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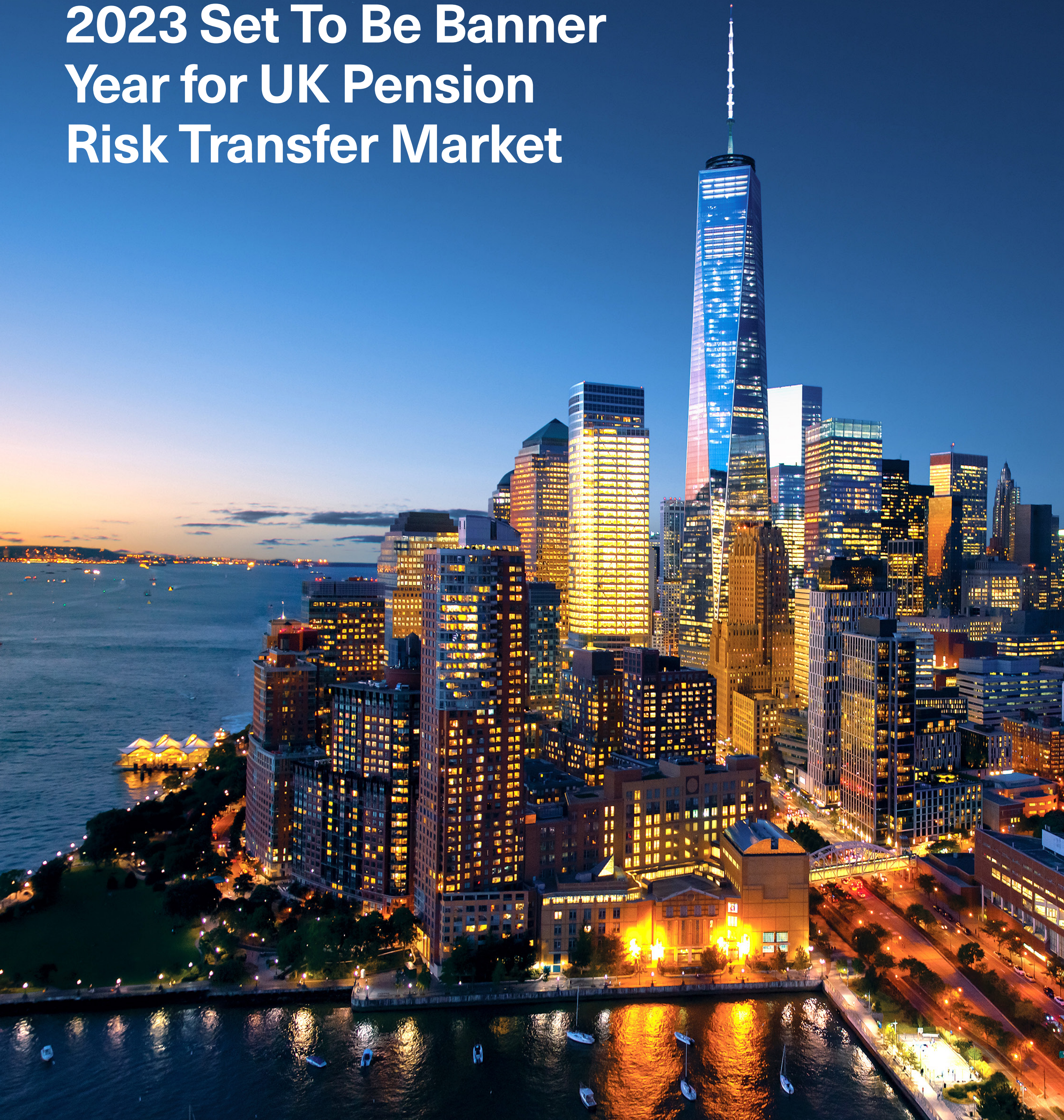

2023 Set To Be Banner Year for UK Pension Risk Transfer Market

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Editor's Letter
Volume 2 Issue 2 February 2023

Chris Wells
Managing Editor
Life Risk News

The pension risk transfer market in the UK had a solid, if not spectacular, year in 2022, with deal volumes largely flat vs 2021. But that could be about to change in 2023, according to a new report from consulting firm **WTW**. *Greg Winterton* spoke to **Louise Nash**, a Director in WTW's UK Pension Risk Transfer team, to get her thoughts on what the market has in store this year in *2023 Set To Be Banner Year for UK Pension Risk Transfer Market.*

Performing mortality analysis is part of the day to day for life insurance companies, but the Covid-19 pandemic continues to present modelling challenges for the industry. *Aaron Woolner* spoke to **Mark Sharkey**, Global Head of Pension Strategy at longevity specialists, **Club Vita**, **Nicola Oliver**, Director of Life and Health at longevity consultancy, **Medical Intelligence**, and **S. Jay Olshansky**, Co-Founder of longevity specialists **Lapetus Solutions**, to get their views on the challenges in *Uncertainty Clouds Insurers' Post-Covid-19 Mortality Projections.*

In December last year, an unexpected data request was made of life settlement providers by the Florida Office of Insurance Regulation. The request has been dropped for now, but *Jeffrey Davis* spoke to **Brian Casey**, Partner with **Locke Lord LLP**, **Bryan Nicholson**, Executive Director at **LISA**, and an anonymous source, to see what all the fuss was about in *Florida Office of Insurance Regulation Data Request on the Back Burner – For Now.*

Our roundtable this month sees *Greg Winterton* speak with life settlements asset managers **William Corry**, Founder and Managing Director, **Corry Capital Advisors**; **Walter Deeter**, Co-Founder, Managing Director & Chief Investment Officer, **Burdette Asset Management**; **Patrick McAdams**, Investment Director, **SL Investment Management**; and **Maurizio Pellegrini**, Life ILS & US Life Settlements Manager, **Azimut Investments**, to get their thoughts on the current state of the life settlement market and their outlook for the coming 12-24 months.

Our first commentary article this month comes courtesy of **Stuart McDonald**, Partner and Head of Longevity and Demographic Insights at **Lane Clark & Peacock LLP**. McDonald offers his views on the consequences of the Covid-19 pandemic on the UK's pensions industry in *The Legacy of the Pandemic for Pension Scheme Mortality.*

Our poll this month asked, *Are Life Risk Investors Generally Price-Makers or Price-Takers? Life Risk News* readers feel pretty conclusively about this one.

Our second commentary piece this month comes courtesy of **James W Maxson**, Partner at **Edwards Maxson Mago & Macaulay, LLP**. Maxson explains the risks when individuals and companies rely on the so-called "natural person" exemption from licensure to purchase policies in *Caveat Emptor: Life Settlements and the Natural Person Exemption From Licensure.*

This month's *Q&A* is with **Meghan Shue**, Head of Investment Strategy at **Wilmington Trust**. Shue offers her thoughts on Wilmington's recent Capital Markets Forecast (CMF) and investor portfolios more generally.

To many, insurance companies don't have the capacity to absorb all the longevity risk that defined benefit pensions currently hold and so enabling capital markets participation in longevity risk is a natural solution to that challenge. *Greg Winterton* spoke to **Avery Michaelson**, CEO at **Longitude Exchange**, to learn about how exchanges could play a part in *Is a Digital Exchange the Solution to the Investor Participation in Longevity Risk Transfer Conundrum?*

2023 Set To Be Banner Year for UK Pension Risk Transfer Market

Author:
Greg Winterton
Senior
Contributing Editor
Life Risk News

The pension risk transfer (PRT) market in the United Kingdom received a boost in November last year as the UK government announced proposals to relax some of the capital constraints for insurance companies under the Solvency II regulatory regime, which should provide insurance companies with additional room on their balance sheets to complete more PRT deals with defined benefit plan (DBP) sponsors.

It's unclear when the proposed amendments to Solvency II will be passed by the UK government, but in the meantime, the country's PRT market seems to be perfectly fine just the way it is; consulting firm WTW says that 2023 could be the best year ever for PRT deals in the UK with the firm forecasting approximately £40bn of deals this year, according to its recent Shifting up a gear; De-risking report 2023, which would be a record.

The bullishness stems from the robustness of current funding levels for UK-based DBPs. The rise in interest rates last year has had the knock-on effect of improving funding levels through higher liquid fixed income returns, and even if rates plateau this year, or fall in future, according to according to Louise Nash, a Director in WTW's UK Pension Risk Transfer team, the generally stronger funding levels of DBP sponsors in the UK is sustainable.

"Stronger funding positions make it more affordable for pension schemes to come to insurers, of course, but then they look to try and hedge against interest rate risk. Once pension plans are in a strong position, they want to hold on to it – they're very proactive in that way."

"Stronger funding positions make it more affordable for pension schemes to come to insurers, of course, but then they look to try and hedge against interest rate risk. Once pension plans are in a strong position, they want to hold on to it – they're very proactive in that way. I don't see funding levels falling back and so I'd actually expect demand to continue to grow in coming years."

Data produced by WTW suggests that historically, market activity in the second half of the year outstrips the first half. That's true for 2022, but to a lesser extent; the £16bn of deals in the second half of last year was only £4bn higher than the £12bn observed in H1, the smallest gap in the past five years.

Reasons for the trend include a more flexible price environment due to insurance companies needing to hit their full year targets, but Nash cautions plan sponsors that waiting for better pricing isn't always the best strategy.

"A lot of insurance companies work on year end business targets and if they have not met volumes for the year, there can be more flexibility on price. But if they have met their targets, plan sponsors might miss the boat in terms of discounts, especially with those who care about half year reporting. Pricing and deal activity really does vary year by year so it's important for plan sponsors to be aware of these business cycles and therefore when they are likely going to get the best deal for them."

It's not a completely rosy picture, of course. The UK's 'mini budget', announced in October 2022 by then Chancellor of the Exchequer Kwasi Kwarteng, had the effect of sending the country's pensions market into something of a frenzy, as many plans rushed to liquidate assets to meet margin calls on derivatives exposures in the wake of surging gilt yields. Pension plans that were previously looking at the partial buy-in option – a common type of PRT transaction for schemes that aren't candidates for a full buy-out but that still want to de-risk some of their book – might find themselves in a more difficult spot.

"Risk is more at the front of pensions' minds as a consequence of what happened in the autumn; they're looking to hold more liquid assets. But buy-ins are illiquid, and many plans are trying to square the circle of having enough assets to support their hedging program, and enough to provide a good enough return to get them closer to fully funded. There are some schemes where buy-ins still make sense and we've seen some strong pricing in the last few months. But many others will have to think a lot harder about pursuing a partial buy-in because the effectiveness of the transaction will be diminished," said Nash.

Also, even for those that are good candidates for a full buy-out or buy-in, it's not as simple as hiring an advisor and knocking on an insurance company' door. Illiquid investments such as third party pooled funds need to be liquidated, and exiting via the secondary market can often mean accepting a discount, which then changes the funding profile of a plan. Other routes to exiting illiquid investments, including a loan from the sponsor and transferring the assets to the provider, exist, but each has their own challenges, including sponsor willingness to take the risk in the former, and investment strategy alignment in the latter. And then there's the pension data issue, which is a big one.

> "Pension scheme data can lack quality and so there are lots of projects that need to be undertaken to make sure the data is correct. Insurers need accurate data to work out what the liabilities are so they can price the deal correctly. Having accurate data is a critical part of the de-risking journey."

"Pension scheme data can lack quality and so there are lots of projects that need to be undertaken to make sure the data is correct. Insurers need accurate data to work out what the liabilities are so they can price the deal correctly. Having accurate data is a critical part of the de-risking journey," said Nash.

Whether WTW's £40bn prediction ends up being correct remains to be seen. But for Nash, the bottom line is that the world's most active PRT market is almost certain to get even busier.

"There are around £1.5trn of defined benefit pension plan liabilities in the UK, and most of that hasn't been touched yet," she said. "There are new insurers coming to market and more talking about it. Obviously, it's hard to predict the future, but there's no reason to think that activity is going to fall off. There's a lot more to come down the path."

Secondary Life Markets Conference 2023

Date: September 12th 2023
Location: EY, Canary Wharf, London, UK

Uncertainty Clouds Insurers' Post-Covid-19 Mortality Projections

Author:
Aaron Woolner
Contributing Editor
Life Risk News

When insurers set their longevity assumptions, it consists of two parts: the baseline assumption, which is essentially a current view of life expectancy today, and the projected future longevity assumption.

Both of those have become more challenging to predict due to the Covid-19 pandemic, so the only certainty for insurers performing mortality analysis in 2023 is that it won't be easy, according to Mark Sharkey, Global Head of Pension Strategy, at longevity specialists, Club Vita.

"There is a wealth of data out there about the impact of the pandemic, but drawing useful insights from that data requires the industry to work with a scalpel as opposed to a sledgehammer," he said.

Sharkey says that taking a broad-brush approach to mortality analysis could present difficulties for the industry. Club Vita offers longevity analysis in the US and Canada, as well as its home market of the UK, and Sharkey says the diverse range of outcomes of the pandemic on mortality is also reflected at a country level.

> **"There is a wealth of data out there about the impact of the pandemic, but drawing useful insights from that data requires the industry to work with a scalpel as opposed to a sledgehammer."**

"That trend is not the same in the UK as it was in the US and Canada," he says. "In both of those countries the effect was flipped around. So even looking at the most basic of demographic statistics, and if you're looking at a global portfolio, you can't simply use that one size fits all approach."

S. Jay Olshansky, Co-Founder of longevity specialists Lapetus Solutions, adds that experts are unsure of the exact mortality rate of Covid-19 so far, let alone its future development.

"Excess mortality is the only statistic I would rely on, I would not call it Covid-19 mortality, because it's not always directly caused by Covid-19. It can be indirectly influenced by it. The bottom line, for those of us that study mortality, is that we don't really know what the death rate is from Covid. And I'm not sure we're ever going to know, at least not accurately or quickly."

Olshansky also says that Covid-19 is so unprecedented that even obvious historical pandemics do not offer a reliable guide to its future impact on life expectancy.

"We have never experienced anything quite like this before. This is not like the 1918 influenza pandemic, which saw a rebound in life expectancy about one to two years after it finished. We have not experienced that yet. And it is unclear whether we will."

According to Nicola Oliver, Director of Life and Health at longevity consultancy, Medical Intelligence, although it may be a century since the last global pandemic that does not mean it's a one in a hundred-year event. Instead, a combination of climate change and the loss of biodiversity means pandemics will occur with increasing frequency.

"There is another pandemic lurking around the corner, it's not if but when and there are lots of factors which are driving that. It starts with the climate crisis and increased deforestation bringing people closer to animals. Roughly 65% of all infectious human diseases have come from animals and this process has accelerated in the last 20 years," she says.

The likelihood of further pandemics may be increasing but Sharkey says that it is possible to learn some lessons already from Covid-19. He points to the current Club Vita longevity base tables used by UK defined benefit (DB) pension funds which are calibrated up to the end of 2020 - the first year of the pandemic.

These show that generally DB pensioners - a population cohort Sharkey says is analogous to life insurers' clients - are more resilient to the pandemic than the general population.

Unlike excess deaths, this time the data from Canada and the US moves in lockstep with the UK. Sharkey says that Club Vita analysed a US state-wide pension fund and found that their excess mortality was lower than the state average itself.

Olshansky says that this difference is to be expected given that insured populations typically have higher income and education levels than the general population, two of the biggest indicators of life expectancy along with genetics and lifestyle.

"In all likelihood, Covid probably had less of an impact on the insured population relative to the uninsured population because of the known variation that exists in survival among those that are educated and have a higher income relative to those that don't. That's what happened in the United States; Covid had a disproportionately negative effect on minorities, who are more likely to be underinsured."

"In all likelihood, Covid probably had less of an impact on the insured population relative to the uninsured population because of the known variation that exists in survival among those that are educated and have a higher income relative to those that don't.

Again, what is true for the UK may not be for the US. Data from the UK's Office of Health Improvement and Disparities, which gives a breakdown of regional excess deaths in England for the period 21 March 2020 to 30 December 2022, shows a wide divergence of excess death during the pandemic in different regions.

The Northwest of England experienced 25,000 excess deaths over that period and a ratio of registered deaths to expected deaths of 1.13, whereas the Southwest, which was the least impacted region in the UK by the pandemic, saw 11,000 excess deaths and a ratio of 1.07. This was despite both regions having an almost identical median salary, according to Statista.

However, the Monthly Populations by Index of Multiple Deprivation (IMD) Decile, data published by the ONS, which buckets the UK population into five levels of separate socioeconomic groups, shows an obvious trend where higher socio economic groups have experienced fewer excess deaths than their lower income peers.

Sharkey says, however, that it is important not to assume that this is due purely to socioeconomic factors. For example, healthcare spending varies widely across the UK and partly explains some of the regional excess death differences.

"The real question is, 'is the IMD data results part of a true socio-economic trend?"

The future mortality outlook may be uncertain, but Oliver says that that one aspect of the pandemic is the potential for it to lead to medical breakthroughs which could increase life expectancy.

"There are actually some positives that you can focus on. During the pandemic we were able to accelerate the rate of which drug approval processes could take place. Secondary to that is the renewed interest in mRNA technology which could result in better early-stage cancer treatment."

Florida Office of Insurance Regulation Data Request on the Back Burner – For Now

Author:
Jeffrey Davis
Contributing Editor
Life Risk News

The end of the calendar year sees many in the finance world cast half an eye towards the holiday season, but for many in the life settlement market, the Florida Office of Insurance Regulation (OIR) gave them extra work.

On 2nd December last year, life settlement providers registered to do business in the state received a 'call for data', which asked providers for a raft of information about all the life settlements they had purchased in the past six years in the state, including sensitive personal information about insureds. Bryan Nicholson, Executive Director at industry trade body the Life Insurance Settlement Association, said that there was initially a degree of uncertainty amongst its members.

"The call for data was unexpected and we had to ensure that all of our provider members who are registered in Florida – which is all of them – understood the request completely and that we were aligned in terms of our response," he said.

> **"The call for data was unexpected and we had to ensure that all of our provider members who are registered in Florida – which is all of them – understood the request completely and that we were aligned in terms of our response."**

The initial deadline for providers to submit their data was 21st December, 2022, later extended to 13th January, 2023, and suddenly changed the description of the request to a 'market conduct investigation'. Concurrently, two life settlement providers, Coventry First LLC and Life Equity LLC, fought the request in court and requested that the Division of Administrative Hearings enter a voluntary dismissal to close their case. Their argument was that OIR had made an unlawful data request that wasn't governed by a rule that had been adopted through the formal rulemaking process.

The request was later dropped entirely, although it's unclear as to whether the legal action by Coventry and Life Equity was the driver.

"This is to advise you that relative to the Letter of Inquiry...on 29th December, 2022, the Office of Insurance Regulation has concluded the market conduct investigation and no further action is required by you at this time. Thank you for your patience, cooperation, and assistance during our investigation," said OIR Financial Administrator Janice S. Davis in a letter dated 25th January, 2023.

Life settlement market participants are taking a close look at the call for data, and some speculate it was caused by unlicensed actors or certain practices with brokers operating in the marketplace. A source, who spoke on the condition of anonymity, said that the action taken by the OIR could be a precursor to an elevated level of interrogation in the life settlement market.

"While this recent action appears to have been undertaken hastily, and possibly improperly, based on the way the call was issued, the short deadlines, and the sudden withdraw of the action, all of which are atypical, routine market conduct examinations by several states were more common in the past and could become more common again," he said.

As with any regulatory-based call like the one observed in December, those who have done nothing wrong should feel no alarm. While the data request was unexpected, providers that tick the regulatory boxes in their course of doing business should not be alarmed.

"The licensed, legitimate industry is very well prepared for such actions. Licensed companies are generally inclined to preserve their good standing status and protect their licenses through compliance with established regulations," said the source. "But there are firms circumventing, misinterpreting, and in some cases breaking the laws of various states, while misleading consumers. These bad actors should absolutely be the subject of much more substantive regulatory scrutiny."

Whether the request was dropped by the Florida OIR because of the legal action on the part of industry participants is unclear – the Florida OIR didn't respond to a request for comment from Life Risk News before press time. But if it was, then it's a straightforward process for it to bring the request back in future.

"The Florida OIR will likely eventually engage in rulemaking to be able to do in future what it wanted to do with the original request," said Brian Casey, Partner and Co-Chair of the Regulatory & Transactional Insurance Practice Group with law firm Locke Lord LLP.

"The marketplace was taken aback because the request came out of the blue and there was an incredibly short initial deadline. We wanted to understand the reasons behind the request and make sure that our members were preparing – and could actually provide - everything that the OIR wanted in the event that the filings from providers were required."

Market participants are going to be monitoring announcements and other FL-OIR activities with interest to see if this request does return. If it does, other states may follow suit. Indeed, others may take Florida's lead anyway.

But if that happens, then Nicholson says that the industry will be better prepared.

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Roundtable
Life Settlements Asset Managers

William Corry
Founder and Managing Director
Corry Capital Advisors

Walter Deeter
Co-Founder, Managing Director & Chief Investment Officer
Burdette Asset Management

Patrick McAdams
Investment Director
SL Investment Management

Maurizio Pellegrini
Life ILS & US Life Settlements Manager
Azimut Investments

2022 provided global investors with one of the most challenging macroeconomic environments in years as higher inflation, rising interest rates and geopolitical instability combined to affect both stock and bond portfolios alike. Life settlements, however, tend to exhibit a low correlation to traditional markets, and Greg Winterton spoke to life settlement asset managers William Corry, Founder and Managing Director, Corry Capital Advisors, Walter Deeter, Co-Founder, Managing Director & Chief Investment Officer, Burdette Asset Management, Patrick McAdams, Investment Director, SL Investment Management, and Maurizio Pellegrini, Life ILS & US Life Settlements Manager, Azimut Investments, to get their take on how their industry did in 2022 and the outlook for the coming 12-24 months.

GW: Let's start with a look back to 2022. Many in the life settlement secondary market say that deal flow improved last year, after a brief retreat in 2021. Do you agree, and if so, what are your thoughts about the sustainability – or not – of elevated levels of secondary market activity?

WD: Yes, we definitely saw a higher volume of origination in the secondary market, last year. That's partly due to the recovery from the Covid-19 pandemic, but it's also the increasing influence of the direct-to-consumer channel in our industry And that's a good thing for the consumer - if it's done correctly, the net amount payable to the insured is greater than they would realise in a traditional secondary market transaction because of intermediary costs. And it definitely has legs – there is a substantial amount of policy flow going through that channel.

PM: We also saw a pick-up in secondary market volume in 2022. Another factor at play is the cost-of-living increases in the U.S. and rising healthcare costs. Consumers are looking at budgets and for pensioners, their payments are flat, so they're asking, 'where can I cut back?' Those that have a life insurance policy are paying a sizeable premium. Cut costs by selling the policy eliminates the ongoing cost as well as providing a lump sum. In terms of the sustainability of that trend, it stands to reason if inflation cools off and there is less pressure financially then consumers may choose not to sell. But a lot of activity in the secondary market over time comes back to a generally heightened level of awareness. Consumers will remember that they looked at selling their policy in the past and so might sell in the future. That residual demand will also drive secondary market activity.

MP: Volumes are certainly picking up and to add to what Patrick said, the cost-of-living situation is having an impact particularly in the $500k – $1mn policy value range. But it also depends on what kind of segment of the market you target. Longer term, higher value policies are less impacted by cost-of-living considerations – the decision-making process for these consumers is different. And at the end of 2022, there was something of a reduction in supply of that paper and I think that the contraction in this policy value range will remain in 2023 if the cost of funding stays high.

WC: I agree on the increase, particularly in Q3 or Q4 of last year. Sustainability-wise, I think it's looking good. Yes, some policies with lower face values are being driven by the economic environment itself. But on the higher end, let's say $3mn or more, that's being driven by the education of consumers and their awareness of the life settlement option. Added to that, our industry has more oversight than most, and state regulators do a good job of consumer education as well. And wealth managers are increasingly participating in the asset class, because of demand from their clients, and because of their own increased understanding of it. This trend is a particular one that I'd expect to continue to grow.

GW: Still in the secondary market, brokers say that the bidding starts too low and that is one of the main contributors to what they think is a drawn-out sales process. What's your view?

PM: Look, this is an open auction market. Price discovery is undertaken by what an asset manager is willing to pay for the asset and the price that someone is willing to sell at.

I'd also emphasize here that the term 'broker' suggests some kind of neutrality. In life settlements, the broker has a fiduciary duty to the seller – their client. They're incentivised to achieve the best price. There is more bias amongst brokers in life settlement market than other markets. If I were a life settlement broker, I'd say that too. But I'm the buyer, and I only want to pay what I think the asset is worth. If brokers think that's a lowball bid, so be it.

WC: You're dealing with two separate fiduciary responsibilities. They have one to the seller and our job is to represent and have a fiduciary responsibility to our investors. I don't see anything wrong with it but because of this, there's no way to draw those two competing interests closer. Fund managers make offers at a fair price based on the provenance of the policy they look at. You're just not going to speed this part of the process up.

WD: This has been an underlying complaint for a while, but with the emergence of the DTC channel it's given us a much better opportunity and a better cross section of policies at a better price than the traditional way. But for me this is a small element of the problems in the secondary market process.

MP: The past few years have been a seller's market in the life settlement space as well, so brokers have been able to keep an auction going. They had time to collect numerous bids and not leave anything on the table - that approach worked for them as many buyers wanted to buy. That's also contributed to a longer sales process. But that is changing now – there are signs of a more balanced market returning. There is less of a seller's market than before.

GW: More broadly, demand for alternative investment assets and strategies, like life settlements, faces at least short-term headwinds from rising yields on liquid debt allocations in the sense that the gap between the risk-free rate and the risk premium offered by alternative investments is shrinking. What's the sales pitch for life settlements in a rising rate environment?

MP: It was definitely easier pitching investments into life settlements at the outset of last year but targeting double digit returns over the risk-free rate now is a different story. Sourcing good policies is harder and it's more difficult to win them, and there is an upper limit to the return you might get. Previously, you could deliver high single digit returns because they were three times the return on treasuries. Now that's only 1.5 times, which is a harder pitch. But diversification has always been a strength of our market, as well as compelling returns to other asset classes with a similar risk profile. This part of the 'sales pitch' hasn't changed.

WC: For me, every investment should start with returns, regardless of the macro environment. Institutional investors should be asking how life settlement managers achieve the target returns. They should want to see the underlying assumptions – things like the stability of longevity extension and how that's mitigated because that affects everybody's book of business. Yes, in a higher interest rate environment, the appeal of life settlement fund earning a single digit return would be lower. And then if you use leverage, you have the chance of delivering higher returns, but that's riskier and your returns become more correlated, which is something that our industry claims not to be. But I think the sales pitch starts with returns, and why investors should be confident you can deliver them.

WD: When treasury rates increase, the spreads of assets priced against them will narrow. But that doesn't make it less interesting. This is a diversification and alternative to mainstream asset class. It's not something to compare to traditional markets really. If we look back at 2022 and say equity markets were horrible, when it turns around you have to acknowledge that, too. For me, this asset class isn't a fixed income alternative either. It's a private equity-style asset, which offers a shorter time frame with more predictable cash flows for investors, meaning returns can be more stable.

PM: I've been asked this a lot last year, when five years ago, I was never asked that question at all. Investors are most attracted to life settlements by low correlation and low volatility. Most other asset classes have suffered losses in value in the past year, but life settlements have held up. Yes, the risk premium is smaller now, but investors have concerns about equities this year and they're unsure how high rates are going to go. Investors got used to getting 15% returns plus and they've had to reset their expectations somewhat, but anyone with exposure to big tech in the past had unbelievably large returns and then heavy losses last year. Investors know that you can't go on like that because investment returns will revert to the mean over time. Life settlements offers a similar return profile to equities over the longer term; that's a consistent sales pitch for the industry in my view.

GW: What are some of the other challenges that you think the life settlement market faces in the next 12-24 months, and is there anything that the industry itself can do to address these challenges?

WD: The differences in the reports from different life expectancy underwriters is one issue that I have. We have done a significant amount of our own underwriting and when that doesn't match up with an external provider, it's frustrating. When two or three don't add up, it becomes even more frustrating.

It seems that underwriters are extending life expectancies for no valid reason which leads to inefficiencies in the marketplace. It makes it a lot more difficult to transact.

MP: It's difficult to scale up and deploy capital as quickly as we would like to in the secondary market and in the tertiary market it is difficult to find good deals - policies in that space are seasoned for long enough that the seller might have gained substantial inside information that's difficult to evaluate in an auction. And the cost of funding is something that is hindering the return potential. If we were to leverage even slightly it would be super costly. Add that to the fact that it's difficult to find safer paper means that deal flow might not be as strong this year.

PM: We'd all like to see more efficiencies in the market. In the 20 years I've been in this market there have been a number of attempts to create exchanges, for example. There are many efficiencies that can be achieved but equally there are a lot of processes pushing against that evolution, like providers and brokers being a necessary part of the transaction on the secondary side. If anyone took a real look at the life settlement market from 30,000 feet, they would do it differently.

WC: I wouldn't use the word challenges – there's no real attack on the industry. The 'challenges' are just like in any other investment – you have to find value in what you're buying. You can't create more policies than what there are for sale and longevity extension is pretty baked at this point. You could argue that medical advances could be challenging depending on what type of portfolio you have, for example those focused on a younger cohort of age. And institutional investors have more options with regards to other asset classes and investments now, but some of that is cyclical and it's just a matter of when it rolls out of that. But again, to me, that's not a challenge. I think the industry is in a very good place.

GW: Lastly, what are some of the opportunities for the life settlement market that should provide encouragement to institutional investors, both those that are allocated to the sector already, and those that are looking to dip their toe in for the first time?

WC: It's the consistent evolution of the industry – there are simply longer track records available now, and I don't just mean returns, I mean track records of longevity performance. The sophistication of underwriting has improved and will continue to improve with medical advances. We're now 20 years into this asset class and there are plenty of data points that are positive.

PM: I'm very bullish on the near to medium term. There is a wider range of investors, geographically speaking, that are taking note of this asset class – wider range in the sense that they're outside of the typical investor base in Europe and North America. Word is getting out to investors about life settlements. My only concern is if investors start to feel that stocks can really rocket again. Again, for me, that would have an impact on many alternative investments, life settlements included. But that's also inconclusive right now. And specifically in our industry, I'm seeing positive signs in terms of increased policy volume.

WD: I'm bullish. Have been, continue to be. I do wrestle with the same thing as Patrick - does an equity market rally pull away the preponderance of cash looking at alternatives right now? The Fed is looking at employment and the stock market. If equities heat up it could be viewed as a negative. But we're also seeing more interest geographically; investments that deliver a stable, predictable yield if managed appropriately will always be of interest to investors.

MP: We are seeing a bit less competition this year than last – as I mentioned, pricing is becoming more reasonable so we can buy at more interesting expected returns as compared to the beginning of 2022. That's good for all managers in the space, considering that our investors are obviously concerned with the level of return we can deliver for them. Life settlements have always offered something different for investors, and I think the outlook is generally solid for all of the reasons mentioned here.

The Legacy of the Pandemic for Pension Scheme Mortality

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The Covid-19 pandemic has caused a dramatic shock to health and life expectancy, disrupting the pattern of mortality improvement seen historically in the UK population.

Since March 2020, we have witnessed over 160,000 excess deaths compared to what would have been expected if mortality rates had remained at pre-pandemic levels. Early on, the vast majority of excess deaths were a direct consequence of Covid infections. As time goes on though we are increasingly also seeing excess deaths arise from indirect impacts of the pandemic such as disruption to the health system and changes to individual health-seeking behaviour. Medical diagnoses have been missed or delayed – for example, 2020 saw large falls in new prescriptions to manage blood pressure and cholesterol levels, which have not been caught up. In December 2022 the average ambulance response time in England for category 2 calls (which can include strokes and heart attacks) was over one and a half hours. That is against a target of 18 minutes.

Whilst most direct deaths from Covid-19 were among older people, the relative increase in mortality rates was broadly comparable across all age groups in 2020. As time has gone on and indirect impacts have increasingly influenced mortality rates, it is younger adults experiencing the biggest relative increase. Many of these excess deaths are from cardiovascular causes.

Age is certainly not the only relevant lens through which to view the impacts of Covid-19. Clear differences have been apparent at various stages of the pandemic when looking at other demographic, geographic and socioeconomic indicators. For example, the most deprived fifth of the population experienced disproportionately high excess mortality during the first wave. This was partly because they were more likely to be in occupations that exposed them to the virus, and partly due to prevalence of health conditions that made serious illness and death more likely.

> "As time goes on though we are increasingly also seeing excess deaths arise from indirect impacts of the pandemic such as disruption to the health system and changes to individual health-seeking behaviour."

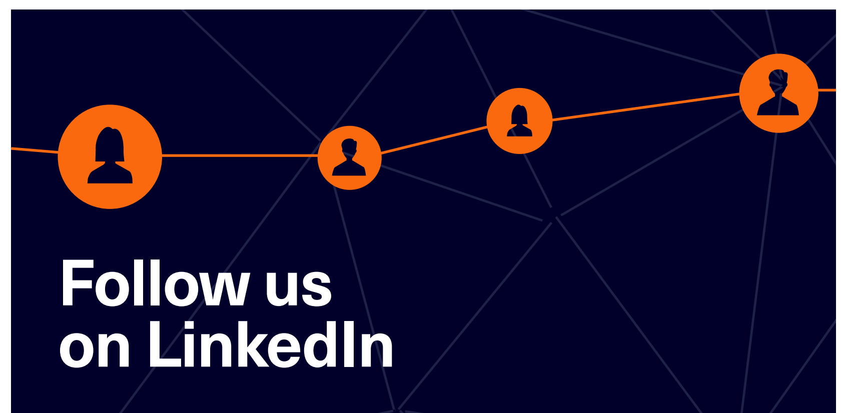
The pandemic presents a significant challenge to pension scheme trustees and sponsors on the allowance that should be made for Covid-19 when adopting mortality assumptions for their schemes. When giving advice on mortality assumptions, actuaries tend to use models which project future mortality rates based on past data. Given the volatility of recent data, these models may now produce unreliable forecasts or require more significant subjective adjustment than previously. The latest model of mortality improvement from the Continuous Mortality Investigation (CMI) makes no allowance for Covid-19 by default.

This means that it has never been more important to understand the underlying drivers of changes to mortality, and how these affect different groups. Some drivers will have a comparable impact on all of society, but others may affect members of a specific pension scheme differently to other pension schemes or the general population. For example, a scheme's membership might be concentrated in a region where waiting lists are particularly long and the local population's unmet healthcare needs are significant.

Even before the pandemic struck, there was extreme longevity inequality in the UK, with an astonishing 27-year gap between the life expectancy at birth of men in the local areas with the highest and lowest life expectancy. The life expectancy gap was widening pre-pandemic and we expect it to continue to do so for at least the next few years. What happens beyond that is harder to say as it depends in large part on political choices.

> "The life expectancy gap was widening pre-pandemic and we expect it to continue to do so for at least the next few years. What happens beyond that is harder to say."

One of the UK Government's "Grand Challenge" missions is to "ensure that people can enjoy at least five extra healthy, independent years of life by 2035, which narrowing the gap between the experience of the richest and poorest". The Covid-19 pandemic will make this ambitious goal even more challenging to deliver.



January 2023 Poll Results

Are Life Risk Investors Generally Price-Makers or Price-Takers?

Author:
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Senior
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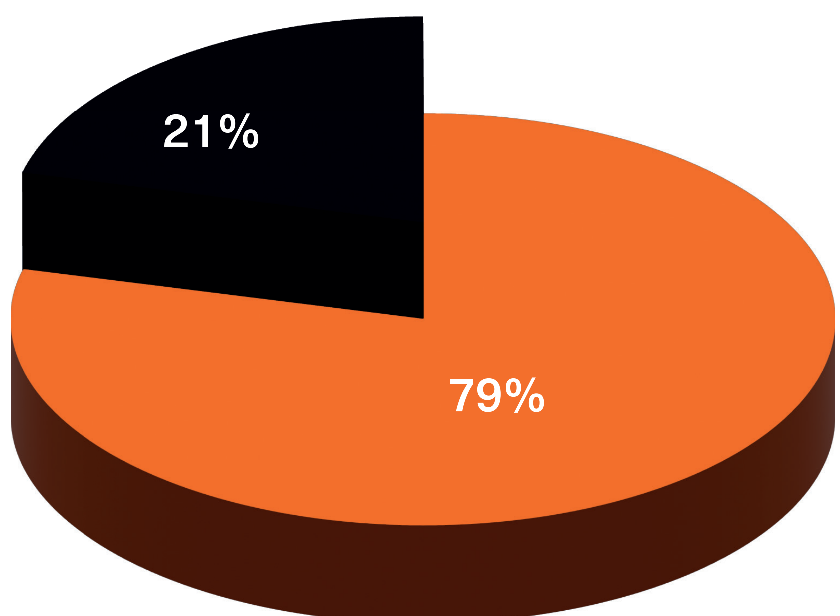
Life Risk News

Being a price-maker is the holy grail of any business, and in investment circles, those who originate business due to the strength of their network and reputation can often benefit, at least to some extent, from this advantage.

So, for our poll in January 2023, we asked our readers whether they thought that life risk industry investors were generally more price-makers, or whether they were really price-takers.

The fact that Life Risk News readers think they are generally price-makers should not come as a surprise. But what is surprising is the extent to which they think they are. Some 79% of respondents voted in the affirmative, versus 21% who didn't.

There are many sub-categories of the life risk industry, from life settlements to value-in-force transactions, from equity release to life contingent structured settlements, each of which has nuances that determines the extent to which investors active in these markets are price-makers versus price-takers. What's clearly not nuanced is the confidence that these investors have when it comes to their own ability to effect price.



Caveat Emptor: Life Settlements and the Natural Person Exemption From Licensure

Author:
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Founding Partner
Edwards Maxson Mago & Macaulay, LLP

Interest in the life settlement asset class, the purchase of an unwanted and unneeded life insurance policy for a lump sum payment, has continued to grow steadily over the course of the last two decades because of potential double digit returns uncorrelated to the capital markets. The foundation for investors' confidence in the asset class is that the policies purchased are legally originated and will not be subject to challenge by the policies' former owners or beneficiaries. A recent decision from a federal court in Texas calls into question the viability of an often-used exemption from licensure and emphasizes how important it is that investors carefully diligence the policies they purchase, or risk losing their entire investment.

Stakeholders and investors in the life settlements market know that to purchase a life insurance policy from a non-terminally ill owner, it is necessary to have a "provider's" license in 43 of the 50 states. These licenses are time consuming and expensive to obtain, and their maintenance entails significant on-going compliance obligations. Thus, it is no surprise that providers who have invested years and tens of thousands of dollars in time and money into procuring and maintaining these licenses take umbrage with individuals and companies who regularly rely on the so-called "natural person" exemption from licensure to purchase policies.

> **"It is no surprise that providers who have invested years and tens of thousands of dollars in time and money into procuring and maintaining these licenses take umbrage with individuals and companies who regularly rely on the so-called "natural person" exemption from licensure to purchase policies."**

This exemption, which is found in both the National Association of Insurance Commissioners' ("NAIC") and National Council of Insurance Legislators' ("NCOIL") model acts, typically reads along the lines of the following:

"Settlement provider" does not include: A natural person who enters into or effectuates no more than one agreement in a calendar year for the transfer of life insurance policies.

According to the Proceedings of the NAIC, when it adopted its model settlement act in 1993, the intent of including the "natural person" exemption was "to exclude from the Act a friend or family member of the policyholder who wanted to enter into an agreement with a [policy owner][,]" because, "it would create a hardship to subject family and friends to the model act." 1993 Proc. 3rd Quarter 439. Hence, the intent of the NAIC in adopting the exemption was clear – to exclude a person with a close relationship to a policy owner from the burdensome obligations associated with provider licensure.

In contravention of the explicit intent of the NAIC, some participants in the life settlements industry have taken this exemption for use by a friend or family member and turned it into a business model, allowing them to act as a provider without having to shoulder the burden and expense of obtaining providers' licenses. This is the fact pattern that the court confronted recently in Consolidated Wealth Management, LLC v. Short, 414 F.Supp.3d 1011 (S.D. Tex. 2019).

In January 2014, James Short, a resident of West Virginia, entered into a Senior Facilitation Agreement ("SFA") with an individual employee of Montage Financial Group ("Montage"). Montage played no role in the transaction with Mr. Short and was not a party to the SFA. Under the terms of the SFA, Mr. Short agreed to assign his interest in the policy for a payment of $25,016. Three days after entering the SFA with Mr. Short, the individual assigned his entire interest in the policy to Consolidated Wealth Management ("CWM") for a payment of $37,700.

> "The full potential of the cloud cannot be realized by simply migrating or replacing existing systems. Rather, it requires that insurance companies reimagine how they do business to leverage the inherent advantages of the cloud."

On June 22, 2018, Mr. Short passed away. Mrs. Short thereafter filed a claim for the death benefit under the policy, and CWM made a competing claim. As a result, the carrier filed an interpleader action.

The parties' arguments were straightforward. Mrs. Short contended that the sale of her husband's policy violated West Virginia's viatical settlement law, and was, therefore, unlawful and void. Whereas, CWM argued that under the "natural person" exemption in West Virginia's law, the individual who purchased the policy was not a "viatical settlement provider" when he entered into the SFA and therefore the SFA is not a "viatical settlement contract" under West Virginia law.

Even though the court found that the individual who purchased Mr. Short's policy had only entered into a single settlement contract in the pertinent year, it nevertheless ruled in favor of Mrs. Short. The court's reasoning was founded on a common-sense interpretation of the language of the statute.

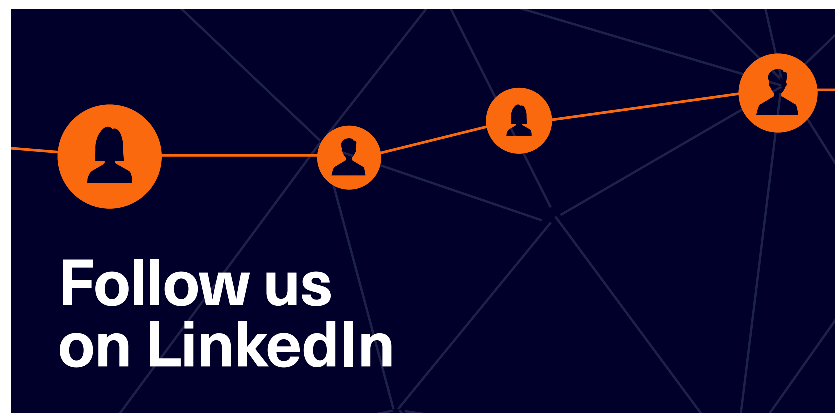
It was the uncontroverted testimony of the individual that he, through Montage, had been involved in approximately 75 viatical settlements in 2014 and a "bit less" in 2013. The court noted that the "statute excepts from coverage persons who neither enter into more than one viatical settlement contract nor effectuate more than one such contract in a year. A person must meet both conditions to be excluded from the Act's scope." 414 F.Supp.3d at 1018-19. The court rejected the argument that the only operative language was "enters into" and ruled that the individual had clearly "effectuated" far more than one contract in his work at Montage.

The court also rejected CWM's argument that the exception applies to persons who regularly effectuate settlement contracts so long as they contract with only a single West Virginia resident in a calendar year, finding that the "exception only covers 'an individual who enters into or effectuates no more than one viatical settlement contract in a calendar year,' without regard to the viator's state of residence." Id.

As a result, the court effectively unwound the sale transaction and awarded the entire death benefit to Mrs. Short.

While this appears to be a case of first impression, it is possible other courts faced with similar facts will reach the same conclusion. Therefore, investors in the life settlements asset class would be wise to deal only with licensed life settlement providers, and not individuals who improperly utilize the natural person exemption from licensing to purchase policies.

Finally, it is worth noting that state insurance departments currently do not appear to be aware of the extent to which this exemption is utilized by individuals to skirt the licensing rules or is used by otherwise licensed providers to purchase policies in states where they are not licensed. If state regulators do become aware of the extensive use, and arguable abuse, of the exemption it is likely regulatory consequences will follow.



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Q&A

Meghan Shue
Head of Investment Strategy, Wilmington Trust

Wealth management firm Wilmington Trust recently published its 2023 outlook, Capital Markets Forecast (CMF), *Inflationary Vortex*. *Life Risk News*' Greg Winterton spoke to Meghan Shue, Head of Investment Strategy at Wilmington Trust, about that report and their views on the outlook for the life settlement market this year.

GW: Meghan, your 2023 CMF refers to the 'inflationary vortex' and a paradox within that. Tell us more.

MS: This year's Capital Markets Forecast looks at three important supply-side forces that have curiously contributed to the past decade of disinflation but are paradoxically expected to result in somewhat higher structural inflation over the medium term. Additionally, the vectors that led us into this inflationary vortex—a pandemic resurgence of demand, supply-chain stress, and an unprecedented dose of stimulus—are not the forces most critical to watch on the other side. A positive note: We are seeing compelling signs of disinflation in the pipeline and expect the headline Consumer Price Index (CPI) to decelerate to 3% by mid-2023.

GW: Inflationary pressures are having a significant impact on how institutional investors are looking at the underlying exposures in their portfolios. What's your view on the 'persistance' of these pressures and consequently, the impact of that on institutional investors?

MS: Persistent inflation is stemming from the three main themes in our CMF—a structurally tight labor market, China's shifting role in the global economy, and the tenuous transition between traditional hydrocarbons and green energy. Inflation will not persist at current levels, certainly, but we also do not expect to return to the very low inflation of the post-global financial crisis era. To put it simply, we expect 3% to be the new 2%.

This means monetary policy will skew slightly more restrictive, which provides a better environment for the diversified investor. The diversified stock/bond portfolio should do much better in 2023 than it did in 2022, and equity investors will also likely be rewarded by diversifying across sectors and industries. For institutional investors with income needs, a higher-inflation, higher-rate environment could make it easier to achieve those income goals without reaching into riskier investments.

GW: Moving onto the life settlement market more specifically. Fund managers in the space regularly tout the fact that the drivers of returns in this space are fundamentally uncorrelated to broader financial markets and thus offer not only diversification benefits but something resembling a hedge. Do you think that the current macroeconomic climate will be something of a tailwind for this industry?

MS: It's difficult to tell. As we discussed, a diversified stock/bond portfolio should do better this year than in 2022; I don't see both asset classes losing money simultaneously like they did last year, which would provide the fuel for the argument to allocate to lower-correlation products like life settlements. Also, it's a smaller space, and most of the funds in the life settlement space are long-dated, private equity style funds, so for those funds that are closed, investors can't get in. You don't rotate in and out of life settlements like you do in public equities and bonds.

They're a longer-term allocation designed to provide diversification – I think demand for life settlements, and other 'alternative credit' products, is not as tied to the prevailing macroeconomic environment as demand for more liquid asset classes is; the main challenge for the life settlement market is selling itself against other alternative credit-style products.

GW: Wilmington Trust itself is a participant in the life settlement market providing trust and agency services to investment managers. What are one or two of the main trends in your area of expertise that you've observed in the past year or two, and what makes you think that they will or won't continue in the next few years?

MS: The main feedback from the capital markets insurance team is that deal activity in the secondary market has rebounded somewhat in 2022 after falling off in 2021, which means that we've been busier, which is good news for us, of course, as a service provider to fund managers in the space. But again, it's hard to predict how persistent this trend might be. In the secondary market, for deal flow to remain elevated, more policies need to come to market, so the intermediaries in the space need to either expand the range of policy sizes they bring to the market, or find a way to source more policies in the existing buy-box. That obviously feeds into the industry's tertiary market as well.

GW: Finally, Meghan, back to global markets. Your CMF says that there will be a mild recession in 2023. What's driving that forecast, and what's the investor to do about it?

MS: Despite our expectation for a rapid deceleration in inflation, we do not think it will be fast enough to avoid a mild recession in 2023. The anticipated stickiness of inflation, coupled with a determination from the Fed to keep policy restrictive until inflation has been totally eradicated, will likely result in a 5.0% or slightly higher fed funds rate. We expect this to curtail consumer activity and business capex, leading to a recession with two quarters of contraction of 1.0%–1.5% annualized. Job losses are likely to occur but, given the structural tightness of the labor market, are unlikely to be significant.

Corporate cash balances, consumer balance sheets, and bank health mean the economy is starting from a relatively good place. At this time, we see no areas of excessively valued capital stock that would need to be worked off and therefore prolong the economic recovery. The labor market is structurally tight, so an increase in the unemployment rate would likely be consistent with a mild recession—likely already largely priced into markets after last year's correction, in our view. This suggests the market will begin to recover in 2023, with potential to deliver better—and in our view, positive—returns for equities.

On the fixed income front, our inflation expectations suggest a more constructive backdrop for both yield-seeking and diversified investors and we are overweight investment-grade securities. In our view, a higher interest rate environment should return the advantage to the diversified investor. A 10-year Treasury yield of 4% is likely approaching the highs of this cycle, and we believe the pain for bond investors is largely behind us. Current yields finally give fixed income investors decent coupon and present a reasonable alternative to riskier assets. The linchpin of our overarching strategy is diversification—across asset classes, factors, and sectors—and it will likely be even more helpful for risk-adjusted returns than it was in the years of ultra-low rates and highly accommodative monetary policy.

Internationally, while we have held a slight underweight to international developed equities since Q4 2022 in light of the Russia/Ukraine war, energy concerns, and recession risks, we are neutral on emerging markets (EM), and advise investors to resist calls to divest from this space. In particular, we believe EM equity investors will need to recalibrate their approach to investing in Chinese equities, which comprise roughly one-third of the EM equity index.

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Is a Digital Exchange the Solution to the Investor Participation in Longevity Risk Transfer Conundrum?

Author:
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Senior
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Partly fuelled by rising interest rates in 2022, Defined Benefit pension funds are increasingly looking to the pension risk transfer market to provide more certainty to the current and future pensioners who are members of their plan. But there are benefits to plan sponsors, too; pension liabilities can be a drag on company performance, so the option to essentially wind up the scheme is an attractive one.

This 'win-win' has fuelled the growth in the pension risk transfer industry in the past decade. The UK has the world's most active and developed market, but meaningful volumes take place in the US, Canada, and the Netherlands as well. Three different types of risk transfer are available, with a full buy-out – where an insurance company absorbs the entire pension scheme, including the assets and the administration as well as the longevity risk – being the holy grail.

> "In order for hedge funds and other institutional investors to get involved in the longevity market, they need a marketplace. Currently, transactions are brokered in an over-the-counter process using transaction formats that aren't well suited to the investment criteria of these players."

The problem is, on a long-term basis, some would argue that there isn't enough capacity for insurance companies to absorb the entire market because accumulating more and more longevity risk – there is approximately £1.5trn of DB pension liabilities in the U.K. alone, according to consulting firm WTW - without hedging it means that pensioners and governments will be exposed to much higher risk in the event of a default.

Whilst insurance companies can de-risk themselves with other insurance and reinsurance companies, that's not sustainable for the industry as a whole, and so there needs to be another place for insurers and reinsurers to transfer longevity risk.

Enter the capital markets, including hedge funds, speciality asset managers, and other institutional investors.

These players have been studying the market for decades and are eager to participate due to the uncorrelated nature of the risk. But before they can get in, they need a much more systematic process, according to Avery Michaelson, CEO at the longevity risk trading marketplace, Longitude Exchange.

"In order for hedge funds and other institutional investors to get involved in the longevity market, they need a marketplace. Currently, transactions are brokered in an over-the-counter process using transaction formats that aren't well suited to the investment criteria of these players," he said. "These investors benefit from a certain level of commoditisation of transactions, something which can be addressed with index-based transaction formats. By basing transaction pay outs on general-population mortality data, information asymmetries can be removed along with much of the analytical complexity involved in pricing and risk analysis."

The hedge fund industry could be a natural home for these products, as they structurally look like an alternative fixed income product. However, for them to really commit capital to the space, the issue of liquidity needs to be addressed. Here again is where an exchange can serve the markets' need by providing a digital marketplace for trading.

Michaelson sees the market expanding rapidly in the coming years, both in terms of volumes and participants.

"Rising interest rates have further accelerated pension de-risking, fuelling greater than ever demand for capital. Fortunately, there are already a number of ILS Funds with experienced life risk teams prepared to commit capital to this space. They will be joined by a much broader range of institutional investors as deal flow and liquidity materialize."

The alternative investment industry manages trillions of dollars. Data and analytics provider Preqin says that, at the end of June 2022, the private equity industry managed $7.97trn, the hedge fund industry $4.13trn, and the real estate market £1.5trn, for example. A more developed longevity market would be large enough to stack up against these established markets.

"There are around $100trn of longevity linked liabilities, globally. And every year of unanticipated life expectancy adds around 5% to liabilities. So,

if estimates are off by three years, longevity risk could cause $15trn of unfunded liabilities," said Michaelson. "The enormous quantum of this risk points to the need for capital markets participation. It's only a matter of time before longevity risk is recognized as its own asset class."

"The enormous quantum of this risk points to the need for capital markets participation. It's only a matter of time before longevity risk is recognized as its own asset class."

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