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UK's CMI Reduces Life Expectancy Projections on Covid-19 Data

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Editor's Letter, Volume 2, Issue 8, August 2023

The CMI, a branch of the Institute and Faculty of Actuaries, released its latest projections using data from 2022, incorporating 25% weighting from that year due to continued excess mortality rates. Aaron Woolner of Life Risk News interviewed **Corbus Daneel**, chair of the **CMI's Mortality Projections Committee,** regarding the UK's Continuous Mortality Investigation (CMI) in *UK's CMI Reduces Life Expectancy Projections on Covid-19 Data.*

The Arizona Supreme Court recently ruled against Columbus Life Insurance Company's claim that a life insurance policy lacked insurable interest, thus voiding the policy after the contestability period, marking an important victory for the life settlement industry. Greg Winterton of Life Risk News interviewed **Jule Rousseau** Partner at **ArentFox Schiff**, offered his thoughts in *Arizona Supreme Court Decision a Win for Life Settlement Industry*

This month's *Roundtable* delved into secondary market activity in the life settlement industry. Greg Winterton was joined by life settlement providers **Simon Erritt** of **Coventry Capital, Aaron Giroux** of **LifeRoc Capital, Michael Freedman** of **Lighthouse Life Solutions**, and **Perry Koons** of **Maple Financial** to discuss trends and observations highlighted by recent industry reports and the potential for future growth.

Insurance regulator the Prudential Regulatory Authority wrote to bulk annuity insurers about their use of funded reinsurance. **Michael Abramson**, a Partner and Risk Transfer Specialist and **Lara Desay**, a Partner and Risk Transfer Specialist at **Hymans Robertson** discuss the pros and cons of the funded reinsurance market in *The Insurance Regulator Takes a Look at Funded Reinsurance.*

In this month's poll readers were asked *Will the Internet Grow in Importance for Provider Success in the Secondary Life Settlement Direct-to-Consumer Market?* Almost half of the respondents agreed that this trend will continue to grow, while just over a quarter disagreed, and 30% were unsure about the future role of internet advertising in driving inbound enquiries for life settlement providers.

Determining an insured's Life Expectancy is one of the most important variables in a life settlement transaction. In our second commentary piece **Vince Granieri**, CEO of **Predictive Resources**, gives us his view on today's practices in Life Settlement Apocrypha.

In this month's *Q&A* Greg Winterton of Life Risk News interviewed **William Corry**, Founder and Managing Director of **Corry Capital Advisors**, and discussed the challenges facing the life settlement market today. Corry highlighted the value of consistency and diversification, along with the importance of assessing transparency, track record, and performance evaluation methods when choosing a fund manager.

FINRA (Financial Industry Regulatory Authority) recently released a consumer advisory notice on the Life Settlement industry, the first since 2009. Greg Winterton of Life Risk News spoke with **Chris Conway**, Chief Development Officer of **ISC Services**, and **Bryan Nicholson**, Executive Director of the **Life Insurance Settlement Association**, to get their views in *New FINRA Life Settlements Advisory Welcomed by Industry.*

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

Chris Wells
Managing Editor
Life Risk News

UK's CMI Reduces Life Expectancy Projections on Covid-19 Data

Author:
Aaron Woolner
Contributing Editor
Life Risk News

The UK's Continuous Mortality Investigation (CMI) carries out research into mortality and morbidity experience using data from pension schemes and insurers. The CMI released its base series of projections (known as the '92' series, after the year its data came from) in 1999 and on a regular basis since.

The CMI is an offshoot of the Institute and Faculty of Actuaries and it released its latest set of projections in the middle of July (CMI_22). These projections are based on data from 2022, and unlike the previous two years, this time the committee decided to incorporate Covid-19 data into their projections, says Cobus Daneel, chair of the CMI's Mortality Projections Committee.

Initially, the CMI decided to ignore Covid-19 and took the view that 2020 was an outlier and given that the model relies on extrapolating a projection from current mortality trends, including data from that year would distort the results. This view was repeated in 2021 but this year the committee decided to - partially - incorporate Covid-19-era data in its projections.

> **"What we concluded was that 2022 is likely to be somewhat indicative of the post pandemic trend."**

So, what changed the CMI's mind?

"Despite a good start to 2022 with fatality rates falling close to 2019 levels we saw a rebound half way through that year and mortality rates ended up still being about 6% higher than in 2019. The CMI Mortality Projections Committee needed to decide if 2022 was again an outlier like 2020 and 2021, and what we concluded was that 2022 is likely to be somewhat indicative of the post pandemic trend." said Daneel.

Daneel stresses that 2022 is just one data point, therefore the CMI decided to opt for a compromise and added a 25% weighting to the 2022 data when making its future life expectancy projections.

"The CMI concluded that 2022 is indicative for three reasons: much lower week-to-week volatility in mortality - unlike the peaks and troughs we saw during Covid.

Secondly it was clear that Covid wasn't the only driver behind the high mortality levels, and finally there is a growing belief that Covid may fade away but it will be with us for a while."

The 25% weighting translates into a slightly more than half a year's reduction in life expectancy for both males and females in the UK and it will shave roughly 2% off the average pension scheme's liabilities.

"Or to put it another way, it's the biggest year-to-year model change the CMI has made since it started with the current methodology in 2009," says Daneel.

Daneel says at this stage it is difficult to say whether the non-Covid-19 deaths are secondary effects of the pandemic, particularly given the different impact that lockdown had on various age cohorts. Younger generations were more affected than older people and the committee chair says that this is due to socioeconomic reasons and will likely have a negative impact on that cohort's life expectancy.

Daneel, however, says that evidence for a slowing down in life expectancy improvements, or even a fall, among younger people has been mounting since before the pandemic even struck.

The actuary says that the decline in UK mortality since the 1970s has been mainly driven by improvements in the treatments of heart and cardiovascular diseases, but this had already begun to stall around 2010.

"So there has been a slowdown in the main driver of the improvement in life expectancy since 2010 or 2011, but more since around 2017 we have seen that slowdown become an increase in mortality among younger age groups, which is a bit concerning."

Daneel says there is no clear explanation at present for this trend but that it is most likely linked to rising obesity rates and changing lifestyles.

"The outlook in the actuarial community on life expectancy probably tends to be slightly less optimistic these days," he says.

It's not all bad news. Daneel points to countries in Scandinavia, where mortality rates have reverted to pre-pandemic levels, as proof there is scope for improvement in the UK.

Likewise, he cites potential breakthroughs in the treatment for obesity and neurological diseases such as Alzheimer's.

And while he says that the short-term outlook for life expectancy in the UK is bleak, this also needs to be put in the context of life expectancy being on an upward trend for a long period and there is still potential for future improvements.

"If you take a long-term view of history you will see that mortality rates have been decreasing for a very long time; we're talking about centuries here. And five years, or even a decade of pausing or slightly slowing down, doesn't mean that that trend has come to an end. We haven't reached peak life expectancy yet."

"So far, we have only placed a 25% weight on the 2022 data but at this stage we fully expect the next version of the CMI model to reduce life expectancies further. The question is just how much will it be reduced?

The experience in 2023 is pretty bad and it looks like mortality rates will end up at about 6% above 2019 levels. This is similar to 2022. So, we are still not seeing any improvements, and this provides extra evidence that the new normal has changed and that we may not get back to the pre-pandemic trend anytime soon."

> **"The outlook in the actuarial community on life expectancy probably tends to be slightly less optimistic these day."**

Daneel may be optimistic over the potential for life expectancy to renew its upward trend but the data from 2023 so far has not been encouraging, with excess mortality still around the 2022 levels.

According to the chair, the CMI only placed a 25% weighting on the 2022 data because it was unsure whether the impact was short-lived. Two years of excess mortality back-to-back suggest the opposite may be true and further reductions in life expectancy projections could be on the way.

Arizona Supreme Court Decision a Win for Life Settlement Industry

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The life settlement market enjoyed a 'win' on July 27; the Supreme Court of Arizona answered "No" to the question: "Does Arizona law permit an insurer to challenge the validity of a life insurance policy based on a lack of insurable interest after the expiration of the two-year contestability period required by A.R.S. § 20-1204?"

The case is the latest of many legal contests between life insurance companies and life settlements investors on the topic of insurable interest; the former, in this case, Columbus Life Insurance Company filed suit in Arizona, claiming that a life insurance policy on Howard Peterson, who died in January 2018, and Eunice Peterson, who died in May 2020, was issued without the required insurable interest. Columbus Life claimed the policy was void because it lacked an insurable interest, and therefore the contract and the two-year contestability period (the period in which a life insurance policy in the US cannot be sold or transferred) never existed, thus it was not obligated to pay the death benefit to the securities intermediary, which represented the interest of the investor.

> "Arizona's incontestability statute prohibits insurers from challenging policies for lack of insurable interest."

"The result is an important victory for the life settlement industry. Incontestability statutes have been ubiquitous in the US for a hundred years but remain a frequent subject of litigation – particularly in recent years, as insurers have argued for an "insurable interest exception" that would permit them to challenge even policies that have been in force for decades," said Jule Rousseau, a Partner at law firm ArentFox Schiff, which advised the securities intermediary Wilmington Trust in the case.

"The Arizona Supreme Court has definitively rejected these arguments and made clear that Arizona's incontestability statute prohibits insurers from challenging policies for lack of insurable interest after the contestability period has passed," Rousseau added.

A spokesperson for Western & Southern Financial Group, owner of Columbus Life Insurance Company, wrote in an emailed statement to Life Risk News, "While we are disappointed in the court's ruling, we do not otherwise comment on pending litigation."

So, good news for life settlement investors with Arizona-issued policies in their portfolio. Indeed, the Arizona Supreme Court ruling brings the state in line with other states, such as New York, Florida, and Michigan, which have already ruled in similar cases. But that's not always the case.

"Courts have routinely enforced incontestability in all cases except insurable interest and some odd imposter cases for years. Thus, the concept is widely recognised, yet the insurer argument that a policy that was issued without requisite insurable interest was void and thus not subject to a contractual obligation of incontestability has been accepted in some states," said Rousseau.

But New Jersey and Delaware are two states that have heard similar cases and ruled against the life settlement investor and/or securities intermediary. The lack of uniformity at the state level brings into focus the risk management function of a life settlements asset manager, namely that the regulatory environment in the life settlement market is a risk that needs to be managed by a life settlements portfolio manager, just like other risks they are exposed to, such as valuation risk, longevity risk and Cost of Insurance risk (another risk where lawsuits have occurred). Buying policies of insureds in states which have ruled in favour of the life settlement market, like New York, Florida, Michigan, and now Arizona, whilst reducing exposure to policies of insureds in New Jersey and Delaware, for example, on the face of it is a risk mitigation exercise that would seem to make sense. Other states have ruled in favour, making this risk less of a concern.

"Most states in the US have already heard similar cases, in particular, the larger, more populous states," said Rousseau. "The legal risk from the perspective of the contestability of insurers when it comes to insurable interest is there in some states, but low overall."

The ruling isn't just a win for the life settlement market, however. The individual insureds also benefit, because if carriers are precluded from later challenges, the reduction of risk to life settlement investors should lead to a better market for sellers/viators. The life settlement industry generally touts itself as being a 'consumer good', because the insured receives more from a life settlement transaction that it would from the cash surrender value from the carrier – and so the ruling means that the Arizona resident can rest assured that their policies will be more tenable in the market.

> **"The legal risk from the perspective of the contestability of insurers when it comes to insurable interest is there in some states, but low overall."**

"This is undoubtedly a win for the consumer as well," said Rousseau. "Insurers in many states have argued for an "insurable interest exception" that would permit them to challenge even policies that have been in force for decades.

States that permit challenges years after a policy was issued cause life settlement investors to tread more cautiously in those states, reducing the likelihood of a transaction occurring. Arizona residents should have more confidence that investors find the state an attractive place to do business."

Secondary Life Markets Conference 2023

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

Roundtable
Life Settlement Providers

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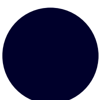
Senior Managing Director
Coventry Capital

Aaron Giroux
Chief Executive Officer
LifeRoc Capital

Michael Freedman
Chief Executive Officer
Lighthouse Life Solutions



Perry Koons
Vice President of Sales
Maple Financial

Two recent life settlement industry data reports - trade association the Life Insurance Settlements Association (LISA)'s 2022 Market Data Collection Survey and industry magazine The Life Settlement Report, part of The Deal's annual report on secondary market transactions – suggest that activity in the secondary market improved in 2022 versus 2021 – albeit, very modestly. Life Risk News' Greg Winterton hosted a virtual roundtable in late July with Simon Erritt, Senior Managing Director at Coventry Capital, Aaron Giroux, Chief Executive Officer at LifeRoc Capital, Michael Freedman, Chief Executive Officer at Lighthouse Life Solutions, and Perry Koons, Vice President of Sales at Maple Financial, to get their thoughts on the state of the life settlement market.

GW: Let's start with secondary market activity. You've all seen the data published in June by The Life Settlement Report, part of The Deal, that suggests that secondary market activity only increased by 4% from 2021 to 2022. If you speak to a life settlements broker, they'll say that they are seeing a much larger increase, which suggests something of a disconnect. Why do you think the increase was actually so low and what's the broker disconnect?

SE: Certainly, the secondary market has grown. It's strong and poised to grow materially. I'd point out that the Life Settlements Report's 4% increase was by number of policies purchased and was a 13% increase by their total face value.

Don't forget that 2022 was a challenging year in other financial markets. The S&P 500 was down 18% and the Nasdaq was down 32%. In light of that, even a modest increase is very positive. And if market participants were to do more to generate business, the market will grow more.

MF: Expanding on Simon's comment about what more market participants can do to grow the market, the biggest challenge I see is that the life settlement market needs more growth capital to support the business of life settlements.

Today, and historically, the capital in our market is asset capital, which is great. That said, however, asset capital is often restricted or reluctant to invest in origination efforts that would stimulate growth in the number of new policies that come into the market. Investing in marketing and advertising by brokers, providers, and third-party advertisers, for instance, would benefit asset managers and funds by generating more assets. Some recent venture and growth investments in the business of life settlements have been made in recent years and are continuing, which is encouraging, but more is needed for the overall growth and success of the market.

AG: We don't originate much with brokers, but observationally, there is difference between submissions and closings. The data in The Life Settlements Report is closings focused. But it can take up to six months for a submission to become a closing. So, there can be a ton of submission activity occurring today that may not show up in the closing data for another six to twelve months. The is just the nature of the pipeline in our industry.

Also, we feel the quality of the submissions coming in the door today is a bit lower than it was several years ago. That's because there is greater awareness around life settlements with advisor and consumer exploring their options.

I would concur with brokers, though. I think submission activity is up, but how much of that activity is going to lead to increased closings is TBD. But my guess as an industry is that we'll demonstrate growth again this year.

PK: We're heavily broker focused, and the quick answer is that I see the broker market getting top heavy. We are seeing large increases with the brokers who work with national accounts and a larger volume of individual producers, so I don't doubt the narrative. There are a smaller number of specialty settlement brokers overall and some of the groups who may have submitted five-10 policies in past years are no longer in the business.

For some specific brokers there has definitely been continued growth and we're seeing that borne out by our performance as well.

I think it's also important to mention how cyclical advisor focus can be. Advisor focus was on new life insurance policies in 2021 and first half of 2022 because so many people wanted to buy new insurance policies after Covid. This has been a driver of slower overall growth than what we might have expected, but still promising for future years by virtue of growing the available pool of policies.

GW: What's your view on smaller face policies and how do you see the brokers reacting to these policies? Are they bringing them to market, or do you think they are discarded in favour of larger face policies? Have any of your fund managers/clients taken more interest in smaller face policies, meaning less than $1m net death benefit (NDB)?

MF: There is clearly an uptick of activity in mid-face policies. In addition, more asset managers and funds are getting comfortable with smaller face policies. It's not traditionally been an area that settlement brokers have dedicated themselves to but it's an area of tremendous growth for the entire market not only because of the growing American senior population is going to double in the next 15 years and because the current economy – with volatile markets, higher interest rates inflation - more seniors today are faced with the lapse or surrender their policy. Direct-to-consumer marketing to these seniors is driving more responses than ever.

PK: We have several fund clients who regularly buy policies under $1m. It's a sizeable part of our business, if not a specific focus. Smaller face policies can be tougher to make the economics work if there are too many hands in the pot, but I'd say the threshold is $500k, not $1m. At $500k, we do see quality submissions. The positives are that a lot of times, the sellers of these policies are more likely to be confirmed sellers, so if such cases are coming in from a broker, they have done the vetting already to ensure that it's worth everybody's time. Essentially, these policies tend to be from needs-based sellers where we have a high likelihood of a win, versus a seller with many strategic angles to their financial planning, where a confirmed sale may be less likely.

SE: Brokers regularly submit policies to us with face amounts less than $1m. We buy policies with face amounts of $100k and up, and the average face amount in our direct business is between $5-600k, small face and direct going hand in hand. And, yes, we have seen investors specifically targeting smaller face policies, particularly when starting new funds and looking for diversity.

GW: What are some other observations you would like to mention when it comes to supply in the secondary market generally? Are there any frustrations, and if so, are they solvable?

AG: Awareness is directly correlated to origination and overall volumes whether it's firm specific or industry wide. We're not in the direct-to-consumer space but we do focus on and invest heavily on origination in the advisor space. Without those investments I don't think we would be growing as a firm. As providers, we're in the business of origination, and if you're not investing in origination, I don't know what it is that you're doing to drive growth.

You have to educate, and it can be tedious, you have to pound the streets and meet people in person. Investing in origination is a large financial commitment. That can be challenge, to make a commitment and it's a long-term one that does not pay off quickly. Investing in origination is a one, two, or five-year investment return proposition. So, you have to have a long view of the resources you're putting into awareness, whether it's in the direct-to-consumer space or with advisors.

PK: Our biggest challenge, which is also our biggest opportunity, is driving organic growth in the broker and agent-advisor channels. Managing relationships with brokers, broker dealers, national accounts and individual advisors each necessitates a different approach. Our forte is with brokers and large agencies, and we aim to provide tools to help identify and build cases, giving us the best chance to see increased volume, compete, and win the business. But whatever channel you're working with, being a resource and providing the hand-holding to make the process easier for everybody is a driver of growth for the entire market.

SE: We don't have any frustrations when it comes to supply in the secondary market. We control the supply that we receive and, to a certain extent, how much the market receives. A significant portion of our supply comes from the direct market, and we can scale that up and down when we want to through our advertising.

Every time we scale up our direct and intermediary marketing efforts, we see commensurate increases in supply. One reason for this is the very low penetration rate of our industry. The ACLI's figures suggest more than 8,000,000 policies were lapsed or surrendered in 2021, compared to the approximately 3,000 policies purchased in the secondary market.

MF: One of the areas the life settlement market players could improve upon that would have an impact on the supply of policies in the secondary market is more co-operation among the market participants.

We're competitors in the field but we're colleagues when it comes to such things as public awareness, professional education and legislative/regulatory advocacy. We can always do more and co-ordinate better on education and awareness to consumers and insurance and financial advisors. Greater consumer understanding and professional acceptance would positively impact policy supply; state and federal advocacy can be used not only to protect against insurers' efforts against life settlements but also to promote the benefits of life settlements to seniors and their families.

GW: The growth in policy flow from the direct-to-consumer market seems to be having a positive impact from the perspective of overall secondary market growth. What trends are you seeing in this space and what is the impact of this on the broader market?

SE: Coventry established Coventry Direct back in 2015, which is our dedicated brand in the direct-to-consumer market. It's become a key driver of Coventry's growth - in the past few years, we've acquired approximately 60% of our policies through this channel. From an investor's perspective, it's a significant source of policies that are unavailable elsewhere. The policies typically have a straightforward history and ownership structure, they're generally well-seasoned and come from a wider range of carriers than traditional channels. For Coventry, the direct contact that we have with policy owners allows us to better understand their needs going into the transaction, and the ability to maintain contact with them should their health or needs change.

MF: Direct-to-consumer is still a largely an untapped opportunity for the life settlement market to grow but asset investors will need to get further comfortable with the characteristics and costs associated with policies sourced from DTC, including underwriting and servicing. Also, more marketing dollars for DTC origination in the space would help expand this channel of policies from a growing number of American seniors. The recent investments into companies, such as Lighthouse Life and Abacus, for instance, are positive signs for the further growth of the direct-to-consumer channel.

Also, some managers and asset funds are in greater need of assets than even a year ago, primarily because of the lack of supply of tertiary blocks of policies. There are some funds that are actively sourcing and purchasing secondary market generated policies for the first time, including those generated via direct-to-consumer. This reinforces the point that the commitment to seeing the secondary market reach its next level – to continue to expand the direct to consumer and advisor channels - is key for continued growth in supply. The need for growth in origination strategies is fundamentally really important.

PK: We don't do any marketing directly to consumers. But from a macro perspective, direct-to-consumer drives activity in the smaller face market. For us, the biggest value add is that the direct marketing should cause consumers with higher face amount policies to discuss the life settlement option with their advisors. Ultimately, the efforts in direct to consumer made by firms in that space drive more activity for all of us.

GW: Let's finish up with a look at future secondary market growth. Firstly, do you think the Baby Boomers aging into the market - who all have smart phones, tablets and laptops and are more internet savvy - will increase the amount of policies brought to market? And second, what else might affect activity going forward?

MF: We have seen tremendous response in digital marketing and advertising for seniors, especially in the current "recessionary" environment. Seniors are on social media and their phones, accessing products, services and shopping. The oldest Baby Boomers are now in their mid-to-late 70s and are internet savvy and tech capable, so digital marketing and social media and other on-line strategies are going to continue to grow.

Our growth opportunity is not an issue of objects in the mirror being closer than they appear. Yes, there were only approximately 3,000 transactions in 2021 and 2022, and some 8,000,000 estimated policies that could qualify for a life settlement in each of those two years. Our challenge is about reaching seniors, educating them, convincing them to make that first click to being the process of selling their policies.

AG: We're clearly bullish, but I think the question ties to a 'back end' problem, which is "transaction friction", which acts as an impediment to our industry's overall growth. The process can be so involved and can take so long. Some of these drivers are outside of our control, as Perry mentioned, two examples are how much longer it takes to get medical records and how much longer it's taking to get data from insurance carriers.

However, there are things within our control that technology can help to improve, such as the length of time it takes to do price discovery, and potentially using limited electronic medical data to underwrite more quickly. We do get negative feedback from the marketplace that the friction to transact is too high which leads to advisors and consumers shying away from the process. To the extent that we can collectively make that process better, quicker, and faster, I believe will lead to more growth. A lot of that will be technology driven; Sure, we can market online, but if we can't deliver on the same frictionless promise that consumers are used to in other channels, like banking or insurance, I think we're going to have break limiters on growth.

We're big believers in tech and know that technological process improvements must be applied across the entire life settlement process.

PK: We're super bullish on the demographic piece – the math is there. Boomers are still aging in, and all of them will have crossed the age 65 threshold by 2030 so we'll continue to see growth in policy count in the coming years. But in terms of the technology side, I think this comes back to market segmentation by channel. The 55-year-old who bought their term policy online is very likely to come back and look for life settlements information online ten years down the road when his conversion period is up. The 75-year-old who perhaps owned a business and is a high net-worth individual, and worked with advisors to purchase the policy individually, is a different scenario - even if they see the messaging online, they're more likely to circle back through the advisor channel.

What's also going to have an impact is that carriers are making their conversion products more expensive. There's cheap term coverage, and really expensive permanent coverage. The stats on people owning cash value life insurance policies are down, so a challenge for all of us is going to be how we figure out these term policies that are a little bit more pricey. I still think that the market will grow, it's just a question of how much.

SE: I'd echo the comments about Baby Boomers – the technical sophistication is there, and the platforms are there for them to use that increased sophistication. An obvious point is that there are more of them, so size as well as sophistication should play into it.

But I'd repeat what I said before, which is that we see the constraints on secondary market growth as largely demand driven. Broadening the investor base will be key to the industry's future success. We can increase our marketing efforts to bring more policies into the market if demand is there from investors to purchase them. From my perspective, it's about continuing to demonstrate good mortality performance and attractive risk-adjusted returns – particularly in the face of volatile financial markets elsewhere. If we can do that as an industry, then we will be in very good shape for growth in the coming years.

The Insurance Regulator Takes a Look at Funded Reinsurance

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> "If an insurer uses reinsurance on a particular buy-in or buy-out, this does not directly expose the pension scheme (or its members) to the reinsurer."

On 15 June 2023, the Prudential Regulatory Authority (PRA) published a letter to bulk annuity insurers regarding their use of funded reinsurance. In this note we seek to help pension schemes understand what funded reinsurance is, its relevance to them, and what the PRA has concluded.

Funded reinsurance is akin to a bulk annuity insurer doing its own buy-in behind the scenes. The insurer takes a portion of the buy-in/buy-out premium received from the pension scheme and passes it on to a reinsurer, often but not necessarily overseas. The reinsurer is then on the hook for providing monthly benefit payments to the insurer, and the insurer passes these payments on to the pension scheme or (following buy-out) the pensioners directly.

Reasons for use of funded reinsurance

Insurers typically use funded reinsurance for one or a combination of the following reasons:

- Investing quickly at scale. Eg: for a £1bn buy-in an insurer could use funded reinsurance for 50% and only need to source £500m of assets rather than £1b.
- Capital efficiency / scale. The insurer can use less capital for writing the business if the risk is shared – either helping the insurer to write a larger buy-in/buy-out, or improve its return on capital. Insurers may even end up with an improved capital position by writing the business, an unusual position for bulk annuities.
- Pricing. The pricing offered by the reinsurer may be sufficiently attractive that it is more profitable for the insurer to pass on the risks than retain them.

Risk
If an insurer uses reinsurance on a particular buy-in or buy-out, this does not directly expose the pension scheme (or its members) to the reinsurer. If the reinsurance fails in any way, the insurer remains on the hook. But pension schemes should still consider the overall risk profile of a selected insurer, including the exposure that insurer has to reinsurers and how associated risks are managed. The use of reinsurance, be it funded or pure longevity, can vary significantly between insurers. Funded reinsurance has more inherent risk than longevity reinsurance, as the asset risk is passed across to the reinsurer at outset, so if the reinsurer fails, there is a potentially sizeable loss for the insurer.

How do insurers manage these risks?
Insurers use a suite of contractual protections and collateral arrangements to protect against a reinsurer's financial strength deteriorating, as well as planned management actions should this occur. The idea in simple terms is that at (or ideally before) the point of a reinsurer failing, the insurer can step in and take control of a portfolio of assets that they can then use to back the liabilities themselves.

PRA letter
The PRA letter shares their insights from a review of funded reinsurance across the sector. It goes into more detail about the risks inherent in funded reinsurance and how insurers are currently mitigating these.

> "Given the expected rapid growth in insurer balance sheets as more and more DB pension scheme sseek to pass them their liabilities, we are encouraged that the PRA is scrutinising the use of funded reinsurance."

The PRA's key conclusions thus far are:

- There is a positive trend of improvement in insurers' risk frameworks and models relating to funded reinsurance.
- However, insurer practices still showed some material shortcomings, in particular some structural risks with regard to collateral portfolios and the assumptions made about the impact of possible reinsurer failure.
- There are limited risks to policyholder security from the use of funded reinsurance within a diversified asset strategy, but there could be significant risks if funded reinsurance were to be used systemically as a way of meeting increased demand for buy-in and buy-out.

The PRA set out a number of next steps, the main ones being:

- Insurers will need to consider whether the letter requires any remedial actions on their part.
- The PRA plans further supervisory work around insurer use of funded reinsurance, and will consider whether any further policy is required
- Insurers need to notify the PRA regarding any material funded reinsurance transactions they enter into.

In summary

Given the expected rapid growth in insurer balance sheets as more and more DB pension schemes seek to pass them their liabilities, we are encouraged that the PRA is scrutinising the use of funded reinsurance – especially given that assets and liabilities are commonly passed to reinsurers who are based overseas and therefore outside of the PRA's remit. The PRA appears to be accepting of the moderate use of funded reinsurance, but remains concerned about a scenario where its systemic use leads to the majority of UK DB assets and liabilities end up moving outside of the Pensions Regulator or PRA remit. We support this overall direction of travel, as well as a continued PRA focus on ensuring that where insurers do use funded reinsurance, they have appropriate risk mitigations in place.

For pension schemes with existing buy-ins or who are considering their use, we believe trustees and sponsors should take comfort from the PRA's approach. We suggest pension schemes consider the use of funded reinsurance when assessing the financial strength of a given insurer.

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August 2023 Poll Results

Will the Internet Grow in Importance for Provider Success in the Secondary Life Settlement Direct-to-Consumer Market?

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The secondary market in life settlements comprises mainly two channels – an intermediary-based one, and the direct-to-consumer one. The former has been, for many years, the larger of the two, as American seniors worked with brokers to sell their life insurance policy to a third-party investor.

But the D2C channel has been growing its share of the pie in recent years, and as baby boomers have aged into the life settlement market – those aged 70 and above – as has the importance of internet advertising in the D2C channel.

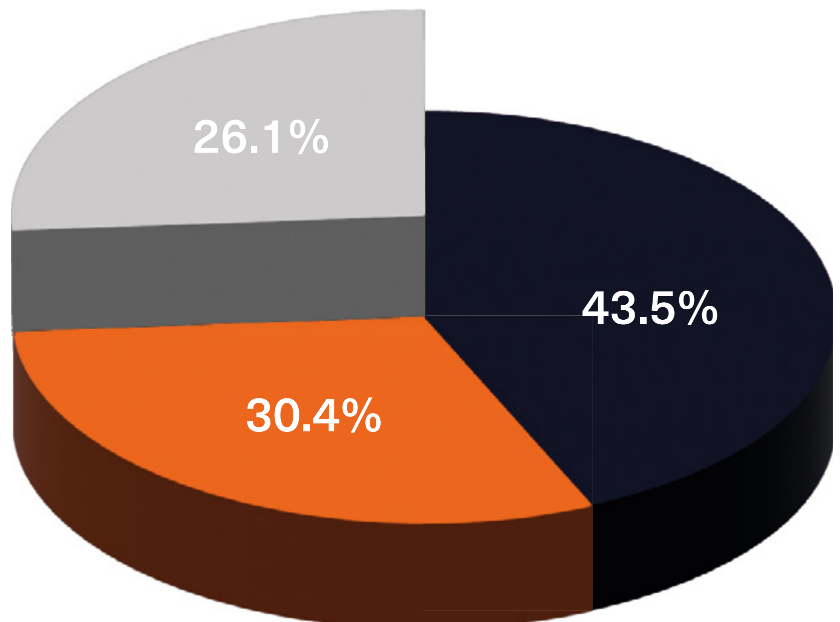
For July's poll, we asked our readers whether they think this trend will grow. Almost half agreed that it will, perhaps a lower number than might have been expected. Just over a quarter disagreed, and 30% were unsure.

Certainly, the direct to consumer market seems set to continue to grow. Whether the internet becomes the main source of inbound enquiries for life settlement providers in the coming years remains to be seen.

Yes - baby boomers are used to the internet which makes this channel increasingly important for providers

Unsure - people use the internet less as they age so it's difficult to say

No - TV advertising will remain by far the primary driver of enquiries in the direct-to-consumer market



Life Settlement Apocrypha

Author:
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Predictive Resources

> **"Mortality improvement data for life settlement insureds is not statistically significant at this point; this means additional data must be considered."**

I find it interesting to draw parallels between theories we see in the Life Expectancy space and what was considered state-of-the-art medical treatment throughout history. Procedures once considered vital have been studied and debunked as unsafe. For example: bloodletting, a medical procedure widely accepted by ancient Egyptians, Greeks, Romans, was still used in the 18th century. Bloodletting was performed on George Washington in December 1799, likely hastening his death. It persisted across centuries as an accepted medical practice despite its extremely harmful effects.

Similarly, certain misguided philosophies and theories have been proffered by life expectancy providers, and some are still being advanced today. Allow me to review some of these doctrines I consider to be apocryphal, that is, lacking authenticity and of questionable credibility. Many persist despite being disproven several times over.

First, let me summarize what I consider to be a solid data-driven process for determining a life expectancy estimate. In a perfect world, the base mortality table and underwriting manual are developed from analyzing life settlement lives. Our world is far from perfect, so some substitutions must be made. US Life Insurance data or US Population data may be considered, but with considerable judgment applied, recognizing that these populations differ greatly from the life settlement population.

For example, mortality improvement data for life settlement insureds is not statistically significant at this point; this means additional data must be considered, such as life insurance studies related to mortality trends. Consider heart disease, the biggest mortality threat 30 years ago, has more successful treatment options now and no longer carries the same risk. Cognitive and pulmonary issues, on the other hand, are becoming more toxic.

We hopefully can consider current medical records that range from at least 3 years ago to today. Underwriters identify relevant conditions by applying the manual consistently and the resulting mortality multiplier is applied to the base mortality table, calculating the life expectancy of someone selling their policy.

With the above ideal in mind, consider the following practices that may be common among industry participants, but are not valid:

1. Averaging Two or More LEs

I must admit, I haven't heard about this one in a while, but I know it still occurs. It is never proper to use the average of two or more LEs (e.g. use 75 as the average of an 80 month LE and a 70 month LE). If you want to use a combination of two or more different LEs, you should average their survival curves (not mortality curves, survival curves) and then calculate the combined LE from the averaged survival curve.

2. Aging LEs.

What is the proper way to utilize an LE that is not fresh; one that has been around for months or even years? First, recognize that the LE certificate date may not be the best point to begin. The date on the insured's latest medical records is the true date they were evaluated. From that time on, one can assume that the insured will become less and less like the homogeneous group they were part of on the date of those records.

> **“The best data from which to derive life settlement mortality is life settlement data; pure and simple.”**

One can reflect this to a certain degree by normalizing the survival curve (i.e., find the point on the curve that represents the time passed since the last medical record or the time since the certificate date, then divide every other point on the survival curve by that point, which creates a new survival curve).

Further judgment should be reflected to account for the insured’s current health. For example, in the case of a cancer diagnosis 2 years ago, there are definite differences between an insured in remission versus one who has had their cancer recur.

3. Mortality and Underwriting are Independent.
In determining a life settlement life expectancy this is false. They are intertwined. Inextricably. The notion that one can separate these processes and mix or match them is misguided. To suggest that one or the other plays a larger role in determining life expectancy is folly, especially in the life settlement market, where the unimpaired lives (base table) do not resemble other populations and a large portion of the folks selling their policies have significant impairments (underwriting process) that must also be considered.

Let’s use a hypothetical example of two major underwriting companies: I will call one of them LEs-R-Us and the other, Acme LE. Assume LEs-R-Us has a light base mortality table and heavy underwriting debits relative to Acme LE, which has the opposite – heavy base mortality and lighter debits. Hypothetically, each company may weight their tables differently, but to be contextually correct, it would be foolish to mix LEs-R-Us table with Acme LE underwriting or vice-versa. Hypothetically speaking, folks would know that.

4. Proprietary Mortality Tables are Bad; the VBT are Good.
Looking at the second part of this statement, the VBT – or Valuation Basic Tables – are built for the life insurance industry, using life insurance data. Further, as valuation tables, they have extra mortality built in, which is conservative for their designed purpose (life insurance valuations) but aggressive for life settlements.

At one time, life settlements’ folks thought the VBT were the best tables to illustrate life settlement mortality, but they were sadly mistaken. It was evident as far back as 2008 (when LEs were notoriously extended) that LE providers who based their tables on the VBT (virtually every LE provider in 2008) were generating LEs that were too short. When the latest VBT were introduced reflecting 2014 mortality, it was again proven that the VBT were inappropriate tables for life settlements.

As for the assertion that proprietary mortality tables are bad, it really depends. The best data from which to derive life settlement mortality is life settlement data; pure and simple. If a proprietary table is properly and faithfully based on life settlement data, it is a good table; if not, it is not.

5. Back-Solving Into a Known Table is Acceptable.
If you know the LE but do not know the table, it is problematic when pricing a policy. So inquiring minds decided to back-solve into a known table, such as the VBT, to solve this dilemma. The only problem is that it doesn’t work. Back-solving forces the shape of the known table onto the LE without regard for the accuracy of doing so. While it is worse to use the VBT as a base mortality table, back-solving an LE into the VBT is nearly as bad.

6. Once an Impairment or Impairments are Identified, It is Easy to Determine When an Individual Will Die.
This misguided principle suggests that there is no statistical fluctuation in human longevity, and nothing could be further from the truth. In fact, a healthy person can die tomorrow, while a highly impaired person can live beyond expectations. This statistical fluctuation may well be the reason for so much variability in LE estimates. Without significant and specific life settlement data, the range of potential outcomes is large. With human longevity, there is much more data available, but, as should be obvious to industry participants, the life settlement population is a very tiny subset of the total human population, and it does not behave like that larger population.

> "Any nuances that are not statistically significant are an exception only because the data does not yet exist insufficient quantities."

7. Micro-Underwriting or Individual Underwriting is Necessary AND Sufficient.
This theory is related to the concept that underwriting is primary in determining life expectancy. As discussed above, both the base table and the underwriting process are critical to determining life expectancy. Ignoring either is perilous. Sometimes emerging discussions within the industry postulate which discipline is most important in determining life expectancy – actuaries, underwriters, and more recently, data scientists.

The disciplines do not matter – it is the discipline to rely on relevant data that matters. Data that reflects life settlement mortality for relatively healthy lives for the base tables, and data that reflects life settlement mortality deltas for the various impairments to inform the underwriting process.

8. Underwriting is not Based on Data.
This is more an inference than a philosophy, and it usually follows a statement about base mortality tables being reliant on lots of data. In truth, underwriting debits and credits are also dependent on data, or should be. Any nuances that are not statistically significant are an exception only because the data does not yet exist in sufficient quantities. This makes estimating life expectancy somewhat difficult.

For example, without data, one might think that high cholesterol shortens life expectancy; that's good logic. Unfortunately, it is not correct, thanks to the ubiquity of statins. However, if evidence exists that suggests the insured cannot tolerate statins, that must be factored into the life expectancy as an exception.

As in bygone days with folks relying on apocryphal medical philosophies to their demise, relying on the above life settlement practices will likely lead to a bad result for industry players. Dr. Howard Markel, writing about George Washington's medical team, opined, "The truth of the matter is that they did the best they could… …using now antiquated and discredited theories of medical practice." Hopefully, we will not be similarly judged for using the above apocryphal life expectancy practices.

Secondary Life Markets Conference 2023

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

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

Q&A

William Corry
Founder & Managing Director, Corry Capital Advisors

Life settlement investor Corry Capital Advisors manages more than $2bn in assets and counts pension plans, foundations, endowments, and sovereign wealth funds amongst its clients. Greg Winterton spoke to William Corry, Founder and Managing Director at Corry Capital Advisors, to get his views on the industry, and to learn more about the firm and its approach.

GW: Bill, a lot has been made of the impact of higher interest rates on investor appetite for life settlements, but there's some cyclicality here, isn't there? Are there any reasons why investors should still be allocating now versus waiting for rates to plateau, or come down?

WC: I understand the discussion regarding higher interest rates vs life settlement investing, however the case for consistency of investing in diversified products, especially those that are to a large degree not correlated to markets, continues to make the case for life settlements to be considered for investors.

GW: In a Life Risk News roundtable in February this year, you mentioned that you saw wealth managers taking an increased interest in the life settlement space last year. Is that a trend that's continued in the first half of this year, and if so, what are the drivers?

WC: I continue to see that as a trend, and I believe the driver is advisors continuing to look into non-corelated investment opportunities.

GW: Moving onto your firm. What do you look for in a policy when you're evaluating policies in the secondary market, and why?

WC: In the secondary market the evaluation beyond pricing is driven by due diligence into the chain of title and origination of the policy. Origination being driven by insurable interest correctly being established at time of purchase.

GW: Corry Capital Advisors is also active in the industry's tertiary market. Discounts in this space have been hard to come by in recent years. Has anything changed this year so far, and if so, what's driving that?

WC: There are several factors that affect the discounts on tertiary policies and portfolios. If the seller is distressed, then the discount rates are typically higher, as well as if you're dealing directly with the capital source vs going through intermediaries, as that can add a large amount of fees that reduce the discount rate. This year there has been an increase in tertiary portfolios in the market, which is a positive trend on the buy side.

GW: Finally, Bill, what's your message to investors when conducting due diligence on a life settlement fund manager? What are a couple of specifics that they should focus on?

WC: Factors that should be considered would be conducting background checks on the manager and senior management as well as researching track record of past funds and the transparency supporting the track record. I think investors should dig down deep into the transparency of a past fund's performance to the point of evaluating the granular investments to see how they've performed over time. The realised events are easy to evaluate, though the unrealised are being driven by different factors, such as medical updates and the valuation methodology of the manager when it comes to the marks of each policy.

New FINRA Life Settlements Advisory Welcomed by Industry

Author:
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The life settlement market is regulated in 43 US states – Alabama, Missouri, South Carolina, South Dakota, Wyoming being the naysayers (Michigan and New Mexico regulate viatical settlements but not life settlements) – and each state follows one of two model acts, NCOIL or NAIC, or a hybrid of both.

Regardless of the model used by a state that regulates the industry, two commonalities are that a licensed life settlement provider must be the purchaser of the life insurance policy from the original owner (often, but not always, the insured), and, when a consumer works with a broker to sell their policy, that broker be licensed as well. But still, unlicensed firms have been known to be active in the space, something that carries risk to the policyholder/seller because there would not be any consumer protections by going down this route. And there would be risks to the potential buyer as well – if a life settlement were not conducted through the correct process, the transaction may be voidable.

"It's long been a frustration of mine that these unlicensed firms somehow slip under the radar," said Chris Conway, Chief Development Officer at ISC Services. "I'd urge anyone in the life settlement market – from institutional investors conducting due diligence on asset managers, to individual consumers doing research on selling their life insurance policy – to only work with licensed firms."

> **"Check with your state insurance commissioner to see whether the life settlement company or settlement broker you're dealing with is properly licensed."**

US broker-dealer regulator the Financial Industry Regulatory Authority (FINRA) would seem to agree. The organisation published an article, What You Should Know About Life Settlements, on July 31, seemingly aimed at American seniors who might be looking to exit their whole or universal life insurance policy.

The article mentions the various factors for American seniors to consider when deciding if a life settlement is right for them, but notably, it flags a recommendation for the policyholder to:

"Check with your state insurance commissioner to see whether the life settlement company or settlement broker you're dealing with is properly licensed—and whether either has a record of complaints. If you're working with an investment professional, use FINRA BrokerCheck to learn about their professional background, registration status and disciplinary history."

Some might say that the timing of FINRA's article is interesting. It's a consumer advisory notice first and foremost, and it comes at a time when the direct-to-consumer channel – where life settlement providers advertise on television, or radio, or the internet, soliciting policyholders to contact them directly for a quote to purchase a policy – is growing its share of deal flow in the industry's secondary market.

Others might say that, given FINRA regulates broker-dealers, it's eyebrow-raising that it should be publishing something like this at all, as any activity by the organisation that relates to life settlements would normally involve broker-dealers only. But FINRA says that the driver of the decision to publish the piece was simple.

"FINRA updated the piece as part of a larger initiative to keep our content current. There was an old Investor Alert article on life settlements that included some dated material. Because life settlements are still offered and tend to be targeted to seniors, FINRA wanted to have an updated overview and tips available on our site for this population and the general investor community," wrote a FINRA spokesperson in an emailed response to a Life Risk News request for comment.

Indeed, Conway says that, whilst the timing may seem interesting on the outside, people shouldn't start putting two and two together and making five just yet.

"I'd say that the market didn't know that FINRA was going to publish this, as there was no chatter about it beforehand. It is interesting that they've done it, sure. But whatever their motivations, it's actually a welcome statement by an influential organisation. As I said, working with licensed brokers and providers is key for the consumer because of the protections that our industry – a heavily regulated one – offers them. You have to take these things at face value, and unless, or until, FINRA follows this up with something else, there's nothing here that's of major concern," he said.

US nationwide regulators haven't waded into the life settlement market for a while. Way back in 2009, the SEC created a taskforce to look at the life settlement market, which never produced any conclusions, and the CFTC isn't applicable to the industry. Insurance is regulated at the state level in the US, and most activity in the legal and regulatory domain involves litigation, as opposed to developments in regulation. Indeed, FINRA's most recent regulatory notice in the life settlement space is from 2009.

> **"For an industry which touts itself as a consumer ally, coverage by influential bodies can only be a good thing."**

Simply publishing a consumer advisory article as FINRA has here is arguably not an example of a regulator amping up its efforts in the space. But regardless, for an industry which touts itself as a consumer ally, coverage by influential bodies can only be a good thing.

"What's important to understand is that there are still too many instances of senior insureds simply letting their whole or universal life insurance policy lapse, or accepting the surrender value, when in many instances, their policy would make a good case for a life settlement, where they would receive more money," said Bryan Nicholson, Executive Director at trade body, the Life Insurance Settlement Association. "Something like this might seem on the surface to raise eyebrows, but the added awareness for our industry from what is essentially a consumer advisory notice is a good thing."

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