of a general trend towards later retirement, Dhamani says the age at which people annuitise is expected to rise, meaning the industry will need to account for the impact of loneliness on life expectancy.

"While it's incredibly difficult to measure loneliness it's something the industry will have to deal with if the annuitisation age moves closer to 75 as we expect. In which case the current medical underwriting approach will become less relevant and actuaries will need to find a way to proxy the impact of loneliness on life expectancy," says Dhamani.

Currently, Dhamani says the UK life insurance sector is not explicitly pricing for loneliness when underwriting annuities.

"It's true from a research perspective there is an increased risk of mortality linked to loneliness, and social isolation, particularly in relation to elderly lives. But is it magnified to an extent that it trumps the other risk factors? That might not be entirely plausible."

"Because of the lack of data and the current annuity observation point being at retirement, this issue is not a critical one for the industry, because everyone is taking the same approach and therefore there isn't a selection risk between companies," he says.

The approach is slightly different in the US life settlement industry. John Lynch, Director of Actuarial and Underwriting Services at Longevity Holdings, said that the firm accounted for loneliness in its Fasano Associates business, but he declined to elaborate citing its proprietary nature.

He also said that Longevity Holdings' other product line, TwentyFirst Services, does not explicitly debit for loneliness in its book of business; it does, however, look at linked factors including mild or major depression, and issues such as anxiety.

"Without a doubt there's a loneliness factor after a spouse dying, but it's more of a flat extra type risk factor than a debit that would endure forever. It's a higher risk factor for the next two or three years. After that mortality levels revert to normal."

While there is uncertainty over the exact impact of loneliness on life expectancy, Lynch says that there is clear evidence for the negative effect of a spouse dying.

According to a study of Medicare data, roughly 50% of men die within nine years after the passing of a partner, a number which falls to about 30% for women.

But even with the clear level of data on the impact of a partner's death there are still limits to its use as a proxy.

"Without a doubt there's a loneliness factor after a spouse dying, but it's more of a flat extra type risk factor than a debit that would endure forever. It's a higher risk factor for the next two or three years. After that mortality levels revert to normal," said Lynch.

It is unclear exactly why widowed women have longer life expectancy than men, but Nawander says that research suggests that after the age of 65 women expend more energy on expanding their social networks, whereas men are more likely to turn to alcohol.

"That could perhaps be the reason women live longer," Nawander says.

Even with the clear link between the death of a spouse and life expectancy, Dhamani says there are still issues using marriage as a proxy for loneliness because there are a number of factors involved which are difficult to isolate.

"You might be the grumpiest person in the world. But if you've got a wife and children who make sure you're okay, you're going to get a mortality benefit from that, even if you are not talking to anyone else."

Other proxy data for loneliness has its own complexities. Facial recognition software could be a good indicator; how often someone smiles is in theory a good predictor of happiness, however, there are already high profile issues relating to racial bias in new technology, as well as the difficulty of relying on as-yet-unproven innovations.

According to the UK's Campaign to End Loneliness, the number of people who said they experienced loneliness increased by 6% during the Covid pandemic, a trend which shows no sign of retreating. But Dhamani points to the success of some retirement communities in North America in dealing with this issue and says this shows there is hope for the future.

"If British people had a more positive attitude about care, and recognised it's not just there at the end of their lives and instead create systems that build upon those seen in the US, it's possible for people to live healthier and happier lives at the end of their age range. It could also mean that some of these people are able to stay in work – and benefit from the social engagement that brings for longer."

North Carolina's Trevathan Ruling A Win for Life Settlement Market

Author:
Jeffrey Davis
Contributing Editor
Life Risk News

In a ruling that sets up North Carolina as a favorable jurisdiction for the life settlement business, a judge has ruled in favor of Wells Fargo in a dispute over the legality of a policy that North Carolina resident Dr. Gordon E. Trevathan Jr. took out on himself to later sell purely as a profit-making venture.

The Hon. Mark A. Davis, Special Superior Court Judge for Complex Business Cases, issued an order in May finding that the Columbus Life Insurance Co. policy Dr. Trevathan had obtained to cover his own life -- and which later came under the control of Wells Fargo Bank NA -- was not an illegal wagering contract.

"This decision is important for life settlement investors because it reaffirms that a prearranged agreement with an investor is required for a policy to qualify as an unlawful wagering contract, even where the insured uses a non-recourse loan. It is not enough for the insured to hope to eventually sell a policy to an investor. This is important because some courts have held in recent years that an insured's use of a non-recourse to purchase a policy that they intend to sell amounts to an unlawful wager, rendering the policy void. Trevathan rejects this conclusion."

The judge emphasised that Dr. Trevathan always had full discretion over the choice of whether to keep, renounce, or sell the insurance policy, writing that, "it is important to note that our Supreme Court has made clear that a life insurance policy is a form of property and that, once lawfully issued, it can be assigned or sold to any third party—for investment purposes or otherwise."

"The ultimate issue in this case lies at the crossroads of two well-settled doctrines in North Carolina," Judge Davis continued.

"First, life insurance policies that are merely 'wagering contracts' on the life of the named insured are void from their inception as contrary to public policy. Second, the holder of a valid life insurance policy is free to sell or assign that policy to any third party for any reason following the policy's issuance.

"The point is that Dr. Trevathan was at all times in complete control over the decision as to whether he would keep, abandon, or sell the policy," Judge Davis wrote.

Andrew Dykens, an attorney with ArentFox Schiff in New York City, called it an important decision for the life settlement industry because even though the court concluded that Dr. Trevathan bought the policy with premium financing intending to sell it, "the court enforced the policy and determined that it was not a wagering contract because the insured had control over the policy's disposition".

Dykens pointed out that Dr. Trevathan used non-recourse premium financing which has been attacked across the U.S. in negative court decisions.

"This decision is important for life settlement investors because it reaffirms that a prearranged agreement with an investor is required for a policy to qualify as an unlawful wagering contract, even where the insured uses a non-recourse loan. It is not enough for the insured to hope to eventually sell a policy to an investor. This is important because some courts have held in recent years that an insured's use of a non-recourse loan to purchase a policy that they intend to sell amounts to an unlawful wager, rendering the policy void. Trevathan rejects this conclusion," Dykens said.

"On a practical level, North Carolina is now a favorable jurisdiction for investors," Dykens said.

The case began in 2004 or early 2005 when Dr. Trevathan learned from his friend, Fred Webb, that Webb had made extra money — with no required upfront investment on Webb's part — by allowing a life insurance policy to be taken out on his life that would subsequently be sold to investors.

In 2005, Dr. Trevathan secured a $1 million life insurance policy along with a $1 million rider from Columbus Life with the aid of an insurance producer.

The initial two years' premiums for the policy were covered through a premium finance loan obtained from E&W LLC, a financial firm located in North Carolina. This loan was backed by the policy itself, which served as collateral.

> **"Judge Davis, in his ruling, pointed out several key aspects. First, he determined that the policy does not qualify as a wagering contract, stemming from the fact that the insurance producer who facilitated the policy's acquisition was not the ultimate assignee of the policy post-issuance, and there was no actual assignment of the policy to the insurance producer."**

After two years of coverage, Dr. Trevathan could choose from three options at the maturity of the premium finance loan:

1. surrendering the policy to E&W in full satisfaction of the loan;
2. paying off the loan balance to E&W and keeping the policy for himself going forward; or;
3. selling the policy and using the proceeds to pay off the loan balance.

In his deposition, Dr. Trevathan testified that he had not been in the market for life insurance prior to his initial discussions with Webb and the producer. When asked if he had any beneficiaries for whom he wished to provide financial benefits by means of life insurance coverage, Dr. Trevathan responded that "they weren't his thoughts at that time".

Instead, Dr. Trevathan testified that he believed that obtaining an insurance policy on his life "looked like an easy way to accumulate some funds."

Additionally, Dr. Trevathan testified that at the time the policy was taken out he had no intention of either paying the premiums himself or subsequently paying back the loan and retaining the policy.

In 2007, the policy was sold to LifeTrust LLC on behalf of its client, Assured Holdings, leaving Dr. Trevathan with more than $200,000. The policy underwent another change in ownership in June 2012 when it was acquired by Wells Fargo, acting as the securities intermediary for the policy owner, LSH Co.

In 2011, Columbus Life included the Trevathan policy in an internal roster titled "potential investor-owned/life settlement policies." This decision was based on a series of "red flags" that suggested the policy might be a stranger-oriented life insurance policy (STOLI), as detailed in the order.

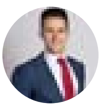
The insurer initiated legal action in January 2021, seeking a declaratory judgment. Their objective was to establish that the policy is unenforceable due to its classification as an illegal wagering contract on human life and void because it lacks an insurable interest.

Judge Davis, in his ruling, pointed out several key aspects. First, he determined that the policy does not qualify as a wagering contract, stemming from the fact that the insurance producer who facilitated the policy's acquisition was not the ultimate assignee of the policy post-issuance, and there was no actual assignment of the policy to the insurance producer. Additionally, LifeTrust and Assured Holdings were not involved in the policy's procurement process.

"No such wager by a 'stranger' on the life of Dr. Trevathan existed at the time of the policy's issuance," the judge said. Judge Davis concluded that the life insurance policy issued by Columbus Life to Dr. Trevathan is legally valid and enforceable.

Attorneys for Columbus Life Insurance Co. or Wells Fargo didn't respond to an emailed request for comment from Life Risk News in time for publication.

Roundtable
Life ILS Asset Managers



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The life ILS market is a multi-faceted one, providing an array of opportunities for both institutional investors and asset managers to participate in the space. Life Risk News' Greg Winterton spoke to Craig Gillespie, Head of Life and Alternative Credit Portfolio Management at Leadenhall Capital Partners, Scott Mitchell, Head of Life ILS, Portfolio Manager at Schroders and Gokul Sudarsana, Managing Director, Chief Actuary at Hudson Structured Capital Management to get their thoughts on the current state of the market.

GW: The life ILS market provides for a wide array of investment opportunities. How do you view the opportunity set? What are your areas of focus?

CG: Leadenhall has been providing insurance linked investment strategies for 15 years and in that time, our investment activity has encompassed all of the major life and health insurance markets. At present we see a wide range of compelling investment opportunities. There is a general scarcity of capital across all investment markets, and we see the current environment as being an opportune one for capital to be better rewarded through both increased return and more remote risk profiles.

SM: Yes, that's right – the life ILS investment universe can be quite nuanced and can mean different things to different investors. Schroders' primary focus for life ILS has always been the structured life insurance financing trades, such as Value of In-Force financing arrangements relating to underlying blocks of life insurance. We have a secondary focus on more traditional life insurance debt financing as well as investments into pure risk transfer instruments relating to mortality or morbidity.

GS: Life ILS has several flavours – asset-intensive, biometric, commission factoring, life settlements, etc. We see the most value today in asset-intensive opportunities - investing in blocks of life insurance and/or annuity business that require significant reserves and running that off over a period of time – because it is a highly cash generative business model with diverse sources of earnings.

I think this subsector is sometimes overlooked in the life ILS conversation, since, as the name suggests, there is of course an asset risk component to the overall return profile. Some of the more traditional life ILS themes are designed to isolate just the insurance policy risk per se, and that certainly has its own merits, but life insurance, by nature, is a longer duration product. As such, investment income will always be a key part of the overall return. When seeking to carve out asset risk in pursuit of a pure insurance policy-related investment, you can miss out on – or worse, not properly underwrite for – core earnings streams to service your capital.

GW: Most alternative investment strategies, including life ILS, are facing capital raising challenges due to higher risk-free rates; the life ILS space now needs to deliver even higher returns to maintain the spread. How has the elevated interest rate environment impacted your approach to asset raising?

SM: With the rising rate environment, many investors have become overweight with their illiquid asset class allocations, which has influenced their appetite to add to existing illiquid exposures. We're seeing that effect globally, with a pronounced effect in specific segments such as the UK pension market, where improved funding positions means there is greater scope to consider a buyout solution and there is generally less liquidity following the mini-budget fallout last year.

All this being said, the core life ILS proposition remains attractive and that message hasn't changed much. While there is reduced appetite from pension funds, which was historically the main source of capital for life ILS, we find ourselves speaking to different segments of the capital markets who are now looking at the space. The different perspective of those segments can result in a different discussion.

GS: A key objective of ILS generally is to access uncorrelated returns, and the recent turbulence in the broader capital markets has presented the opportunity for the industry to demonstrate that, and ultimately attract more capital. Within Life ILS, it may sound intuitive to think asset-intensive life investments would be more correlated than some of the other themes, but the business is well-insulated from most capital markets risk because of tight ALM and strong credit quality. In fact, a well-managed asset-intensive block actually benefits from a rising rate and widened spread environment, since that expands net interest margins. On the other hand, the effect of rising rates on lapse behaviour has challenged some other life ILS products. So, from a returns perspective, asset-intensive acts as a natural inflationary hedge that can support the higher return rates some allocators are looking for.

I would also add that there continues to be a robust bid for the asset-intensive blocks themselves, that has kept pricing fairly inelastic despite rising rates. I would point to two drivers. First, there is a secular shift of life and annuity blocks being acquired by asset managers, because the stable, long-term, low-cost funding provided by the reserves is highly complementary to their credit capabilities. And second, there is growing interest from long-term institutional capital – pension plans, sovereign wealth funds, Japanese financial institutions, etc. – that values the stable cash flow profile.

CG: There's certainly been an upending of the macro environment that had prevailed since 2008; the era of the Zero Interest-Rate Policies ("ZIRP") has now ended. Low rates were a big driver of institutional investors including pension funds turning to alternatives during that period as a way to boost and diversify overall portfolio yields to help meet the cost of their liabilities. That strategy of allocating to alternatives worked out well for many of these institutional investors in the post-2008 period. Now that central bank interest rates are up to 5% in certain markets - historically higher than any point in the past 20 years - a lot of institutional investors such as pension funds are now well funded and so this has reduced their short term need for alternatives.

From our perspective life ILS has always been a specialist investor product – it's not something that is "bought off the shelf". Sophisticated institutional investors that have done the work can still see a compelling rationale, especially those with a medium to long term investment time horizon that continue to see value in diversification and the opportunity to capture illiquidity premiums. Another consequence of the changed macro environment in the last couple of years is a reversal of any potential spread compression from broader generalist investors.

Generalists did start to creep into the space during the late stages of the ZIRP period, but now, with central bank interest rates reverting to historic norms this has had the effect of flushing out the generalists from the space. We see spreads as especially attractive at the moment relative to the last 10 years, but certainly, the case for allocating to alternatives is a tough one to bridge for many investors right now with other simpler more liquid markets also offering attractive absolute returns.

GW: This time last year most of the restrictions imposed by governments due to Covid-19 had been lifted. Now that we've had a year of something resembling normality, what's the current state of the impact of the pandemic on longevity and mortality risk investing?

GS: In asset-intensive, the market dislocation caused by Covid in March 2020 certainly paused deal activity temporarily. The public equity market was particularly punitive to life insurers, and that perhaps accelerated their thinking on divesting legacy reserves and pivoting to a more capital-light business model. That was followed by a period of quantitative easing through 2021 which made for an attractive environment for buyers to acquire blocks with low cost of funds. As rates have since steadily have moved up since 2022, margins expanded. The block market certainly cooled off in 2022 after a very busy 2021, but has picked up again in 2023 as the new rate environment seems to be settling in.

I would also add that primary sales, in both life insurance and annuities, have been strong since the pandemic.

CG: Over time our investment activities have been closer to the mortality risk investment side given the nature of our investor base. Mortality risk was stable for quite some time in the developed world during the pre-Covid era, however post-Covid it appears that we have entered into a more uncertain environment in terms of mortality experience. Excess mortality effects in recent years were initially being directly attributed to Covid incidence but now that we're a more than a year on from when lockdowns were fully lifted excess mortality has remained present in certain age groups and geographies around the world. There are a range of reasons for this excess mortality: individuals not being treated for other health issues during Covid, and the continuing opioid epidemic in the US, for example.

The impact of this excess mortality has fed through into the ILS markets with it being publicly reported that certain mortality risk transfer instruments are at risk of being triggered, leading to potential losses for investors.

These mortality risk instruments are, by their design, exposed to excess mortality events, however triggers being met on these will force some reflection and thinking in some parts of the investor community. In this post-Covid era we are treading more carefully when assessing mortality exposed investments as we seek to navigate the volatility in realised mortality rates.

The flip side to this volatility is that we observe increased demand for coverage as these excess mortality events and Covid itself has emphasised the potential benefits of mortality risk transfer. From a risk taker perspective, we are proceeding cautiously, to ensure that the risks being transferred to investors are priced correctly.

SM: We have historically focused more on mortality than longevity, so specifically in that space, we're still seeing mortality rates running at excess levels in the main markets we operate in – particularly, excess mortality in the working age groups.

What's making mortality modelling trickier is that the causes of excess mortality appear to vary by territory; it looks quite different in the US and UK, for example. That makes it more difficult to quantify the risk and naturally makes us more cautious when we're looking at prospective mortality-linked investments.

GW: Still on the deal space: the life ILS market exhibits the irresistible force paradox because insurers don't have many places to turn for financing options, but higher rates bring a lower appetite for deals. Which of these is winning out at the moment and why?

CG: It almost splits into those counterparties that have a firm need to finance and those who have the capacity to wait. This is a consistent dynamic with other industries whereby individuals or institutions that have the capacity to, defer major economic decisions until the environment is more certain for them.

Life insurance companies are, in general terms, benefitting from the higher interest rate environment, and so now may be a compelling time for life insurers to make strategic investment decisions. These strategic decisions often have associated financing needs, and this may be a driver of continued financing deal flow for the life ILS space. The higher interest rate environment may make absolute financing costs more expensive than they would have been in the past and this will be considered when assessing overall profitability of the strategic transaction that the life insurer may be considering.

SM: From our perspective, the sponsors of transactions are adjusted to the reality that we're not in the ultra-low interest rate environment anymore.

As rates were starting to hike there was perhaps an initial reluctance by deal sponsors to transact at higher rates, but now I'd say that the market has adjusted. And from our perspective, there is a strong flow of deal opportunities and spreads have been resilient, and that situation has probably benefited from the general tightening of liquidity across the broader markets.

GS: In a low-rate environment, buyers of asset-intensive blocks will assume lower prospective net interest margins and so need more upfront value to meet their return targets – i.e., lower purchase prices or lower ceding commissions. This generally limited the deal space to simpler, cheaper liabilities that are adequately reserved for; otherwise, sellers would have to have accept significantly higher upfront costs to clear the market. With higher rates, that paradigm reverses, so that has made complex, higher-cost products more addressable. For example, we've recently seen a number of Secondary Guarantee Universal Life blocks transacted that were previously challenging.

GW: In the UK, there is a lot of coverage in the news media about inflation and the cost-of-living crisis and the impact on consumer discretionary spending, which could feed into life insurance. Are you seeing changes in lapse rates in both the UK and other markets, and if so, how are you navigating that?

SM: The affordability of premiums can influence lapse experience on a block of life insurance policies but there are nuances here. Lapse rates can vary quite significantly by the type of life insurance product – for example, a savings product will behave differently to a pure protection product. But the financing structures that we put in place are typically structured conservatively and can absorb a significant lapse stress before it impacts invested capital. We're not seeing material impacts from lapses that are causing us any concerns. But again, that's because we adopt a conservative approach to structuring these transactions.

GS: In terms of managing lapse risk generally, we think about product design, business mix, asset/liability matching, and liquidity. Diversification among non-lapsable, lapse-supported and lapse-sensitive products helps stabilize your liability base, and to the extent there is lapse-sensitive business, focusing on product design to ensure strong surrender protection. Additionally, paying close attention to cash flow matching, and ensuring appropriate access to liquidity, will allow you to service any excess lapses without potentially being a forced seller of assets to raise cash.

This goes back to my earlier observation on the diverse earnings profile in asset-intensive business. In a pure lapse trade, rising rates can drive up lapse experience and impair returns whereas in

asset-intensive, a well-managed book of business actually benefits from rising rates, so it's a compelling way to participate in lapse risk.

CG: At present, in the markets we are active in, we do not perceive this as a meaningful issue. Lapse risk has always been a more volatile peril – it's not as stable a performer as mortality risk. The latter is a biometric peril with inherently more stability than a behavioural peril such as lapse risk. During Covid, people were worried about having life insurance in place in case the worst were to happen, and this was reflected in lower lapse rates, so it was a good time to hold lapse risk. As society has readjusted to life post Covid it would be reasonable to assume that there would be some mean reversion occurring in lapse rates, but nothing is jumping out to us specifically at present.

It's also important to note that lapse risk differs by product line. Many life insurance products have explicit disincentives to lapse such as surrender penalties and clawback periods where it may cost the policyholder to cancel. There are also inherent disincentives to lapse as if an individual lapses their policy, they are likely to have to be re-underwritten which could lead to a reduction in available cover or increased premium cost to obtain the same level of cover as before

GW: Aside from lapse rates, what are some of the other challenges that the life ILS market faces as we look to the next 12-18 months - and on the flip side, what about the opportunities?

GS: In asset-intensive, I would say the key focus areas are pricing discipline and heightened focus on ALM, liquidity and credit quality. As mentioned earlier, buyers can expect higher asset yields in this environment to support higher cost products, but it is critical to lock in those net interest margins so you're not exposed to reinvestment risk if rates fall and therefore stuck with a high cost of funds you can no longer cover. Similarly, the spread environment is also attractive in supporting asset yields, but you'll need to ensure that the underlying credit quality does not deteriorate.

I think there is a great opportunity in the pension risk transfer market globally. If you consider how pension funding has evolved over the last decade, we can expect to see a lot of volume transacted in this space (and already are seeing this). Pension funding status was generally impaired by the global financial crisis given substantial equity allocations. The subsequent equity bull market helped replenish the asset side, but the protracted low-rate environment kept liabilities high. Now with rising rates, those liabilities have come down and funding ratios have improved into a transactable range.

When you then overlay a potentially challenging corporate credit environment, it creates a compelling opportunity for corporates to de-risk their balance sheet via pension risk transfer. Meanwhile, the insurance market is also keen to assume these liabilities as a source of low-cost, persistent funding, so we anticipate attractive capital opportunities to support this demand.

CG: It's important to remember that all markets exhibit some form of cyclicality. Whilst the last couple of years have been tumultuous from a macroeconomic perspective, we continue to focus on a core message around why these strategies should be compelling for investors as part of their medium to long term investment portfolio planning.

Practically this means that is a case of steering our existing portfolios through the current environment and, when in discussions with potential future investors, making the pitch as to why an allocation should still be on their agenda when these investors are presented with other opportunities that may appear more compelling in the short term. Understanding where the likely next flows of capital are coming from – that will form our capital base in the next few years – is a focus area for us.

SM: I'd say the main challenge is probably around the reduced appetite in the capital markets for illiquid asset classes – it may take time for existing exposures to reduce naturally before we see similar levels of appetite that we saw prior to interest rate rises. We also anticipate a slowdown in mortality trades due to the ongoing uncertainty and difficulty in quantifying mortality rates.

On the flip side, we continue to maintain a primary focus on the financing trades, where the risk return profile – low volatility, excess spreads, and low correlation with broader capital markets – remains attractive compared to comparable asset classes. We think that remains attractive to investors relative to other comparable asset classes.

The views expressed in this article are those of the individuals.

Deciphering Longevity Assessment: Unveiling Macro-Longevity and Micro-Longevity Perspectives

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In an effort to differentiate between cohort and large population mortality information that predominates most discussions about longevity, life expectancy and other life underwriting-related topics, we have used two different terms. We use the term macro-longevity to refer to information about life expectancy involving large groups of people, the population of the United States for example. We use the term micro-longevity when we talk about the life expectancy (LE) of an individual. However, these are merely labels we use to keep any discussion about longevity risk focused on the situation at hand.

Using These Terms and Their Scope

We do not use the terms macro-longevity (risk) and micro-longevity (risk) to describe or imply anything about our underwriting methodology or the data and information we use to develop our underwriting tools or conduct our life expectancy assessments. The information we use to inform our underwriting philosophy, develop our underwriting manual, and apply our underwriting methodology is vast and constantly growing. As we assess more and more lives over time, this body of work expands and we learn more and more about the macro and micro implications of our work. In addition, we often see the work product of our competitors and we are occasionally asked to explain our assessment relative to that of one or more competitors who have evaluated the same individual. However, we are never asked to explain our assessment when the mean life expectancy figure assigned to the insured as a result of our underwriting is shorter than that of a competitor. Only when our LE is longer are we questioned. (We assume our competitors get these questions too when their LEs are longer than ours or any other underwriting firm).

Comparing Competitor Assessments

The question we are most often asked is, simply put, “Why is your LE longer than this other underwriter’s?” Usually, when the question is first posed, we have no documentation or any information about what the other underwriting firm’s report says. We always ask for this information, because without it, we cannot compare and contrast our work product with anything other than the assertion that our LE is longer than someone else’s LE. Once we have both sides of the picture, we do the work of comparing our assessment with that of our competitor(s).

The first thing we look for is the mortality rating applied to the insured by our competitor and the rating we applied. If they are the same (and it’s becoming increasingly rare that they are), and the LEs are different, we know that this is likely to be caused by a difference in the morality table used to calculate the LE figures themselves. In other words, if a given insured person is viewed by ISC and another underwriting firm as being impaired to the same degree (eg: both firms assigned a 200% mortality rating to the insured), and the LEs are different, the table is the most likely cause of the difference. (NOTE: There are underwriting firms out there touting the use of morality tables that are simply not suitable for use in the life settlement marketplace. Following these so-called “experts” can result in severe consequences).

> “The first thing we look for is the mortality rating applied to the insured by our competitor and the rating we applied. If they are the same (and it’s becoming increasingly rare that they are), and the LEs are different, we know that this is likely to be caused by a difference in the morality table used to calculate the LE figures themselves.”

> "When we look for the reason why another underwriter assessed the life differently than we did, we hope to see an indication as to what the other underwriter decided were the primary and secondary impairments, as well as other "comorbidities," factors that might also be influencing the insured's degree of impairment."

A Comprehensive Perspective

If the mortality ratings are not the same between the reports, then we have to look for the other underwriter's rationale, or some indication as to why they rated the insured the way they did. More often than not, there is no discernible correlation between the morality rating schemes used by various underwriters, and therefore, the differences between two LE reports are driven by significant differences in both the risk assessment methodology and the mortality tables used. When we look for the reason why another underwriter assessed the life differently than we did, we hope to see an indication as to what the other underwriter decided were the primary and secondary impairments, as well as other "comorbidities," factors that might also be influencing the insured's degree of impairment.

However, what we find most often is a list of health issues using medical jargon, nothing more. Assuming the same medical records were used by us and the other underwriters, we can see where this list comes from, but the list itself tells us nothing about the underwriter's "view" as to which of these issues is really driving the insured's mortality rating. As a result, we can always explain why our assessment is what it is, but it is rare that we are able to explain why another underwriter's view is different. Since it is always the case that we are asked about the difference only when our LE is longer, we assume the other underwriter is never asked by the client why their LE is shorter. (They may be, but we never are). Thus, the client cannot possibly understand the full context of our response, which we always provide. If the client really wants to know why two LEs are different, they have to ask the same question of both underwriters, and they need to be qualified to understand the responses they get.

October 2023 Poll Results

What Is Your Best Estimate for the Total Value of Life Settlements in Assets Under Management (AUM) Across All Life Settlement Funds?

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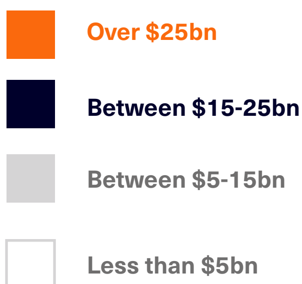
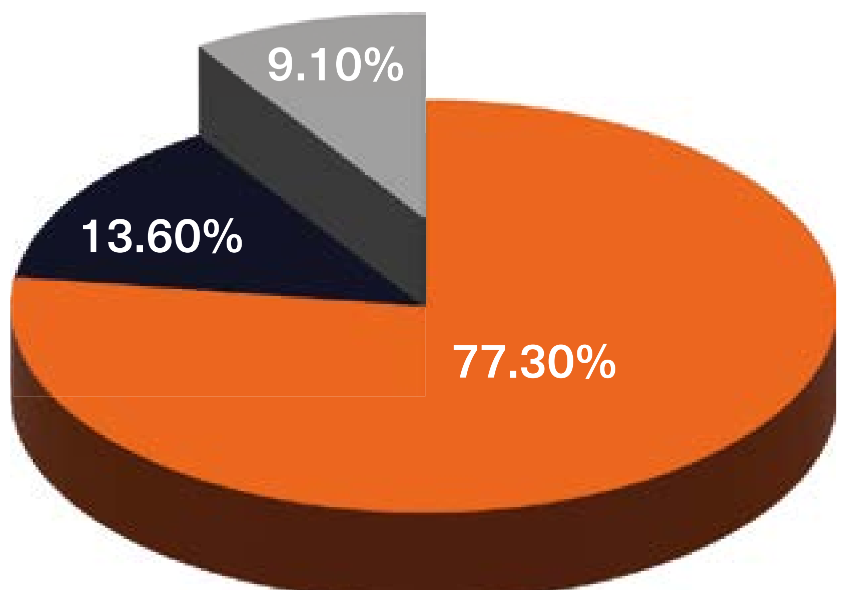
The life settlement industry tends to measure its size based on the US dollar value of policies transacted in the space's secondary market, which was $4.5bn in 2022, according to data published in the summer by The Life Settlement Report, part of The Deal, which uses data from state insurance departments to collect this information.

The industry's tertiary market is, by most accounts, much larger. And almost all funds will transact every year. But exactly how large is the market? It's difficult to know because of a lack of publicly available information. And specifically, we're looking at AUM here, so large, closed-ended, private equity-style funds will be raised that are purchasing large blocks of policies each year. So, for this month's poll, we asked Life Risk News readers what they thought.

A massive 77.3% think that the market manages more than $25bn in AUM at the moment, with the remaining respondents saying that industry AUM is between $5 and $25bn. None think it's less than $5bn.

The actual number is, of course, unknown. But what's certain is that the life settlement market itself thinks that it manages a not-insignificant amount of capital. They will be hoping that efforts to grow the size of the secondary market will drive the space to greater highs in the coming years.





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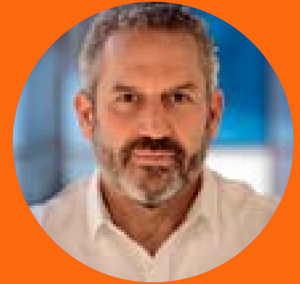

Michael Freedman
CEO, Lighthouse Life

Consumer awareness in the secondary life settlement market is a perpetual hot topic in the industry. Greg Winterton spoke with Michael Freedman, CEO at life settlements provider Lighthouse Life, to get his take on the current state of consumer awareness in the space and what could be done to improve.

GW: Michael, let's start at the beginning. If you were grading the current state of consumer awareness in the space, what grade would you give, and why?

MF: Greg, thanks for the opportunity to share some thoughts related to consumer awareness in life settlements.

Consumers' – particularly seniors' – awareness about their right and ability to sell their life insurance policies has risen in recent years largely as a result of advertising by life settlement companies directly to consumers (DTC). More seniors today than, say, a decade ago, know that selling their life policy is a more valuable option than lapsing or surrendering it because they've seen a television commercial, an advertisement when they are browsing the internet, or received direct communications via email or direct (snail) mail.

Likewise, perceptions about life settlements among seniors seem to have improved. This is again a result of advertising about life settlements, but also because the tens of thousands of seniors who have sold their policies over the past decade have had a valuable and positive experience. That said, many people still don't know much about what is involved in selling a policy. They may not think a life settlement applies to them or their personal or financial circumstances, or know how much their policies are worth, or be aware that consumers can be confident when selling a policy because the market is broadly and heavily regulated.

There's still vast room for advancing both general awareness and perceptions about life settlements. There are an estimated eight10 million seniors each year who will lapse or surrender a life policy over $100,000 that could have qualified for a life settlement (according to Conning), compared to the approximately 3,000-plus settlements that were transacted in 2021 and 2022 respectively.

Likewise, the senior population in the US will double over the next 15+ years. A majority of seniors own a life policy, and a vast majority of those seniors will lapse or surrender their policies. Now is the time to make further strides in consumer awareness and perceptions about life settlements and DTC will lead that charge.

GW: Americans with a life insurance policy that qualifies for a life settlement have other options available to them to access capital, including reverse mortgages. Why life settlements?

MF: Seniors who have a life policy and a need for that policy in order to protect loved ones or business interests, or to preserve assets, should try to keep their policy if they can. Life settlement companies are already required in most states to advise the seller to explore ways to keep the policy. (It's worth noting that a few states require policyowners who are planning to surrender or lapse their policies to be made aware of the life settlement option). A reverse mortgage is something that seniors who own homes can and should consider as well to meet their retirement needs.

But, if a policy has become too expensive to maintain, or if the owner of the policy has to access other resources to meet needs in retirement, it makes sense for the senior to explore a life settlement. A life settlement will always be worth more – usually multiples more – than if they lapsed or surrendered the policy.

Seniors report that they most often use their life settlement proceeds for retirement investments, or to pay medical bills, or just to live on.

There have been comparisons between life settlements and reverse mortgages because both involve seniors and an asset they own. But that comparison does not go beyond that. There are significant differences and reverse mortgages should not be a compared to a life settlement. A reverse mortgage, for instance, is a mortgage – a loan – that typically incurs interest and other charges and costs. There are other conditions and restrictions in reverse mortgages that can negatively impact government assistance for retirement and health care.

A life settlement, by contrast, is not a loan, and there are no on-going fees or costs that might incur to the seller after the sale of their policy. A life settlement pays the senior a lump sum payment – money that can often be used to help the senior stay living in their home for the rest of their lifetime.

GW: Life settlement market participants frequently point to the growth of the direct-to-consumer segment of the market as one that is driving growth in policy sales. What's your view on DtC?

MF: A fully functioning life settlement market has the capacity to be over two times larger than residential real estate. As the reverse mortgage market has peaked in the past few years, life settlements will continue to grow and will far exceed that market.

But there has not been much growth in life policy sales over the past several years, with life settlement companies reporting about 3,000 settlements in each of 2021 and 2022. What is interesting, however, is that those companies engaged in DTC have actually increased their share of the total life settlement market, suggesting that this channel is one that has significant potential to contribute to future growth.

Also noteworthy is that the average size of the life policies purchased over the past two years was approximately $1.5m. Yet the average size of a policy owned by a senior is just over $100,000. Again, this is good news for the DTC efforts of life settlements. The market can grow to capture more of the nearly 10 million seniors each year that are going to otherwise lapse or surrender their average sized policies. The current market leaders in DTC can be joined by others to "grow the pie" as the market for life settlement grows.

GW: What about the intermediated universe? Are there any subsets of this segment of the space that are responsible for either increased – or decreased – demand?

MF: The rising tide lifts all boats.

At the outset of DTC marketing in life settlements a few years ago, there were some fears (and grumbling) that consumer direct advertising would hurt the intermediary businesses of settlement brokers. The notion was that seniors would opt to go direct to providers. Those fears have been proven to be unfounded.

Increased consumer awareness has benefited intermediaries like settlement brokers, but also insurance producers, financial planners, advisors and others. Greater awareness has led to greater acceptance among insurance and financial advisors and their firms. Seniors are asking their advisors about life settlements because they saw an advertisement on television.

GW: Lastly, Michael, is there any low hanging fruit here that, if picked, would significantly accelerate the volumes of deals conducted in the secondary market? Or is it a case of 'keep on keepin' on'?

MF: I don't know if it's low-hanging fruit, per se, but let me summarize what I've tried to get across.

The opportunity for the life settlement market is vast and growing. The supply of policies can increase substantially. Strides have been made to reach seniors through DTC marketing and advertising, but these strides are only really the beginning of what can and should be done to unlock the value of life settlements for seniors, market participants and investors in the assets.

Matching Adjustment Portfolio Reform Unlikely To Open Illiquid Assets Floodgates Just Yet

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The UK government's plan to reform the country's insurance regulatory regime took its latest step on 28th September with the publication of the Bank of England Prudential Regulatory Authority's (PRA) Consultation Paper regarding the planned changes to matching adjustment (MA) portfolios.

One of the key points that British politicians are trying to push here is that they want the insurance sector to be able to invest in a wider range of assets than they currently can (because of the restrictions imposed by the existing Solvency II regulation). Pursuant to that objective, one of the most significant changes comes in the form of expanding the list of assets that qualify for MA portfolios from purely those with fixed cash flows (which is the current situation) to assets with 'highly predictable' cash flows, such as the infrastructure sector, an opportunity specifically called out in the November 2022 Consultation Response.

> "Demand for private assets is down across the board. Inflation hasn't proven to be transitory in the UK and the numbers are not coming down at the moment. If rates remain elevated – at least, compared to the last decade or so – in the medium term, then the outlook for allocations into illiquid assets from life insurance companies will remain subdued."

That sounds encouraging for infrastructure asset management firms. But the recent rise in interest rates means that liquid fixed income investments are back in vogue after more than a decade of central bank zero interest rate policy (ZIRP), which is causing appetite for illiquid assets generally to recede.

According to data and analytics firm Preqin, at 8th June, the global infrastructure market has raised just $6.5bn from 21 funds in 2023, compared with $185bn across 133 funds last year and $135bn from 187 funds in 2021. The story is similar in other private markets asset classes, with the private equity, venture capital, real estate and private debt all showing marked downturns in fundraising so far this year when compared to last. And it's a trend that may not be short-lived.

"Insurers will compare the expected return on illiquid assets to the alternative of traded assets. All other things being equal, if spreads on traded assets increase, that makes illiquid assets less attractive, unless their prices also fall," said David Burton, Partner at EY in London.

Another trend impacted by the rising interest rate environment is that of the relative boom in the UK's bulk annuity market. Many defined benefit pensions have found themselves fully funded and are therefore turning to the pension risk transfer space to insure their schemes so they can remove them from their balance sheets. Life insurers are awash with bulk annuity capital, and that capital will need to find a home. But another potential hurdle comes in the form of a regulatory warning.

In April this year, Charlotte Gerken, the Bank of England's Executive Director for Insurance Supervision, gave a speech at Westminster and City's 20th Annual Conference on Bulk Annuities which covered three topics: an expansion of BPA insurer risk appetites; an increased reliance on third party capacity; and greater interconnectivity with the wider financial system. Within her remarks about risk appetites, Gerken referred to illiquid assets.

"The disruption in the UK gilt market last autumn resulted in some pension schemes being overweight in illiquid assets as gilt values fell significantly, and schemes sought to reduce their leverage under liability driven investment strategies. We see insurers increasingly developing solutions to accept illiquid assets as part of the BPA premium, as pension schemes may be reluctant to dispose of these assets in the open market, potentially at a large discount. This requires significant due diligence, and we are seeing insurers seeking more advice from third party specialists such as property valuation experts both for illiquid asset valuation and to calibrate adequate market value haircuts. Alternatively, we have seen deferrals of premiums incorporated in deals giving pension schemes time to dispose of such assets in an orderly fashion. These premium arrangements can be complex and potentially capital intensive due to the increased uncertainty they can create."

Gerken's remarks focused on pension funds' existing exposure to illiquid assets during the scheme's journey to buy-out via the pension risk transfer market as opposed to any risks that life insurance companies may take from new investments. But it is added fuel on the fire. Schemes that hold illiquid assets as part of their investment portfolio could find themselves at the back of the queue, because the PRT market is enduring something of a labour shortage, meaning that the market can't absorb much more activity.

> "Life insurers will simply invest in what they think is the best opportunity within the confines of the prevailing regulatory regime," he said. "That opportunity might be infrastructure. But it might not. The current interest rate regime makes liquid fixed income investing very attractive for them and just because there is a change to the matching adjustment doesn't mean that the floodgates will open for illiquid asset managers – at least, in the short term."

"Constraints on insurers' asset allocation can arise from both the MA rules and also their specific MA and internal model applications," said Burton. "As a result, there are many types of illiquid assets that insurers may find difficult to take onto their balance sheets and pension schemes will need to recognise this. Having liquid assets that allow the insurer to reposition the portfolio itself will make such schemes more attractive at a time when insurers are being asked to provide quotes for a larger number of schemes."

So, manufacturers and distributors of illiquid asset strategies find themselves at something of an impasse in terms of desirability, at least from UK life insurance companies, at least in the short term.

"The Treasury hopes that the changes to the solvency regime will lead to more insurance investment in infrastructure, and other illiquid assets to support the UK economy. However, the impact of the proposed changes on insurers will very much depend not only on what the eventual rules say, but also how the PRA uses the increased discretion that it has in regulating. As a result, it is going to be a little while yet before we fully understand the impact of the new regulatory regime," said Burton.

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Life Risk News

Life Risk News
ISSN 2753-7374
Volume 2, Issue 10
October 2023

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