Life Risk News

Volume 1
Issue 3
July 2022

U.K. Pension Risk Transfer Market Just Getting Started

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Life Risk News
ISSN 2753-7374
Volume 1, Issue 3
July 2022

Publisher
ELSA
97 Fable
261c City Road
London EC1V 1AP

+44 (0) 203 490 0271
admin@elsa-sls.org

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Editorial
Managing Editor
Chris Wells
chris@elsa-sls.org

Contributing Editor
Greg Winterton
greg@liferisk.news

Editorial Assistant
Katie Honebon
katie@liferisk.news

Editorial Enquiries
editor@liferisk.news

Design & layout
Kieran Reilly
hello@kieranreilly.com

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Editor's Letter
Volume 1 Issue 3 July 2022

Greg Winterton
Contributing Editor
Life Risk News

The pension risk transfer market in the United Kingdom is more than a decade old but in its early years, growth was sluggish. Recently, however, the market has shown signs of accelerating growth, and a new development promises to further propel the market. *Life Risk News* spoke to James Mullins, Partner and Head of Risk Transfer Solutions at Hymans Robertson, and Ashu Bhargava, Senior Actuary and Head of Clients at Clara Pensions, for this month's cover story, *U.K. Pension Risk Transfer Market Just Getting Started.*

The life settlement market is even older than the pension risk transfer one and can trace its roots back to 1911 with the Grigsby vs Russell case. The market in its current form, however, is approximately two decades old, but growth is anaemic. *Life Risk News* spoke to Rob Haynie, Owner and Managing Director of Life Insurance Settlements Inc., and Steven Shapiro, President and CEO at Q Capital Strategies, for *Life Settlement Market Still Held Back By Lack of Awareness.*

Over the years we have witnessed the successful commoditisation of several risks, including credit risk, interest rate risk and property catastrophe risk, opening up their trade to capital markets investors. Similar commoditisation of longevity risk has been slow to take off, despite many seeing a significant need for more risk takers in the market to boost capacity to service the world-wide c$80tr of longevity-linked liabilities. Erik Pickett, Actuary and Chief Content Office at Club Vita, reviews a recent panel at ELSA's Life ILS conference in May in a commentary piece, *If Longevity Risk is an Asset Class, How Do We Make It More Tradeable?.*

Each month on *Life Risk News,* we run a poll, asking our readers for their views on a hot topic in the life risk industry. Last month, we wanted to know, *What Is the Greatest Barrier to Increasing the Number of Life Risk Transactions?* Our readers were clear in what they thought the reason is.

The life settlement industry has had to endure its fair share of naysayers down the years and misconceptions about the asse class remain to this day. Life Equity CEO, and ELSA Chair Scott Willkomm, identifies some of these misconceptions and addresses them in a commentary piece, *Myths About the Life Settlement Industry*.

Life settlement investors don't buy a life insurance policy without the data and analysis support of a life expectancy analytics firm. *Life Risk News* spoke to Chris Conway, Chief Development Officer at ISC Services, to learn more about how firms like his are adapting and changing to better model longevity risk for their clients for this month's *Q&A.*

Insurtech is a buzzword in venture capital circles and has been for some time. However, most of the activity is in the property and casualty side of the insurance world. *Life Risk News* spoke to Brian Casey, Partner and Co-Chair of Regulatory & Transactional Insurance Practice Group at Locke Lord and Tom Scales, Senior Analyst at research and advisory firm Celent, to learn more about trends in the life insurance-specific insurtech world in *Insurtech Yet To Significantly Impact Life Insurance Market but Change Is Coming*.

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*.

U.K. Pension Risk Transfer Market Just Getting Started

Author:
Greg Winterton
Contributing Editor
Life Risk News

Pension risk transfer (PRT) – the process whereby a defined benefit pension fund transfers its longevity risk to an insurance company – has been around for more than a decade and the United Kingdom is the most active market. But despite its longevity – pun intended – growth has been anaemic, at least until recently.

According to consulting firm Hymans Robertson, the value of deals in the U.K. across the three variants of LRT – buy-ins, buy-outs and longevity swaps - only exceeded £20bn once, in 2014, when £26bn of longevity swaps pushed the overall total value to almost £40bn. In 2018, the market value jumped to almost £30bn, and then it jumped again in 2019 to around £55bn. A drop-off in 2021 – 156 deals worth less than £28bn were completed last year - is an aberration of an upward trend that's set to continue, says James Mullins, Partner and Head of Risk Transfer Solutions at Hymans Robertson in Birmingham, U.K.

"The first six months of 2021 were quiet, but a lot of pension funds had other things to worry about due to the uncertainty around Covid-19, so they weren't starting a new process. There is a lead time to these deals, and they came back strongly in the second half of last year and the market was incredibly busy. The switch to work from home didn't really stem the deal flow."

Defined benefit pension funds' exposure to longevity risk is growing as humans live longer. But the increase in activity in the LRT market isn't necessarily being fuelled by this trend.

> **"Defined benefit pension funds' exposure to longevity risk is growing as humans live longer. But the increase in activity in the LRT market isn't necessarily being fuelled by this trend."**

"I'd say that it's more just being prudent and taking advantage of the ability to insure longevity risk," said Mullins. "Pensions in the U.K. have done a lot of hard work to tackle other risks, such as investment risk. If you tackle investment risk, longevity risk is the key remaining risk which is why buy-ins and swaps are seeing interest."

The LRT market sees less activity in longevity swaps than in buy-ins or buy-outs; longevity swaps are much more complicated to execute, which is why, according to Hymans Robertson's report, only 53 deals have been completed since 2009. Buy-ins are more common, with around 150 deals done in 2021 with plenty of capacity for more. But, going forward, buy-outs are likely to be where the fastest growth is.

"We'll see more, full buy-outs going forward. Funding levels at pension funds have improved, managing investment risk has improved, and pricing from insurers to take on liabilities from pension funds has become more competitive. Many pension funds can now afford to insure the whole scheme," said Mullins.

Some pension funds have a well-funded scheme but a financially weak sponsor; some schemes are insolvent and have to enter the U.K.'s Pension Protection Fund; sometimes the sponsor wants to undertake corporate M&A activity but can't because that acquisition or divestment is contingent on not having pension assets and liabilities on its balance sheet. Trustees and sponsors in these situations, and those where buyout is not affordable, didn't have access to the PRT market until very recently.

The U.K.'s appropriately named The Pensions Regulator approved its first ever consolidator, Clara, in November 2021. Ashu Bhargava, Senior Actuary and Head of Clients at Clara, says that the approval, which came after a lengthy review process, means that the market for pension risk transfer in the country is now bigger.

"There are over 5,000 pension schemes in the U.K., and the top five to ten per cent are candidates for the insurance market [from a PRT perspective] because the gold standard is insurance. Schemes which can afford the insurance-based buyout get the greatest level of security" he said. "But the next ten per cent is where consolidators like Clara come in. Until now, these schemes didn't have an option for risk transfer."

Clara expects to close its first deal towards the end of this year and expects to have closed £5bn worth of deals by the end of 2025. Part of the reason that this level of dealmaking can happen so quickly is that Clara, and any other 'superfunds' that get approved in future, can hold a lower level of capital than an insurance company has to (at a 1 in 100 level rather than a 1 in 200 level), meaning

that schemes that cannot afford buyout are now able to improve security for members. But, Clara's model also acts as a bridge to the insurance model, because it doesn't hold pension scheme assets and liabilities ad infinitum. This will create a kind of secondary market in years to come, fuelling even greater activity in this corner of the pensions world, and an age-old problem is what Clara is solving for.

"We can be a good pipeline for the insurers, partly because we can remove the capacity constraints in the market from a people perspective, by making the transfer process more efficient – there are a limited number of people who have PRT experience, which acts as a constraint to growth in this market," said Bhargava.

The U.K. is expected to approve other superfunds in the coming years, and some will have different models to the one adopted by Clara. Whilst each transfer into a superfund has to be reviewed and approved by The Pensions Regulator, Bhargava sees yet another possibility to broaden the pool of defined benefit pensions that could make use of a consolidator and, over time, become the largest sub-sector in the country's PRT market.

> **"Clara's model also acts as a bridge to the insurance model, because it doesn't hold pension scheme assets and liabilities ad infinitum."**

"When the pensions industry gets comfortable with the consolidator model, it wouldn't surprise me if we see some kind of 'superfund lite', which could first transfer to Clara and ultimately to an insurer. There's absolutely scope for the consolidator version of pension risk transfer to become bigger than the insurance-based market in years to come," he said.

Other developments in the PRT market should provide for increased deal flow in the coming years. The private equity industry is increasingly getting in on the insurance game by acquiring insurance companies or setting up reinsurers in Bermuda. Insurance companies have natural capacity constraints because of regulatory capital requirements, and private equity sees funded reinsurance as a way to access consistent cashflows and investable assets.

Regardless of the counterparty, at the deal level, Mullins says that the relative health of the defined benefit pension sector in the United Kingdom should naturally translate to an increase in a specific type of LRT deal in the coming years.

"Up until now there have been a lot of buy-ins - pension schemes insuring only part of the scheme," he said. "Many can now afford to insure the whole pension scheme which means we'll see more and more full buy-outs as opposed to buy-ins. Additionally, pricing from insurers to take on liabilities for whole schemes has become more competitive in recent years. I'd expect more and more full schemes insuring in the coming years than we've seen so far."

Life Settlement Market Still Held Back by Lack of Awareness

Author:
Greg Winterton
Contributing Editor
Life Risk News

According to the American Council of Life Insurers' Life Insurance Factbook 2021, around 5% of all in-force life insurance policies in the United States lapsed last year. Given that the total amount of life coverage in force at the end of 2020 was approximately $20.4trn, you don't need to be a maths whizz to work out that this amounts to around $1trn worth of cover that pretty much vanished, save those that received a nominal surrender value from the carrier.

A recent survey of its members by U.S.-based trade group the Life Insurance Settlement Association suggests that its members paid out 7.8 times more on average than the cash surrender value of the life settlements they bought in 2021, good for an additional $600mn plus going directly into the pockets of sellers.

> "Life settlements in their current form have been around for two decades, but clearly, there exists a knowledge gap. After all, who wouldn't sell something for more money if they could?"

Life settlements in their current form have been around for two decades, but clearly, there exists a knowledge gap. After all, who wouldn't sell something for more money if they could? Steven Shapiro, CEO at Q Capital, a life settlements provider, says that the industry faces something of a conundrum if firms like his are to see more deal flow from the broker community.

"The direct-to-consumer deals are driven by television advertising spend. That is very expensive," he said. "Some have tried doing online lead generation because it's more cost effective and efficient. But it's uncertain what percentage of our industry's target customers are searching for information online. The number of keywords and searches around the industry has not seemed to grow much over the years. This could be the result of not knowing about our industry or not looking for online resources. As a result, people looking to generate leads online are competing more intensely for a limited number of leads that has remained consistent year to year."

Given these challenges, the life settlement industry needs the front lines to step up. Wealth managers and insurance agents are natural allies to the life settlement industry from an awareness perspective but educating these firms isn't without its challenges.

"Educating RIAs is low hanging fruit because they are working with our target clients," said Shapiro.

"But the vast majority of RIAs don't have a huge volume of potential cases a year, they only have a handful. Marketing to them efficiently is hard to figure out. It's the same with insurance agents. So, both RIAs and insurance agents continue to be valuable partners, but it's a very intensive, high touch process."

Rob Haynie, Managing Director at Life Insurance Settlements, Inc., a broker that represents sellers of life insurance policies, says that he's surprised that the front lines don't do more to educate their clients in this area.

"If you're acting as a fiduciary you're supposed to act in the best interests of your clients," he said. "Also, it's a non-binding appraisal, meaning no commitment. Sometimes it's a benefit to the individual to keep their policy as opposed to sell it. But no-one is forced to sell their policy and getting an appraisal doesn't cost the individual anything."

A structural feature of the life settlement market provides additional challenges to growth beyond the awareness issue. Providers typically buy policies with a face value of $2mn or more, because the brokers that bring them the policies tend to focus, understandably, on the larger policies, because they make more money. But according to the Life Insurance Factbook 2021, only 7% of policies fit into this grouping. The other 93% is where additional capacity could come from.

"The other 93%? That's where we're not doing a good enough job, and this is where the direct marketing efforts can have a big impact. Firms like ours would be happy to buy policies with a lower value because that's where the biggest growth potential is," said Shapiro.

Analysing deal flow trends in the life settlement market is difficult because of the lack of publicly available information. However, trade publication The Life Settlements Report recently published data

suggesting that activity in the industry is generally on the rise; the number of policies sold increased from 2027 in 2017 to 3241 in 2020; a slight drop-off occurred last year to 2937 but the general upward trend would seem to be encouraging.

Still, many in the life settlement industry think more effort is required to turn a larger chunk of that $1trn of annual lapsing life insurance into life settlement transactions. Ultimately, what's going to drive this is a mix of effort and perseverance.

> "If you truly believe that growing the size of the pie benefits everyone, we should all be in this together."

"If more companies like Coventry were to come into the market – but firms outside the life settlement market, those still with a recognisable household name but that might have an even bigger budget and a good reputation to the general public – and they were to spend a lot of money on TV advertising, newspaper ads and going on the radio talking about life settlements it would help," said Haynie. "But there's no silver bullet here. Our marketing efforts as an industry haven't been good enough and we need to do more and do it better."

Shapiro agrees and says that the nature of most of the players in the space necessitates collaboration.

"Many in the life settlement market are small businesses, so it's hard to have a large impact independently. If you truly believe that growing the size of the pie benefits everyone, we should all be in this together. Coordinating to educate will help not only firms in the industry but the consumer as well."

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If Longevity Risk is an Asset Class, How Do We Make It More Tradeable?

Author:
Erik Pickett
Actuary and Chief Content Officer
Club Vita

Over the years, we have witnessed the successful commoditisation of several risks, including credit risk, interest rate risk and property catastrophe risk, opening up their trade to capital markets investors. Similar commoditisation of longevity risk has been slow to take off, despite many seeing a significant need for more risk takers in the market to boost capacity to service the world-wide c$80tr of longevity-linked liabilities.

During May's ELSA Life ILS conference, Jennifer Haid, CEO of Club Vita hosted an expert discussion with Joyeeta Kanungo (Phoenix Group), Stephen Richards (Longevitas), Scott Willkomm (Life Equity) and Phil Kane (Leadenhall Capital Partners) on the current outlook for a commoditised longevity risk market. Here are some key learnings from this session.

What is longevity / life risk?

Longevity risk is the risk that people live longer lives than expected. Any institution guaranteeing lifetime payments is exposed to adverse longevity risk. This includes defined benefit pension funds, life insurers, reinsurers, and government social security systems. Life insurers are also exposed to the opposite risk of policyholders dying sooner than their expected. Collectively, this pair of opposing risks is called "life risk".

> "The average time taken to close a longevity reinsurance transaction is 6 to 8 weeks. There're definitely efficiencies to be had from a standardisation of terms."
>
> Joyeeta Kanungo
> Phoenix Group

As part of an effective risk management strategy, the originator of a risk will often look to transfer it to a party better suited to handle it. This risk taker, may itself then look to pass on all or some of this risk. This process, known as the risk transfer chain, can continue and should result in risk ultimately ending up in institutions that are better equipped to manage it. But the more market frictions, the more inefficient the risk transfer chain becomes. Currently, in almost all cases, each step of the longevity risk transfer chain is underpinned by full indemnity contracts, tracking the survival of a named group of people. This means risk cedants are relieved of their complete profile of longevity risk, but risk takers take on highly specific long-term contracts that are difficult to trade.

> "We've only de-risked around a third of the DB pension scheme market. Another third is expected in the next decade. Where is all the capital going to come from?"
>
> Joyeeta Kanungo
> Phoenix Group

> **"The commoditisation of longevity risk is the development of fungible, tradable financial instruments linked to longevity risk that increase the efficiency of each step of the risk transfer chain."**

> “There is no fixed precedent for the capital relief available to insurers when using commoditised structures to pass on their longevity trend risk.”

What do we mean by the commoditisation of longevity risk and what are its benefits?

The commoditisation of longevity risk is the development of fungible, tradable financial instruments linked to longevity risk that increase the efficiency of each step of the risk transfer chain and ultimately the creation of a deep liquid market for longevity risk. Commoditisation should attract more, much needed, capacity in longevity risk takers.

> “Index-based contracts do not address basis risk, idiosyncratic risk or concentration risk. In contrast, insurers can transfer all of these with indemnity reinsurance contracts.”
>
> Stephen Richards
> Longevitas

This is expected largely to come from capital markets investors entering the market, attracted by returns diversified against key financial risks, with some extra capacity also released from existing players due to standardisation and automation.

> “The property catastrophe market really developed with the common acceptance of a model. We can take an underlying customized risk, put that into a model and turn it into an easily digestible reference point that becomes translatable into a common index.”
>
> Phil Kane
> Leadenhall Capital Partners

It is often not economical for small pension funds to enter into complicated indemnity contracts to remove longevity risk. Streamlining of contracts such as those implemented by Mercer and Zurich have opened up this market to smaller players to a certain extent, but complete commoditisation would open it up further. By simplifying the process and increasing the supply of risk takers, commoditisation should create competitive pricing for longevity risk transfers. The clearing price will of course be affected by any increase in demand, but price loadings due to market frictions should be reduced; a commoditised market could allow risks that have not traditionally attracted insurers or reinsurers, such as deferred annuity longevity risk contracts. A standardised risk classification system and index-based instruments will enable more efficient risk management solutions, in particular allowing more efficient balancing of longevity and mortality risk and reducing capital demands.

> “The way to motivate industry is to pay them, or pay them and protect them to a certain extent.”
>
> Scott Willkomm
> Life Equity

> "In the event of a capacity crunch in the conventional longevity market, the cost of protection could rise, offering higher returns for capital market investors."

Why hasn't it happened (yet) and what needs to happen to develop this market?

Commoditisation is based around insuring longevity trend risk and results in some components of risk being left with the risk cedant. Cedants may prefer to transfer all their risk, especially as current market prices are perceived as low. The capacity of risk takers has so far been sufficient for the risk cedants coming to market – only a small percentage of world-wide longevity-linked liabilities have transferred into global reinsurance regimes.

There is no fixed precedent for the capital relief available to insurers when using commoditised structures to pass on their longevity trend risk. Insurers want to ensure they receive the capital relief they deserve in the event of insuring risks; investors have been put off by the length of term in traditional run off longevity hedges. To dates there has been no wide acceptance of a standardised model, index or terms on which to trade commoditised longevity.

For a commoditised market to develop, there needs to be a standardisation of terms for the writing of financial instruments. Central to that will be the development of a set of widely accepted and accessible reference indices that would mimic the movements on the risk cedants' balance sheets. Index-linked instruments would be highly tradable and could protect cedants from extreme outcomes; they would also allow risk traders to act on their sentiment to future longevity risk. Innovative approaches to structuring financial instruments need to be developed that are attractive to both risk cedants and risk takers, in particular, instruments that reduce the time horizon of traditional indemnity swaps (such as those using commutation mechanisms) are needed to attract capital market investors. Shrinking the margins of dealers in a commoditised market could help to increase returns. Articulating the potential capital benefits of pairing longevity and mortality risk, or the diversification effect of longevity with key financial risks could help engage investors with the potential returns.

In the event of a capacity crunch in the conventional longevity market, the cost of protection could rise, offering higher returns for capital market investors. If governments could provide some back up liquidity in the market as they do in some secondary mortgage markets, it may encourage more risk takers to enter the market and ultimately strengthen the whole eco-system. Confirmation of regulatory capital relief obtained from any new financial instruments must be confirmed before they will become attractive to institutions governed by those capital requirements.

Why is now any different?

Despite some previous false starts for the commoditised longevity market, it feels like the stars may finally be aligning. Over the last few years there has been real concern in the reinsurance community about a capacity crunch if the projected annual market demand materialises. Pension fund consolidators and the success of streamlined longevity swap contracts are bringing smaller pension funds into the de-risking market and new ideas about structuring financial instruments to address the key obstacle of shorter term contracts have now been developed. Players in the market such as Longitude Exchange and Club Vita are working to standardise models and index data to get everyone talking the same language.

For a market to develop, timing of many factors need to align. Maybe that is what's happening right now.

July 2022 Poll Results

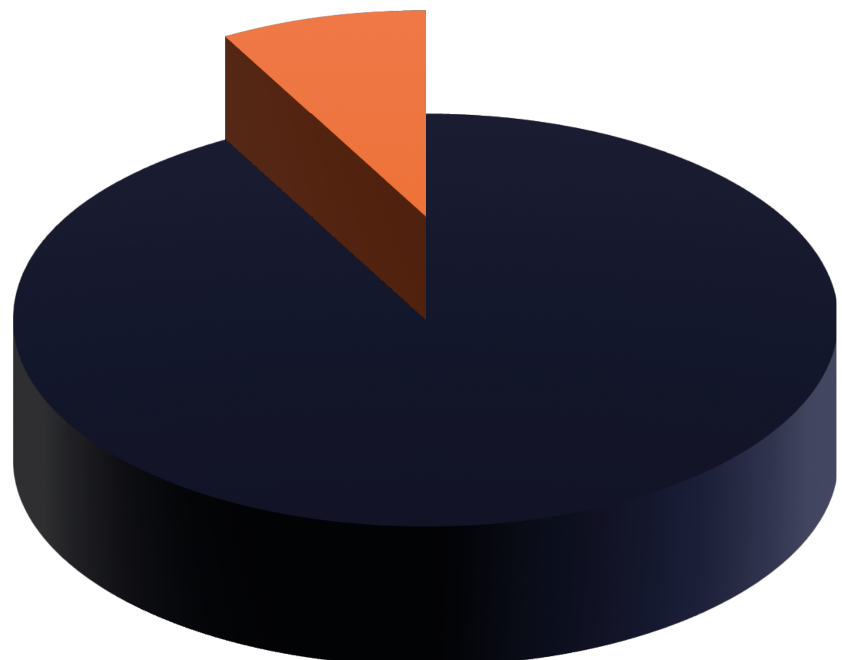
What Is the Greatest Barrier to Increasing the Number of Life Risk Transactions?

Author:
Greg Winterton
Contributing Editor
Life Risk News

The market for the transfer of life-based risk to the capital markets remains an embryonic one despite some of the sectors in the industry being decades old. For Life Risk News' most recent poll, we asked our readers whether the greatest barrier to increasing the number of these deals is one of demand - i.e., there isn't enough money interested in these types of deals – or one of supply, where there aren't enough deals to absorb the capital that desires a piece of the action.

Life Risk News' readers overwhelmingly think that it's a deal flow problem, with 91.67% of voters saying this is the case.

The result is hardly surprising but speaks to the structural challenges this industry faces in terms of figuring out how to move the needle. Many of the transactions in the space are bespoke, with little uniformity; more consistency is needed in order to accelerate deal flow to unlock the potential of this market.



Myths About the Life Settlement Industry

Author:
Scott Willkomm
CEO
Life Equity

A "life settlement" is the sale of an in-force life insurance policy to an unrelated party, typically for investment. That party continues to pay the premiums and collects the death benefit when the insured passes away.

Over the past 30 years, a niche industry has emerged around this practice in the United States. In the industry's early days, one might have heard, on occasion, the seller of life insurance ask, "Is my policy being sold to The Sopranos?"

While this question was asked tongue in cheek, it was a reflection on the market during its infancy. In those early days, the life settlements sector could be characterized as reminiscent of the "Wild West," governed by few rules, and where you survived by your own initiative and perseverance.

While The Sopranos quip may be a myth, today it is perhaps also a myth that life settlements are unregulated and somehow "unsafe". In fact, what was once an unconstrained, rough and tumble landscape, has matured: on one hand, into a highly regulated business that provides newfound liquidity to consumers, and on the other hand, into an exciting institutional market for biometric insurance risk.

Oversight and Regulation

Virtually every participant involved in purchasing life policies from consumers is subject to comprehensive oversight. Life insurance agents who represent life policy seller, life settlement brokers who source policies for sale, and life settlement providers who purchase policies on behalf of investors are all regulated by a web of state and federal laws and regulations that cover consumer protection, market conduct, and privacy.

In addition to regulating transaction participants, the states oversee certain aspects of transactions. At a high level, officials approve forms used for purchasing a policy, just as they have to sign off forms issued by insurance companies.

Different states have different rules on which policies can be purchased in certain circumstances. For example, some states require a five-year waiting period after a policy's issuance, but some only require two.

The bottom line is that life settlements are regulated using much of the rubric used to regulate life insurance.

> "Virtually every participant involved in purchasing life policies from consumers is subject to comprehensive oversight."

The Covid-19 Pandemic Has Not Had The Perceived Impact

In terms of the fallout from the Covid-19 pandemic, the near-term impact will likely be less significant for the industry than widely assumed. We have certainly seen individuals in a life settlement setting die from Covid-19. But on average, Covid-19-related deaths have not materially increased the level of claims relative to what would have been expected.

A lot of the people who are in the life settlement pool tend to be healthier and wealthier than the general population. While Covid-19 doesn't care how much money you have, insured people who comprise life settlement portfolios have better access to healthcare and can afford to work or live remotely; this means that life settlements managers haven't, by and large, been paying out early, which would hamper returns.

What we don't have a good grip on at present, which has the potential to be substantially more impactful on the industry's performance, is the long-term impact of Covid-19 on morbidity. We know of people who recovered from Covid-19 quickly and six months later suffer from lingering effects. You also have other issues at play, such as mental health problems, which may not be directly due to Covid-19 but are a by-product of the environment. While these issues may have a longer-term impact on the performance of our business, the direct impact from Covid-19 hasn't been significant.

> "Talking about returns in a credible and consistent fashion has always been a challenge in this industry. However, much has changed in recent years."

Models and Returns are Improving

Talking about returns in a credible and consistent fashion has always been a challenge in this industry. However, much has changed in recent years. Some investors got burned in the early days of the market. They were looking at outsized returns and were sold on the idea that as everybody dies, the investments always pay off. However, you have to bear in mind that these are negative carry investments – in other words, you have to pay to keep the policies. While everyone dies eventually, you can actually pay a lot more than you get back, if you are not careful.

Life settlements are a long duration asset and as such the performance takes decades in some cases to emerge. The industry has only been around three decades and does not have a long history to look upon. Investors should be aware there is a difference between the return on an investment and the implied return on a particular policy or portfolio.

In any case, the level of knowledge around longevity is evolving every day. Modelling it isn't the hard part, rather it is what assumptions go into the models and much of that is based on experience. The most important assumptions are those that describe the longevity profile. In the early days, medical underwriting and longevity modelling by life settlement market participants was rather unsophisticated compared to that done by life insurers and reinsurers. Yet, that too, has changed over the years. Now, the life settlement industry is home to life actuaries, home office underwriters, demographers, and other professionals with deep roots in the life insurance business.

Transparency has also bought discipline to the marketplace. They say transparency is the best antiseptic. For example, disclosure regarding compensation, which is generally required in transactions with consumers, has helped the industry grow up a bit.

Investors have also evolved in their level of sophistication. Few investors today do not have their own underwriting views. They might not go to the extent of completely re-underwriting a policy, but they have a reasonably informed opinion on what the underwriting of a particular case should look like.

Institutional Choice Isn't Limited

The investor mix in the life-settlement arena may surprise people. In the old days, there were a lot of retail and near-retail investors at large in the market but that is no longer the case. Today, the sector has evolved into a largely institutional investor space, with a wide range of investment managers from which to pick

For example, many US pensions, endowments, and foundations have life settlement investments, although it took some time for these to become commonplace. In addition, pension funds spanning the Asia- Pacific region have put substantial capital to work in the sector.

Presently, there is little take-up from European pension funds...but that may be changing. As is widely known, some pensions in Scandinavia, Belgium and The Netherlands got into the market too early and got their feet trampled.

However, there is increasing interest across the continent, as well-respected institutional managers are proving and validating themselves and the asset class with the European set. Many of these managers now have 10-year plus track records in life settlements. If you asked about track records a decade ago, there would be few managers who specialize in this space who would have been able to advertise 10 years' experience.

in general, pensions have been allocating more and more to alternative asset classes, and in that bucket to insurance-linked securities and other insurance-related risks. That is a general trend and is leading reluctant folks to take another look at life settlements, not just in Europe but globally. They are able to see that certain segments of the market have performed well over the past decade or so.

> **"Pensions have been allocating more and more to alternative asset classes, and in that bucket to insurance-linked securities and other insurance-related risks. That is a general trend and is leading reluctant folks to take another look at life settlements, not just in Europe but globally."**

Life Settlements Can Fit Into The ESG Box

People may not know that life settlements have a lot to offer under the ESG banner. Not every investment ticks every box, but they tick certain boxes. For example, life settlements can play a pivotal role in plugging US retirement deficits. Over 40% of Americans have zero retirement savings and 80% of Americans have retirement savings less than their annual salary. Social security cannot make up the difference – the program is projected to have insufficient funding to pay more than 79% of entitled benefits after 2034.

Life settlements can help fill long-term care gaps. Some 95% of Americans over 65 are covered by Medicare which covers major costs due to acute illness or manifestations of chronic illness, such as surgery. However, Medicare was not designed to pay for long-term care, which approximately 47% of men and 58% of women of retirement age or older will need in future. The average annual cost of a shared room in a skilled nursing facility is $80,000, a punitive amount to pay out of pocket on a limited income.

Additionally, insurance premiums are a significant financial burden for seniors on a fixed income. According to LIMRA (Life Insurance Marketing and Research Association). 4.5% of American policyholders over age 65 lapse their policy each year for which they are not paid a benefit, after paying decades of accumulated premiums.

The Covid-19 crisis has triggered unprecedented economic chaos for millions of Americans, including seniors. Market volatility and uncertainty is impacting household savings and financial resources. Life settlements can be a solution to these significant ESG issues providing a non-traditional source of capital and liquidity and a consumer-friendly choice.

The life settlements industry, like many industries, endured difficulties in its early days, something that many emerging industries go through. These difficulties gave rise to certain views about the industry; views which are now little more than myths. Life settlements has evolved in the past thirty years into a mature, well-regulated asset class; indeed, one can argue that there is nothing 'mythical' about this asset class at all.

ELSA

Secondary Life Markets Conference 2022

TUESDAY 20TH SEPTEMBER 2022
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For more information please reach out to ELSA Executive Director Chris Wells on info@elsa-sls.org

Q&A

Chris Conway

ISC Services

Life settlement investors don't buy a life insurance policy without the data and analytical support of a life expectancy analytics firm. *Life Risk News* spoke to Chris Conway, Chief Development Officer at ISC Services, to learn more about how firms like his are adapting and changing to better model longevity risk for their clients.

LRN: Chris, let's start with the obvious. Modelling life expectancy is a bit like economists making forecasts – it's almost impossible to predict. So, what certainties – if any - can life expectancy analysts offer to life settlement investors?

CC: The most important thing to understand about life expectancy underwriting is that there are huge differences between "macro-longevity" and "micro-longevity." Life expectancy underwriting in the life settlement sector is first and foremost an exercise in evaluating "micro," as in individual, longevity risk. Not only are we trying to forecast the lifespan of a single individual, but we are generally looking at individuals who are approaching or already beyond the age of insurability. This is important because the life insurance industry is not issuing new life insurance to the members of the population we are evaluating; therefore, the data life insurance companies have in very large volumes, that spans many decades, does not include the information our sector uses to estimate life expectancy.

So, to provide investors with some degree of certainty, which we would define as consistency, we use a methodology that is very similar to that used by the life insurance industry. For example, we have a formal proprietary underwriting manual that provides research-driven guidance to our underwriting staff; we have policies and procedures that are consistently applied to the escalation of cases to our secondary and clinical review processes, and we are continually educating and training our underwriting team to apply our methodology uniformly and consistently. We do this by ensuring that our system enables our underwriting team to observe the entirety of the information we have about each subject insured over time. Lastly, and perhaps most importantly, we are focused on the scalability of the platform. In other words, we are focused on building a track record for the long term based on a methodology and platform that is not tied to an individual underwriter or even a small group of expert clinicians. We can't offer consistency to our clients if what we do is tied to personalities as opposed to process, technology, and consistency.

LRN: No two people are the same, of course, and each insured individual will have specific health-related idiosyncrasies. So, where does accurate-as-possible life expectancy modelling start? Is it at the individual level or the population level, and why?

CC: The concept of accuracy in our sector has been misconstrued throughout the history of life expectancy underwriting. It's understandable, even desirable, and it is frequently touted by some using a single metric, "A-to-E" [actual to expected], but again, in our view, consistency and scalability are far more important in the long term. Each individual case is indeed unique and involves an array of variables that make the work we do even more challenging. For example, we get hundreds or even thousands of pages of medical records in PDF format, for each insured. This "raw data" must be digitized, organized and summarized - not just indexed or sorted, but truly distilled into a meaningful summary of the information that matters for underwriting purposes.. Through that process, the data becomes information, and with the information derived from the data, we can seek to "know" what is and is not meaningful with respect to the insured, their lifestyle and capabilities, and their medical health. So, the process starts with the input we receive from clients. If the data is incomplete, redundant, indicative but not decisive, etc. then the work we do becomes more forensic, deeply investigatory, and deductive in nature. The data available about the population of which our insureds are members is relevant for purposes of comparison, but the unique characteristics of the individual are far more important to our work and our clients, since that is how they deploy capital and take risk.

LRN: Tell us about some of the improvements in the life expectancy analysis arena and drivers of these improvements, and why this should provide confidence to investors in life settlement funds.

CC: The improvements made in our sector are less about the models used to evaluate individual lives and more about the degree to which advances in medical science, healthcare and technology are changing either the guidelines applicable to evaluating older aged insureds, or the speed with which data can be transformed into useful information for the underwriting exercise. In addition, the more lives we underwrite and the more outcomes we experience over time, the more complete and clear the body of information and knowledge we have to refine and focus our underwriting processes. In the last decade or so, the impact of these changes has been that mortality tables focused on the population we serve have been developed and continue to be refined, technology has enabled parts of the process to be accelerated

Chris Conway
ISC Services

and standardized without a decrease in specificity, utility or a loss of context, and again, the concept of consistency can now be pursued and validated against a much more significant body of work to further refine the risk assessment process. As a result, investors can take more comfort in the viability of the asset class itself.

LRN: Are there any developments, technological or otherwise, that makes you think that life expectancy forecasting can improve further? Indeed, just how accurate can this really get?

CC: I think the work we do will develop much further over time in the sense that the outcomes we have predicted and continue to predict will eventually become known, and that will tell us whether we were "right,". However, I'm not talking about actual-to-expected results so much as the degree to which the drivers of our predictions, the debits and credits we apply to each life through the underwriting process were or were not correct relative to the impairments involved. The more underwriting we do and the more outcomes we experience, the more we will be able to fine tune the considerations we apply to the evaluation of unique lives. However, no matter how finely tuned the instruments we build are, as they are "played," in other words as time passes and medical science progresses, these tools will always be going "out of tune." I don't think we'll see absolute certainty anytime soon, but I do think that there is room for improvement.

LRN: Lastly, Chris: Accurate valuation of policies, for which life expectancy analysis is a most critical component, is the number one driver of performance for life settlement fund managers. To what extent are firms like yours being included in the due diligence process undertaken by end investors and what are your thoughts here?

CC: Disappointingly, few have. And that's something I find odd, because by talking to us to try and understand what we do would help them to ask the fund managers better questions during their due diligence process.

I think that one of the reasons for the lack of engagement by the end investors could be that not many of them know how to go about conducting due diligence on companies that do things they don't know a lot about. But in life settlements, I'd argue that doing this is very important, because there are quite a few underwriting companies in our industry, and each has its own way of doing things, its own methodology and practice, its own "view" as to how this work should be done because this is a field that has not yet clearly defined itself or its own standards.

One thing I think is very important to highlight that investors should know is that different managers use life expectancy reports differently, and how they use the information we provide is critical for investors to understand. Investors often think the underwriting work is driven solely by actuarial factors, that the "calculator is the key," but it isn't. Calculators are driven by input; they don't drive input. An incorrect risk assessment applied to the "best" table will produce an invalid result. Also, mortality tables are modified relatively infrequently, and changes must be predicated on empirical analysis conducted on work done over long periods of time, not on a whim, inference, or based on undocumented perceptions of "experience." The truth is that the risk assessment part of what we do determines the input and the calculators themselves all generally do the same thing in the same way. However, all underwriters do not assess risk the same way and investors need to understand the bases for a given underwriters approach.

Evaluating a life expectancy underwriting company takes time, experience, and a fairly strong background in underwriting, not math. The tables matter, of course, but the underwriting risk assessment process is the critical first step. Underwriting companies are a significant and influential part of the life settlements infrastructure, and I'd urge investors to engage with life expectancy providers as part of their manager due diligence process more frequently.

Have you registered yet for the Secondary Life Markets Conference?

Date: 20th September 2022
Location: EY, Canary Wharf, London, UK
Conference & Registration details at elsa-sls.org

Insurtech Yet To Significantly Impact Life Insurance Market but Change Is Coming

Author:
Greg Winterton
Contributing Editor
Life Risk News

The insurtech market juggernaut keeps on going. In the past five years, total global venture capital investment into the sector has increased from $1.9bn in 2017 to $11.7bn in 2021, according to data and analytics firm Preqin. The growth of the sector is encouraging for both investors and consumers, as these technologies could lead to something of a revolution in product development, competition, and price in what is widely acknowledged to be a slow-moving industry.

Most of the investment dollars from the VCs are going to insurtechs related to property and casualty (P&C) insurance, however. And, according to Tom Scales, Senior Analyst at research and advisory firm Celent, the reason for the disparity is simple.

"From my perspective, the biggest reason is complexity," he said. "And P&C products are also generally easier to sell. Everyone needs auto and homeowners' insurance. They have to have it. Life insurance, while critical, is viewed as more optional."

> **"Despite the slower burn in activity in the life side of the insurance sector, the number of start-ups receiving funding is still robust."**

Despite the slower burn in activity in the life side of the insurance sector, the number of start-ups receiving funding is still robust, and so far, activity has been dominated by two main areas critical to the life insurance business model.

"Activity has been heavily focused on the distribution side," said Brian Casey, Co-Chair of the Insurance Regulatory and Transactional Practice Group at law firm Locke Lord. "That's been the primary driver during the last five or six years. Independent distributors see this as less of a tech investment and more something where they can reinvent themselves, and benefit from cheaper distribution, but some are starting to morph into becoming risk bearing businesses seeking to obtain and leverage underwriting profits."

Scales also says that he's seeing activity in the distribution arena but that the underwriting function in an insurance company is also seeing some disruption.

"There is considerable investment in the sale of life insurance. Whether it be online B2C or through a call center, a higher percentage of life insurance sales are going to shift away from the 'agent at the kitchen table' model," he said. "In terms of underwriting, the process to underwrite and approve a life policy has, until recently, involved medical records and giving blood and a paramed exam. What money is going into Life is focusing on improving that process, including what they call 'fluid-less underwriting'."

Some insurtechs are using artificial intelligence and alternative data. These terms are buzzwords in tech and finance circles and have been for a few years now and the life insurance industry is trying to get an invite to the party.

"Alternative data is extremely hot in life insurance; it's focusing on underwriting. Insurance companies want to underwrite with more public data and less medical records. In the U.S., electronic medical records are less of a thing, but there is less to ask a doctor personally if you have electronic health records," said Scales.

But it's not as straightforward for the life insurance industry as it is for the hedge fund space, for example. In December 2019, five U.S.-based regulators – the Board of Governors of the Federal Reserve System, the Consumer Financial Protection Bureau, the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency and the National Credit Union Administration issued a joint statement about the use of alternative data - some of which is generated using AI - in underwriting. It's an area that causes confusion, not least because each state will have various nuances in their insurance laws. Some state insurance regulators like the New York Department of Financial Services and the Colorado Insurance Department have jumped on the AI use train.

"Some states prohibit the use of occupation and education as a rating factor in insurance so that there isn't discrimination against a class of persons," said Casey. "And the regulators want to see what's in the black box, but insurtechs that use AI and alternative data want to protect their trade secrets.

There are lots of moving parts, but this is all still at a fairly early stage with the insurance regulators."

The life settlement industry in the United States longs for more awareness amongst the general

population that those with a life insurance policy can sell it on the secondary market for fair value, so developments supporting insurance agents' ability to communicate this option would naturally be welcomed by firms in that space. For Casey, however, the application of insurtech to the life settlement market goes beyond the sales process.

"AI could provide better life expectancy estimates and therefore pricing could become more accurate. And if life settlement companies had a partnership with a distributor, as long as they adhere to privacy laws, could get more predictive underwriting, enabling better distribution. AI underwriting could have a big impact here," he said.

> "I saw technology recently that can use your phone camera to test your oxygen level AND take your blood pressure. With the camera. That is the kind of tech that can be game changing."

Casey also says that blockchain technology also has a role to play in the life insurance market. A life insurance policy can sit on the blockchain, can be sold as a life settlement and disrupt and streamline the paper processing of transactions as wells automating the collecting of a death certificate from the coroner's office through distributed ledger technology processes. Rules – such as the requirement in many states to prohibit the sale of a life insurance policy within two years of the policy being written – can be implemented into a blockchain process in quite a straightforward way.

The life insurance industry is still in the very embryonic stages of adopting many of these technologies. And, despite the recent tumult in public equity markets and the knock-on effect on the valuation of private companies, the foundations of the insurtech sector remain solid. Whilst the P&C market will continue to see development, insurtechs focusing on the life insurance industry have a significant opportunity.

"Traditionally, in looking at the use of tech, P&C companies are farther ahead of life insurance companies. Online sales, standardized applications, simplified underwriting, online service all exist and dominate in P&C today, but not life," said Scales. "But there is so much room for improvement. For example, I saw technology recently that can use your phone camera to test your oxygen level AND take your blood pressure. With the camera. That is the kind of tech that can be game changing."

Life Risk News

Life Risk News
ISSN 2753-7374
Volume 1, Issue 3
July 2022

Editorial Enquiries
editor@liferisk.news
+44 (0) 20 3490 0271

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