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Life Settlements Not Such an Unlikely ESG Ally

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Editor's Letter, Volume 1, Issue 2, June 2022

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Life Risk News

ESG pervades all areas of finance, and the life risk industry is no exception. But for holders of longevity risk, and in particular life settlement investors, the perception is that they can't be aligned to the ESG movement. Arguably, those holding that view can't see the woods for the trees, and so we spoke to Jonas Martenson of Ress Capital, and Rob Haynie of Life Insurance Settlements Inc. to explore this issue in this month's cover story, *Life Settlements Not Such an Unlikely ESG Ally*. At the onset and during the first few months of the Covid-19 pandemic, one of the many themes to emerge was that of comparing its effect on the population to the 1918 Influenza pandemic or the SARS pandemic of 2003, this was also of particular concern to holders of mortality risk, such as life insurance companies and life contingent structured settlement investors. We spoke to Matthew Edwards of Willis Towers Watson to learn more about the effects of the pandemic in *Mortality Risk Holders Thinking About Covid-19 Pandemic Impacts.*

New for this month, and something that you'll see in future issues of *Life Risk News*, is a litigation bulletin. These bulletins will examine the outcome of recent litigation in the life risk market, and this month, we have two articles from ArentFox Schiff discussing the outcome of two recent cases in the life settlement market, *Estate of Ann Rink, by its Executor, Michael Rink v. VICOF II Trust and Wells Fargo Bank, N.A. and Berkshire Hathaway Life Insurance Company of Nebraska v. Estate of Phyllis M. Malkin.*

The European life insurance market is facing several challenges and opportunities that are going to shape the future of the industry. Chief among these is an aging European population, which is having a polarizing effect on how insurers service their clients, as well as how they win new ones. Peter Manchester of EY discusses some of the immediate challenges that need to be addressed at a much more rapid pace than most retirement-focused companies are used to moving in a commentary article, *How To Navigate European Life Insurance and Retirement Trends.*

Another commentary piece this month comes from James W. Maxson of EM3 Law, *LLP. Life Settlements Due Diligence: Legal Counsel's Perspective*, sees Maxson explain the characteristics of life settlements that make legal due diligence particularly important for both managers and investors.

Our Q&A for this issue is with Chris Anderson of EY. Anderson is an actuary, and we spoke to Anderson to learn more about the impact of longevity on insurance companies and capital markets participation in life risk from an actuarial sciences perspective.

Finally, this month, we go to MedTech. Advancements in technology that are enabling more tailored risk assessment and treatment of the individual will have a profound impact on how companies and investors with exposure to longevity risk price that risk and construct their portfolios. We spoke to Nicola Oliver of Medical Intelligence to ask *Why Longevity Investors Should Pay More Attention to MedTech Trends.*

As always, if you're interested in getting in touch, whether that's with an idea for a topic that you'd like to see covered, or just to offer some feedback, please do so at greg@liferisk.news or send a note to the team at editor@liferisk.news. In the meantime, on behalf of ELSA, we hope you enjoy this second issue of Life Risk News.

Life Settlements: Not Such an Unlikely ESG Ally

Author:
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Life Risk News

Financial security in retirement for many is a precarious concept. According to Annuity.org, the average American woman retires with just $57,000 in savings. It's double that for men at $118,000. But, given the average American retires at almost 67 years of age and lives to be almost 77 years old, that nets out to $5,700 per year for women and $11,800 per year for men.

That's not a lot. Clearly, America, like many (all?) western countries, faces a critical societal challenge for its citizens in in their autumn years because they will likely need to secure additional and alternative funding options for their retirement.

For a certain segment of the population - those with a life insurance policy - there is one often underutilised option. It's called a life settlement. And for investors that strongly consider the 'S' leg of the ESG stool when allocating to alternative investment products, the life settlement sector says that their corner of the world aligns strongly with the ESG movement.

"There are all sorts of reasons that people need to turn to life settlements," said Rob Haynie, Managing Director at Life Insurance Settlements, Inc., a broker that represents sellers of life insurance policies. "The most common occurrences include paying medical bills or retiring debt. The costs of long-term care in the United States are exponentially increasing; the system is at a breaking point. Many seniors are already struggling to fund their retirement."

> **"We have the ESG conversation at the start because investors don't want to waste their time on a due diligence process only to find that the investment strategy doesn't align with their ESG policy."**

Many scoff at the notion that allocating to life settlements can support an ESG mandate. However, Jonas Martenson, Sales Director and Founder at Stockholm-based life settlements investment manager Ress Capital says that in Europe particularly, the ESG conversation comes into the due diligence process rather quickly.

"Pension plans in Europe won't invest in hardly anything without the approval of the ESG committee," he said. "So, we have the ESG conversation at the start because investors don't want to waste their time on a due diligence process only to find that the investment strategy doesn't align with their ESG policy."

Life insurance policies in the United States are considered property, and thus can be sold by the policy owner. Indeed, every life insurance policy has a 'surrender value' which is a price that the life insurance company that underwrites the policy must pay the individual when that person surrenders their policy (assuming that the premium payments are up to date). Selling a policy on the secondary market, however, could net the individual a significantly larger sum; according to the Life Insurance Settlement Association, up to 7.8 times as much on average.

The problem is that many Americans do not do that. They simply stop paying the premiums, in which case the policies lapse (after a certain grace period) and they get nothing, or they take the cash surrender value of the policy, when they could have potentially received much more.

The Association of Life Insurance Companies (ACLI)'s Life Insurer's Fact Book 2021 says that the lapse rate – the percentage of insurance policies that expire each year without a settlement figure being paid, usually due to the insured individual ceasing to pay the premiums - of an individual life insurance policy in the United States in 2020 was 4.1%; it's been above 4 since 2011 and was 5.4% in 2010. Additionally, total life insurance in force at the end of 2020 was $20.4trn.

Life settlements don't pay par of course, due to these investors assuming responsibility for paying the premiums until the policy matures. But even using a conservative valuation model, this is billions of real monetary value that American seniors are potentially missing out on each year. And therein lies the opportunity for life settlements to be a continued ally to the ESG movement. Martenson says that this is the key conversation point that supports the alignment of interests between ESG and life settlements.

"One of the biggest constraints when it comes to the growth of the life settlements industry is the lack of awareness amongst the population with regards to this even being an option," he said. "Life insurance companies are not informing the policy holders that they have the option to sell their policy for a much greater sum than they would get from the surrender value, so people are lapsing their policies and getting zero."

The life settlement industry is heavily intermediated – two brokers are involved in every transaction. One works on behalf of the individual policy owner, which sells the policy to one that works on behalf of the investment manager before the manager eventually takes ownership. Haynie says that a significant part of the industry is already ESG-friendly.

"One of the biggest constraints when it comes to the growth of the life settlements industry is the lack of awareness amongst the population with regards to this even being an option."

"We have a fiduciary duty to our clients to secure the highest possible price for their policy," he said. "Selling a policy involves a process that is well established with a focus on consumer protection. It is worth noting that life settlement market participants have received zero consumer complaints in the last five years. I am unaware of any other financial services market with zero consumer complaints. This is in part because every time we sell life insurance policy, the consumer gets more than they would have received if they had taken the surrender value from the carrier (the insurance company) and the maximum that they were able to get at the point of sale. Not only that, but it's a non-binding sales process; it puts the consumer in the best position. Sometimes it's worth selling, sometimes it's a benefit to them to keep it. Life settlements is naturally aligned with ESG at both a micro and macro level here."

A 2019 survey by Netherlands-based investment manager NN Investment Partners asked institutional investors which out of E, S or G offered the best opportunity to generate returns; E was the overwhelming favourite at 66% and S came in last at 16%. It's difficult for a life settlements investment manager to make the case for the E, unless they hold the life settlement rights to the insurance policies of a bunch of CEOs of clean energy companies. But it's not impossible.

"Life settlements tends to fit into the social in ESG but in our industry, buying life insurance policies has no carbon footprint. We're just emailing lots of documents and having phone calls so the environmental consequences of what we do are pretty much zero. And again, from a governance perspective, life insurance companies don't have a fiduciary duty to the insured people to make them aware of this and so we're improving governance in a market by making it more transparent and getting policyholders more money than they would have got otherwise," said Martenson.

Even so, S is where life settlements naturally align to the ESG movement. But whilst recent events in Ukraine have showcased the value of the 'S' exposure in a diversified portfolio to a much greater extent, many other investment opportunities are available to investors to scratch their social investing itch, such as real estate with social housing, not to mention allocating to more diverse and women-owned investment managers of all strategies. Whether the life settlement industry can get a seat at the table remains to be seen.

"We need to educate investors about the asset class because it's still an unknown asset class," said Martenson. "The risk characteristics of life settlements are extremely interesting for long term investors, and we need to continue to argue for the fact we are sustainable. If life settlements didn't exist, the consumer would have to sell at a lower price. Life settlements offer a clear social good and by extension that social benefit is shared by investors as well. Articulating this both to policy owners and investors is our next challenge."

Mortality Risk Holders Thinking about Covid-19 Pandemic Impacts

Author:
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Life Risk News

Everyone has wanted to know about the likely future impact of the pandemic because of worries about their own health as well as societal and economic health. But there's one group of people particularly interested: holders of mortality risk, such as life insurance companies and life contingent structured settlement investors. They wanted to know whether the Covid-19 pandemic would be so severe that mortality rates would spike high enough to bankrupt their operations.

It didn't turn out that way, fortunately. And Matthew Edwards, Proposition/Innovation Lead, UKI Life at consulting firm Willis Towers Watson, says that even though the past two years have been awful from a mortality perspective, the future is going to be a great deal more normal.

But the pandemic has led to many side-effects that risk holders will need to model, as 'more normal' does not mean 'back to the old normal'.

Statisticians love comparisons. And for analysts – actuaries, mainly - attempting to decipher the full extent of the fallout from the Covid-19 pandemic, comparisons with the 1918 Influenza pandemic and the subsequent improvements in mortality in the decades after would seem a good place to start. Unfortunately, this is one comparison which is less helpful.

"The reason that the improvements in mortality were so impressive in the 1920's and 30's was because there were so many amazing things happening generally in public hygiene and improvements in personal lifestyle. Then we had antibiotics kicking in the 1940's and 50's. These were dramatic reasons why we observed improving mortality in the decades after the Spanish influenza pandemic. It does not mean we should expect the same post-Covid," said Edwards.

So, when it comes to understanding the effects of Covid-19 on mortality, what is helpful for actuaries– and, consequently, holders of mortality risk? Many commentators now say that we're now in the endemic phase of Covid-19. Whilst the World Health Organisation hasn't formally declared that to be the case, when that state does arrive, the life risk industry needs to factor in the 'new normal'.

"One of the biggest things is endemic Covid-19. We're always going to be in a world of Covid-19 of some sort, with new variants emerging and vaccines, to some extent, waning. We also have to think about the non-vaccinated portion of the population and put all those together, adjusting for country specific and socioeconomic profiles," said Edwards. "We think it's likely to be of the order of magnitude of another seasonal flu or half a seasonal flu on top of normal seasonal flu, so it's not 2020 all over again, but it is material."

Other factors for actuaries to consider in their modelling going forward include delayed diagnoses for many conditions, in particular cancer.

"The CDC in the United States said 4 in 10 US adults had been avoiding health treatment due to their own concerns and worries about Covid-19. In the U.K., waiting lists for the NHS are now around 10 million, up from 6 million before the pandemic. While neither of these will have a massive mortality impact because they are generally not about mortality-critical conditions, it does mean tens of thousands more cancer deaths in the next few years than would otherwise have occurred. Whilst not a game changer for the risk holders, it is a material number."

Some of the health-related consequences of Covid-19 are, strangely enough, positive. There is a short-term 'mortality displacement' effect whereby the survivor pool should be, all other things equal, slightly healthier because the victims of Covid-19 were disproportionately those with serious comorbidities: this would reduce future mortality slightly. However, the effect is not likely to be large compared with many of the other changing elements to be considered.

It could be that a non-health related impact of the pandemic is the real driver of changes in mortality modelling. Data from the World Bank shows that GDP growth in 2020 was -3.3%. Developed economies such as the U.K. suffered a drop of -9.4%; the United States -3.4%; Germany and Japan -4.6%; France -7.9%. For Edwards, the impact of this on mortality risk holders could be the main driver of changes in mortality.

"We've all taken for granted economic growth which feeds into improved healthcare and personal lifestyles; we were used to mortality improving by 2-3% most years. But the economic mortality hit – the impact on mortality improvements over the next five to ten years is going to be very noticeable. We are in new waters now."

Litigation Bulletin: Rink

Estate of Ann Rink, by its Executor, Michael Rink v. VICOF II Trust

Author:
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On May 17, 2022, a jury verdict rejected claims brought by an executor seeking the proceeds of a $1.5 million life insurance policy in the most recent development in so-called "estate cases" brought under Delaware law.

Phoenix Home Life issued the policy in 2006, and the insured used a premium finance loan from LaSalle Bank to pay the first two years of premiums. The initial owner of the policy was a Delaware trust, of which the insured's husband was the beneficiary and her son co-trustee. In 2008, as the premium finance loan approached maturity, the insured attempted to sell the policy as a viatical settlement but was unable to obtain a bid for more than the outstanding balance of the loan. Rather than pay off the loan and retain control of the policy, the family chose to relinquish the policy to the lender in satisfaction of the loan. The subsequent owners of the policy then continued to pay the premiums necessary to keep the policy in force. After the insured died in 2018, Phoenix paid the resulting claim to the policy's owner.

The premium finance loan was administered and serviced by Coventry as part of the Premium Finance Plus (PFP) program that has been the subject of a flurry of litigation in recent years. Life insurance carriers have brought most cases involving the PFP program, and Sun Life has been particularly active in filing such suits. Cases by carriers have recently given way to cases brought by estates and their executors seeking to capitalize on Delaware's "estate statute." Estate cases brought under that statute are a recent phenomenon: the first such case, Estate of Phyllis Malkin v. Wells Fargo Bank, N.A., was filed in federal court in Florida in 2017, piggybacking off another decision in which Sun Life successfully argued that another policy on Ms. Malkin's life was invalid.

The instant case was filed in the federal district court for the Western District of North Carolina in March 2020, just four months after the court in Estate of Malkin entered judgment in favor of Ms. Malkin's estate. The Complaint, filed by the insured's eldest son Michael Rink as executor for his mother's estate, alleged that the policy was a stranger-originated life insurance policy (STOLI) that the insured did not want and could not afford, and that the estate was entitled to its proceeds. Although the policy insured a North Carolina resident and the case was filed there, the suit claimed the policy was governed by Delaware law, and asserted a claim under a provision of Delaware's insurable interest statute, Del. Stat. 2704(b), which permits insureds or their executors to seek disgorgement of the proceeds of life insurance policies that allegedly lack insurable interest. Prior to the trial, the Court determined that the case was governed by North Carolina law, but found that there was no conflict between Delaware and North Carolina law in that both states require life insurance policies to be supported at inception by a valid insurable interest, the requirements for which were substantially identical in both states.

During the two-day trial, the jury heard testimony from two witnesses: the executor (the insured's eldest son), and the life insurance agent that originated the policy. Both testified that the family took out the policy with the intention of selling it, and their testimony confirmed that the family not only participated in the application for (and relinquishment of) the policy but did so with a full understanding of what they were doing. Michael Rink is a CPA and financial planner, and the family sought legal advice on the loan documents.

While a few cases brought by estates, including the Estate of Malkin case, have been decided on summary judgment, this was the first time such a claim has been presented to a jury. The eight-member jury was asked to answer a straightforward question: was the policy supported by an insurable interest? Its unanimous verdict was that it was, and it thereby rejected Mr. Rink's claim that the policy was a wager on his mother's life. The jury may have been influenced by the family's undisputed, knowing involvement in the application for, and relinquishment of the policy.

Litigation Bulletin: Malkin

Wells Fargo Bank, N.A. and Berkshire Hathaway Life Insurance Company of Nebraska v. Estate of Phyllis M. Malkin

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On May 26, 2022, the Supreme Court of the State of Delaware issued its decision in Wells Fargo Bank, N.A. and Berkshire Hathaway Life Insurance Company of Nebraska v. Estate of Phyllis M. Malkin (19-14689, 17-cv-23136, 172, 2021) ("Malkin"). The Malkin holding is particularly important for life settlement investors because it categorically rejects the proposition that Section 2704(b) (Delaware's so-called "estate statute") forecloses all defenses and does not allow the party being sued to recover premium under any circumstances. Instead, the Court made clear that common law defenses and counterclaims are available in response to a claim under Section 2704(b) and that an investor may recover premium paid on a void policy depending on the facts of each case.

In Malkin, the Delaware Supreme Court decided two important certified questions concerning the Delaware Uniform Commercial Code's application to transactions involving so-called "stranger-originated life insurance" (STOLI) policies. First, Malkin held that, when faced with an action brought by an estate under 18 Del. C. § 2704(b) (Delaware's insurable interest statute), an innocent downstream investor-owner of a STOLI policy, or the investor's securities intermediary, cannot assert the bona fide purchaser and securities intermediatory defenses codified in Delaware Uniform Commercial Code (UCC) Sections 8-502 and 8-115, respectively. Second, an investor may assert common law defenses in response to a Section 2704(b) claim and may recover the premium it paid to the insurer to keep the policy from lapsing even if the policy is determined to be void ab initio, if the investor can show entitlement to premium based on a viable theory such as unjust enrichment.

In Malkin, the insured Phyllis Malkin, was issued a life insurance policy by insurer American General Life Insurance Company (AIG) in 2005. To pay the policy's premiums, Mrs. Malkin used a non-recourse premium financing loan. The only collateral for the loan was the life insurance policy itself, which had a face value of $4 million. When the loan came due in 2008, Mrs. Malkin chose to relinquish the policy in satisfaction of the loan instead of paying the amount due on the loan.

Between 2008 and 2012, Mrs. Malkin's policy was transferred several times and was eventually acquired by appellant Wells Fargo Bank, N.A. (Wells Fargo), as securities intermediary for its client, Berkshire Hathaway Life Insurance Company of Nebraska (Berkshire Hathaway). Berkshire Hathaway paid all policy premiums to keep the policy from lapsing.

Mrs. Malkin passed away in 2014, and AIG paid the death benefit to Wells Fargo as a securities intermediary for Berkshire Hathaway. By 2014, Berkshire Hathaway had paid approximately $137,000 in premiums to AIG. In 2017, Mrs. Malkin's estate sued Wells Fargo in the United States District Court for the Southern District of Florida to recover the entire death benefit under 18 Del. C. § 2704(b). The estate claimed, among other things, that the policy was governed by Delaware law and was void because it was issued in violation of Delaware's insurable interest statute.

The District Court held that Delaware law applied to the Malkin policy and that the policy lacked insurable interest and was therefore void ab initio. The Court of Appeals for the Eleventh Circuit affirmed the District Court's determination that the policy was void ab initio under Section 2704(b) and certified two questions to the Delaware Supreme Court in Malkin: (1) can an innocent downstream investor, or its securities intermediary, assert bona fide purchaser and securities intermediatory defenses under Delaware UCC Sections 8-502 and 8-115, respectively, to an estate's Section 2704(b) claim and (2) may a party against whom a Section 2704(b) claim is asserted recover premium from an estate even if the policy is void ab initio?

On Question 1, the Court held that the UCC defenses are not available as a matter of law. The Court held that the UCC defense under Section 8-502 applies only to "adverse claims," which the Delaware UCC defines as "a claim that a claimant has a property interest in a financial asset and that it is a violation of the rights of the claimant for another person to hold, transfer, or deal with the financial asset." According to the Supreme Court, purchasers of a STOLI policy never acquire the right to the death benefit. Instead, they acquire only a void ab initio policy that, under established law, does not exist and does not entitle the holder to receive any proceeds. The Court, therefore, held that because "[n] obody can have a 'property interest' in a STOLI policy or its proceeds," Section 8-502 does not apply to a claim by an estate under Section 2704(b).

The Court reached a similar conclusion regarding Section 8-115 of the Delaware UCC, which provides that a securities intermediary "is not liable to a person having an adverse claim to [a] financial asset," unless certain circumstances are met. The Court concluded that a claim under Section 2704(b) is not an adverse claim and, therefore, the defense was not available against such a claim by an estate.

Importantly, the Court also held that Section 2704 does not bar a defendant from asserting common law defenses and counterclaims such as unjust enrichment in response to a claim under Section 2704(b). The Court held that to determine the availability of such defenses, "courts must look to the elements of the common-law defenses or counterclaims asserted—and, where appropriate, the public policy underlying the ban on human-life wagering—to decide the viability of such defenses or counterclaims to an estate's action under Section 2704(b)."

The Court then addressed the second certified question and held that a party that is being sued under Section 2704(b) may recover premiums it has paid on a void policy so long as it proves its entitlement to those premiums under a "viable legal theory." The court explained that recovery is possible based upon common law defenses and counterclaims such as unjust enrichment since such counterclaims do not on their "face violate the Delaware Constitution's general prohibition of wagering or the State's longstanding policy of preventing STOLI policies from paying out to investors." The court held that "Section 2704(b) defendants may recover the premiums they paid on a policy later determined to be STOLI if they can establish the elements of a viable legal theory, such as unjust enrichment."

Malkin is a significant development in the field of STOLI litigation because it provides investors with potential counterclaims and defenses against claims asserted by estates under 18 Del. C. § 2704(b), including for the recoupment of premiums in the event a policy is deemed STOLI. In addition to unjust enrichment, other common law defenses that may be pursued include ratification and laches, which were relied upon in the 2019 United States Court of Appeals, Second Circuit decision John Hancock Life Ins. Co. of New York v. Solomon Baum Irrevocable Fam. Life Ins. Tr., or other common law defenses that are routinely raised, including promissory estoppel, forfeiture, and unclean hands. As many cases arising under Section 2704(b) often involve knowing and willful participation by the deceased insured in STOLI conduct, Malkin provides multiple fronts on which to attack these so-called estate cases based on the insured's knowledge and participation in the procurement, sale or transfer of a policy. Although investors and securities intermediaries defending against estate claims under Delaware law after Malkin may not assert Delaware UCC defenses to Section 2704(b) claims, they may assert common law counterclaims such as unjust enrichment to recover damages from estates for the insured's participation in STOLI conduct and recoup premium paid to the insurer to keep a STOLI policy from lapsing.

How To Navigate European Life Insurance and Retirement Trends

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The European life insurance market is facing several challenges and opportunities that are going to shape the future of the industry. Chief among these is an aging European population, which is having a polarizing effect on how insurers service their clients, as well as how they win new ones.

A key impact of these aging populations is that state-funded pensions are becoming costlier to manage. Governments are responding by placing more responsibility on individuals to plan for their own retirement, which is shifting the emphasis to private sector solutions. For instance, in the UK, the introduction of automatic enrollment in workplace pension schemes has brought 10 million new individuals into pension saving so far, all as private pension customers.

At the same time, where once retiring typically meant buying an annuity and then sitting back, forgetting about your pension arrangements, and simply cashing your pension check each month, regulatory changes across Europe mean that this is no longer the case. Retirees now have much more choice in how they can use their funds. This is creating opportunities for insurance firms looking to meet their needs.

However, there are also immediate challenges that need to be addressed at a much more rapid pace than most retirement-focused companies are used to moving.

Dealing with financial challenges

Muted economic growth across the continent since the financial and eurozone crises of 2007-09 has led to the stagnation of wages, an extended period of low-interest rates, and a subsequent lack of growth in the returns that funds are seeing. Despite recent interest rate rises by the Federal Reserve and the Bank of England, it is likely that a comparatively low interest rate environment is here to stay, making it one of the biggest problems facing the industry. On top of this, Europe's mature asset management sector poses a serious threat to life insurers' ability to grow.

> **"There are also immediate challenges that need to be addressed at a much more rapid pace than most retirement-focused companies are used to moving."**

Low growth across the sector has also been exacerbated by increased financial pressure being placed on the region's working generation – a situation that has only been made worse by the Covid-19 pandemic. With another economic crisis looming large, individuals are being compelled to choose between their long-term goals of saving for a comfortable retirement and meeting short-term financial obligations, such as mortgage repayments or rent.

This downward pressure on pension schemes is significant. However, the current crisis is also an opportunity for life insurers to adjust their business models to building lasting, meaningful relationships with customers and increase their own profit margins. In practice, this will mean a shift to:

- More personalized products that offer the customer greater value
- Better access to product distribution via digital tools
- Adjacent products and services that complement the broader insurance ecosystem

The benefits for insurance organizations could range from increased customer loyalty to reduce acquisition, distribution, and admin costs, and an opportunity to grow from adjacent sources of profit.

Addressing the ongoing evolution of customer needs

The changing nature of work – exacerbated by Covid-19 – is affecting not only businesses and individuals but also the way that offices and retail spaces are being used. If more people are working from home, there may be different patterns of demand for office space and other commercial units going forward. This may, in turn, dampen returns and increase the risks associated with property-related asset classes.

Even without the rapid shift to working from home, the trend has been toward individuals being much more flexible in the choice and direction of their careers. Moreover, the rise of flexible working is expected to accelerate as we move through 2022 and beyond.

However, to reach a generation of project contract workers who are often lower-paid, the industry will need to transform its business model to reach a lower price point and find new ways to engage such customers in their long-term financial needs. "Employee benefits for the self-employed" might be one gateway offer to attract a more flexible talent. Equally, greater digitization could enable organizations to offer robo-advisory services as a cheaper, yet effective, way of servicing this growing customer segment.

> **"Financial well-being and resilience are now recognized as crucial to people's mental health and happiness. However, with government pension and retirement plans looking less viable, such financial well-being will be harder to achieve."**

Meeting the growing desire for financial well-being

Financial well-being and resilience are now recognized as crucial to people's mental health and happiness. However, with government pension and retirement plans looking less viable, such financial well-being will be harder to achieve. Consumers are increasingly looking for partners and service providers to help them manage their day-to-day financial needs while helping them plan for the future.

In the UK, the market is slightly more advanced than in other European countries in the way the retirement sector services customers, largely due to the maturity of its pensions market.

Other countries are at varying stages of progress. Germany, for example, has only recently started introducing defined contribution (DC) pension schemes, while France is currently considering regulations similar to the pension freedom reforms and auto-enrollment measures introduced by the UK government in 2015. The pension freedoms allow people aged 55 and over to access their DC pension pot in whatever way they want – thus allowing them to withdraw one lump sum should they wish to do so.

This increased choice – and the accompanying customer confusion for less financially-savvy consumers – presents a real opportunity for life insurers and pension providers. By educating their customers and supporting them in making the right decisions through related services such as financial planning tools, insurers can not only improve the financial well-being and resilience of customers but also build loyalty and trust.

Supporting customers in their long-term financial decision-making can turn into a sustainable revenue stream, running from the beginning of an individual's career all the way to retirement.

Building trust in technology

The threat of disruption from FinTech companies and Insurtechs continues to form part of the conversation around the future of the life insurance industry. Yet, to date, these companies have struggled to make significant headway.

Put simply, customers do not yet trust these relatively untested, young start-ups to take care of their long-term retirement funds. This gives traditional players a real opportunity to take advantage of their established reputations.

To build on this, and compete effectively with FinTechs, traditional insurers must act faster to embrace new technologies – to not only service their customers better but to also attract the next generation of talent. Widespread use of automation and self-service can help to achieve a level of cost efficiency that allows for both asset growth for customers and profit margin for the provider.

Open finance continues to offer customers a complete overview of their pensions, insurance products and savings. With more power to choose the financial product that suits them best, customers will increasingly look to insurers for improved technological capabilities and digital product offerings.

Several established European insurers are already making efforts to improve these capabilities – often in partnership with FinTechs and other start-ups.

Covid-19 could also provide the push needed to help insurers make this leap and provide the digital tools that customers are demanding. The lockdown restrictions that came in across Europe have increased demand for online solutions that offer peace of mind and ease of use such as electronic signatures and document exchange. With these initiatives, organizations can provide the kind of personalized guidance and support that builds lasting customer trust and loyalty.

> “Covid-19 could also provide the push needed to help insurers make this leap and provide the digital tools that customers are demanding.”

Thinking differently about risk

As we’ve mentioned, the pressure from low and negative interest rates is of particular concern in Europe, where regulations surrounding solvency make it more difficult for insurers to offer traditional products backed by a life fund. With rates around 1%, costs are a key differentiator for long-term investment providers.

Overall, the life insurance sector is much more sensitive to interest rates given the fact that the sector is dominated by savings products and long-dated multi-year contracts. In Switzerland for example, life insurers have long suffered in this environment, with an average interest rate of just 0.66% since 2000, and -0.75% as of March 2021.

Insurers have taken some steps such as changing product features and looking for higher investment returns to help them manage the persistently low-interest-rate environment. For instance, some players have lowered the guaranteed benefits of new savings products.

In effect, some insurers are gradually beginning to move some of the interest rates and other investment risks to the customer. The focus is shifting to unit-linked products, thereby reducing insurers’ exposure to financial market risks.

However, it remains to be seen whether this strategy will work in the long run. Insurers must still lean toward their unique selling proposition: risk protection. Protection from both biometric and financial risk should not be abandoned in favor of performance-oriented products. However, it is a difficult balance to strike. To give themselves the best chance of success, insurers will have to work hard to transform their organizations. Investing heavily in technology will help reduce costs and increase the range of ancillary services that will favor the customer's overall well-being.

Providing more value through ecosystems

Accumulated savings will serve different retirement needs for different customers. To accommodate each customer, insurers will have to provide an ecosystem of evolving products and services (also by partnering with others). Here, health services are a natural integration. Several insurers now offer combinations of health and retirement products. This ecosystem can be further enhanced by digital health platforms with personal customer portals.

The insurers that will thrive in this new normal will offer their customers not only the products they need to aid them in realizing their financial and life goals, but also the support, advice, expertise, and personalized user journeys that they have come to expect from all industries. Here, an effective use of technology will be key to both providing the levels of service required and improving insurers' efficiency. This, in turn, is crucial to increasing individuals' confidence in being able to save for a comfortable retirement – and society's ability to meet the needs of an aging population.

Life Settlements Due Diligence: Legal Counsel's Perspective

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In addition to the important diligence issues associated with the pricing and valuation of life settlements, life settlements have characteristics that make thorough legal due diligence particularly important. Unlike stocks or bonds, there are no widely accepted exchanges across which life settlements trade, nor are there regulatory agencies, such as the Securities Exchange Commission, that mandate standardized disclosures to investors in the asset class. Hence, transactions tend to occur on a one-off basis, and are frequently subject to information asymmetry between the seller and the purchaser, heightening the need for robust due diligence.

Some of the issues associated with life settlements that require diligence include certification of title to the asset; regulatory compliance with origination of the asset; and insurable interest issues.

Verification of Title

Certification of title for life settlements is more difficult than typical assets. The life insurance policy may have been owned by an individual or entity, usually for a period of several years, prior to being sold as a life settlement. As a result, it may be subject to liens, loans, divorce decrees, judgments and other encumbrances. If these encumbrances are not discovered prior to an investor's purchase of a life settlement, significant impairment to the value of the asset can result.

A policy can be owned by an individual, a corporate entity or by a trust, often an irrevocable life insurance trust, also known as an ILIT. ILIT's can be complex and are usually structured by trusts and estates experts. Whenever the purchase of a policy owned by a trust is contemplated, the trust agreement must be reviewed carefully for two particular issues: the state of the trust's situs or location and whether the current trustee(s) of the trust are properly authorized to act on behalf of the trust. The situs of the trust is important as it will determine the law that governs the transaction, and if the trustees are not properly authorized to act on behalf of the trust, the validity of the sale could later be called into question.

> "Even where a policy is owned by an individual, it is necessary to perform careful diligence to ensure there are no unseen pitfalls."

Even where a policy is owned by an individual, it is necessary to perform careful diligence to ensure there are no unseen pitfalls. A life insurance policy can only be obtained by individuals making representations about their health and financial status, hence running a basic background check on the policy owner is a simple step that can help ensure the quality-of-life settlement assets. For instance, a background check can reveal whether a policy owner has a judgment or liens levied against them that cloud title to the policy to be sold. If the seller does not affirmatively disclose this fact, it could remain undiscovered until some later date, causing serious issues for the then-owner of the policy. A background check can also show if the policy owner has filed for bankruptcy. And, notwithstanding a specific exemption for life insurance policies in the bankruptcy code, if the owner is currently in bankruptcy an order from the court approving the sale should be obtained to confirm that the bankruptcy trustee approves of the transaction and will not later try to unwind it.

It is also not unusual for one party to a divorce decree to have an obligation to keep a life insurance policy in force, with the other spouse as the beneficiary. Case law holds that the beneficiary spouse has an equitable interest in any life insurance policy subject to such an obligation, and it is probable that the insurance policy sale transaction could be unwound by the beneficiary spouse if it is undertaken without his or her consent.

Similarly, in states that have martial property laws, if the existence of the policy was not disclosed to the court and addressed in the property settlement agreement, the former spouse will retain an interest in it. If that former spouse learns of the sale of the policy, he or she might have a cause of action to challenge the sale of the policy to an investor. Thus, any divorce decree must be carefully reviewed in order to ensure there is no cloud on the policy's title.

Regulatory Compliance

> "Having counsel with experience with the differences between the states' laws, and the ability to determine if transactions were undertaken in compliance with those laws is imperative."

In the United States, life insurance is regulated by state governments, rather than by the federal government. As a result, and through the vicissitudes of the legislative process, it is the insurance departments of each state that regulate the life settlement industry. While the life settlements industry is only regulated at the level of the secondary market (the sale by the original policy owner to a licensed provider, not the sale of the policy from the provider to a fund), it is nevertheless critical to ensure that the original sale transaction was undertaken in compliance with pertinent law. The upside of state regulation is that transactions undertaken in compliance with pertinent law have the imprimatur of approval from the state; but there are downsides too. Chief among the downsides is the fact that, while the states' laws are based on one of a few model acts, no state's law is precisely identical to any other's. As a result, there are forty-five states that regulate life settlements transactions, but the specific law of each state varies from state-to-state. The failure of parties to comply with pertinent state laws during the origination process, such as proper licensing, mandatory disclosures, pricing regulations, etc., in the secondary market can result in challenges to the ownership and validity of the asset. Again, having counsel with experience with the differences between the states' laws, and the ability to determine if transactions were undertaken in compliance with those laws is imperative.

Insurable Interest

For a life insurance policy to be lawfully issued, a valid insurable interest must exist between the policy owner and the insured at the time the policy is issued. A person or entity has an insurable interest in another person where there is a special relationship between them such as marriage, family or certain financial relationships such as partners in a business. If there was not a valid insurable interest between the owner and insured at the time the policy was issued, then the policy is considered void ab initio (from the beginning) and can be declared void and rescinded by the issuing carrier, even decades after the policy was issued. Concerns about insurable interest were particularly prevalent as a result of the profusion of non-recourse premium-financed policies that flooded the secondary market in the early and mid-2000s. If a policy was originated from an improperly structured premium finance program, the owner may not have had an appropriate insurable interest at the time it was issued, thereby potentially rendering it null and void. This is another reason to ensure that experienced legal counsel assists investors in acquiring life settlements assets.

Thorough due diligence is a basic tenant of virtually every corporate transaction. Because of the relatively informal origin of the secondary market for life insurance, and its comparative nascency, however, the life settlement industry is only beginning to embrace a comprehensive due diligence regimen designed to ensure that the life settlement assets purchased by investors are of the highest quality possible. Any investor considering deploying capital into life settlement assets is well advised to make certain that any participants in the life settlement industry with whom they work has implemented a robust diligence program.

Q&A

Chris Anderson

Senior Manager, EMEIA Insurance - Risk and Actuarial Services, EY

Longevity risk – the risk of insured individuals living longer than expected – is a thematic one in the life risk industry, having far-flung ramifications for insurance companies and capital markets participation in life risk. This month, Chris Anderson, Senior Manager, EMEIA Insurance - Risk and Actuarial Services in EY's Edinburgh office discusses the impact of longevity from an actuarial sciences perspective.

LRN: Chris, let's start at the beginning. What is the main topic or theme in longevity risk from an actuarial perspective right now?

CA: One of the topics that keeps coming up is whether and how to adjust longevity risk in light of the data emerging from the pandemic. In normal circumstances, such risk would be calculated by using data from the last 5 years to set a baseline view of mortality from which to project the long-term view. Many firms in the last 24 months have effectively left everything static, with assumptions almost entirely unchanged from 2019 given the lack of certainty and the lack of precedent. As we gather more data about the health effects of the pandemic, insurers pricing risk will have to continue with the current model, and decide how and when to allow for changes to their reserving calculations and new policy estimates.

LRN: The pandemic's effect on longevity risk won't be fully known for years, maybe decades; we don't know the extent to which 'long Covid' will impact the health of the general population, and we don't know what variants might emerge in future. What's the current thinking here?

CA: At the moment, the prevailing opinion is to assume no change to the view of long-term mortality. Some firms believe that the positive and negative factors will net out over time, while others claim there's not enough evidence yet to decide which direction will be stronger. As the pandemic in the UK has subsided to some extent following high vaccination levels and a growth in natural immunity within the population, the number of deaths recorded has also begun to stabilise back towards pre-pandemic levels, which is encouraging. However, we still don't yet have a strong understanding of how long the current immunity will last, what new variants might emerge, or what the impacts of long covid will be on mortality rates.

There are also socio-economics at play for insurers to consider. More affluent groups of people (who tend to be overrepresented within financial services policyholders) appear to have been less affected by Covid-19, possibly due to enjoying better general health and showing that as a group they are more likely to be vaccinated. At a minimum, the range of uncertainty around future mortality rates is wider than it was a couple of years ago, and so insurers must hold more capital to account for that wider range.

LRN: Outside of the pandemic, what are some of the other concerns that your clients are coming to you with regarding their exposure to longevity risk? Are any themes emerging?

CA: The key themes align with the dynamics of the market. In the UK annuity space, a significant amount of longevity risk held by insurers is reinsured outside of the UK given the high level of capital requirements that the current solvency regime demands against the risk. However, there is an ongoing review of the solvency regime being carried out by HM Treasury and the PRA, with one of the areas of focus being the level of capital required to be held against so-called "unhedgeable risks" (one of which is longevity risk). In a recent speech, John Glen, Economic Secretary to the Treasury, hinted at a 60%-70% reduction in the level of this capital, which may be enough to convince some firms to consider retaining more of this risk within the UK.

Within the US annuity market however, insurers have the opposite concern, with regulators considering introducing a capital charge for longevity where one currently does not exist. This may result in more reinsurance than we currently see in that market.

Within the ILS space, where investors are exposed to longevity risk on the policies they invest in, the concerns are around the quality of the life expectancies received to value policies. Some existing life expectancy providers have recently changed their methodologies, and a number of new providers have emerged. This is making it more difficult to have confidence in life expectancy methodologies that don't yet have a long track record of successful forecasting.

LRN: What's the most misunderstood part of an actuary's job – from a client perspective - and what's the impact of that misunderstanding?

CA: I think many people still think of actuaries as people who are only great at building complex models for insurance and pensions… and not much else! As a result it's easy for us to get overlooked for other roles where our skillset can be really valuable, and it also does little for our street cred! The modern actuary is essentially a financial risk manager and a great communicator, and we can therefore add value wherever there is uncertainty over the future and a need for the situation to be understood and explained. We're starting to see actuaries broaden out into a wider range of fields including climate risk, infrastructure projects and government planning, and I hope this trend continues.

LRN: Insuretech has been a buzzword in venture capital and insurance for a few years now. What's been the impact of this so far on the actuarial sciences? Is that impact one that's going to persist, and is it generally good for clients?

CA: Insuretech in the broadest sense is simply a commitment to innovation and developing new technologies that improve insurance. In that context, the whole market is committed to this, and we see firms investing in improving their customer experience and focusing on improving efficiencies through better use of technology. For actuaries, this has mainly involved moving towards ever more powerful analytic tools that improve the quality of the analysis, as well as the control environment. I think this trend will not only persist but accelerate, particularly as a newer generation of actuaries emerge with greater capabilities in new technology.

In the narrower sense of Insuretech being related to startups that are shaking up the industry, quite a lot of companies are doing some very interesting things, particularly around the customer experience via apps and portals. Some of this is filtering up to the more established players and encouraging them to take more steps also to improve customer experience.

LRN: Lastly, Chris, we're seeing an increasing amount of longevity risk transfer deals being done in the UK. What are some of the best practices you've observed, and what's the message to the market in terms of expectations and opportunities?

CA: The UK pension risk transfer market is an incredibly attractive market right now, as it's one of the few places in insurance seeing significant growth, with volumes increasing from single digit billions only five or so years ago to around £30bn today. With over £2trn of pension scheme liabilities remaining that could potentially transfer, the opportunity over the next 10 years and more is huge. As a result, existing providers are investing heavily to meet demand and to maintain or grow market share, and a number of other firms are investigating market entry.

In terms of best practices in this market, it is about who is getting the customer experience right and who is doing things sustainably.

Whilst some insurers are providing a good customer experience already, I think there is also a lot of opportunity. For a long time, providers had been used to servicing only current pensioners, which involves little more than making sure their money arrives in their bank account every month on time. However, there is a growing contingent of "deferred" members who are not yet retired and have many more options over what to do with their money. These individuals need more engagement and guidance through their options, and providers can do more to support with this. The upcoming UK Pensions Dashboard Programme may be a catalyst to some of this change.

On sustainability, all of the providers have now set out net zero commitments, but some are moving more at pace than others to put these into practice and to decarbonise both their operations and their asset portfolios. As more pressure is put on pension schemes by regulators and members to consider climate risk (and ESG more widely) more explicitly in their decisions, this will in turn put pressure on insurers to have a positive story to tell relative to their peers when trying to win schemes.

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Why Longevity Investors Should Pay More Attention to MedTech Trends

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Historically, much of the conversation about the decades long continuous improvement in mortality rates has revolved around behavioural changes, such as stopping smoking, doing more exercise, and eating a better diet. Of course, these remain recommended public policy endeavours by governments around the world.

These are general recommendations, however, aimed, from a statistical perspective, at a large population just as much as they are aimed at an individual. But what has emerged in recent years, however, are advancements in technology that are enabling more tailored risk assessment and treatment of the individual, advancements that will have a profound impact on how companies and investors with exposure to longevity risk price that risk and construct their portfolios.

> **"For companies and investors exposed to longevity risk, access to more and better data will enable them to model an individual's life expectancy more accurately, and therefore price that risk better"**

The increasing use and development of wearable technology is one key driver of this. Nicola Oliver, Founder at Medical Intelligence, which provides consulting services to actuaries, says that, whilst items like smart watches and smart clothing get the headlines, healthcare technology that is being developed for use in healthcare settings is an emerging area that brings a whole new meaning to what we think about 'wearable' tech.

"For instance, something known as ingestibles, which are small devices designed to be swallowed, are able to provide imaging of the gut, as well as feedback to a healthcare professional that an individual has taken prescribed medication – this is particularly useful for monitoring medication use in older people," she said.

However, the use of personal wearable tech shouldn't be underestimated for its clinical utility. One example is the potential to detect Atrial Fibrillation (AF), a condition where the heart beats rapidly and inefficiently for short periods of time, during which clots can form. If any of those clots get into the brain, they can cause a stroke. Prevention is better than the cure, so they say, and both personal wearables, and hospital-grade remote monitoring devices are providing encouraging results in early detection in situations like these.

"You may not be aware that you are having an abnormal heart rhythm and people have been diagnosed with AF who had no previous symptoms," said Oliver. "If you're aware of that abnormal heart rhythm, then preventive measures can be taken that could prevent you from having a stroke as well as other complications, where the clot can enter a lung, for instance."

Big data and artificial intelligence offer further avenues for advancements in medicine and indeed, positive trends are emerging in this area as well. Lung cancer, for example, is typically diagnosed at a later stage, and the prognosis tends to be grim. Early-stage detection is crucial for increasing survival rates.

"A radiologist will read a CT scan and they are supposed to detect any subtle changes in that scan versus a scan of a healthy lung just with the naked eye. It's a very difficult job and the rate of missing very small lesions is high," said Oliver.

That's not all. This typically can take around half an hour and the world generally has a shortage of radiologists.

Enter technology.

"AI, machine learning and deep learning can look at CT scans quickly and identify cancers that would not have been detected by a human. This is actually happening now, and in the U.K. for example, there are sites piloting the use of this technology and it's showing great promise," said Oliver.

The targeted therapies relating to the treatment of cancer can be very expensive and one of the challenges the medical industry faces is how to pay for all this. Most western economies have some version of a socialised health system and therefore the budgeting challenges that go with managing that. But even the model used in the United States doesn't have an endless supply of money.

Fortunately, tech advancements aren't limited to complicated medical conditions.

"A recent breakthrough in detecting heart disease involves a scan of the blood vessels feeding your retina," says Oliver. "The tiny changes undetectable by the human eye can give us a risk ratio for an individual's potential for having a heart attack. This is something that could typically take place at your local doctor's surgery in the future."

Both hardware and software are clearly driving advancements in this area but advancements in how humans use their own immune system to fight disease are also taking place. Monoclonal antibodies – synthetic antibodies manufactured in a lab that are given to patients with cancer that help their immune system identify and break down cancerous cells – came into use 20 years ago, and clinical trials continue with advancements in this area.

> **"For companies and investors exposed to longevity risk, access to more and better data will enable them to model an individual's life expectancy more accurately, and therefore price that risk better."**

Due in no small part to the development of treatments during the pandemic, one area that has recently received much more coverage, however, is the use of mRNA solutions.

"When you look at the clinical profile of mRNA technology, it's expanding. There is an understanding of this type of therapy and production can be incredibly fast and the understanding of that technology has accelerated over the last two years due to Covid," said Oliver. "Advancements here are also enabling the move to more targeted treatments in the future."

For companies and investors exposed to longevity risk, access to more and better data will enable them to model an individual's life expectancy more accurately, and therefore price that risk better, whether that be a reinsurance company entering into a longevity swap with a defined benefit pension plan, or a life settlement investor conducting due diligence on an individual policy. The latter would have a substantial impact on the performance of a portfolio of life settlements, for example.

For the last 15 years, Oliver has been providing medical and sociodemographic insights to actuaries from across the industry that has typically covered the impact of newly approved pharmaceuticals and diagnostics, as well as wider issues including air pollution, pandemic potential of infectious diseases and health policy. Many organisations with exposure to longevity risk use actuaries, and Oliver says that the actuarial industry is paying increasing attention to technological developments when modelling longevity risk.

"Being prepared for some of these events has helped many of my clients make key adjustments to their assumptions on life expectancy, and thus gain greater insight into potential future longevity and mortality risk. Actuaries are embracing the fact that they need to understand these types of trends and that they do have an impact," she said. "Technology in healthcare has the potential to mitigate risk much more at an individual level. This is going to have a massive impact on how pensions, insurers and investors understand and therefore model longevity for their businesses going forward."

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