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Spotlight Falls on US Life Insurers' Private Debt Investments

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Editor's Letter
Volume 2, Issue 9, September 2023

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Life Risk News

The pension risk transfer market in the United States is now a $50bn+ market, but unlike the UK, it's one where private equity and private debt funds are playing increasing roles. That's not gone unnoticed by some groups, so *Aaron Woolner* spoke to **Charles Decker**, a Researcher at **UNITE HERE**, and **Joe Engelhard**, Senior Counsel, US Policy & Regulation at the **Alternative Investment Management Association** to understand both the reservations that some have about this development, and the rebuttal, in *Spotlight Falls on US Life Insurer's Private Debt Investments*, our cover story this month.

Higher interest rates have had an impact on all alternative investment strategies in the past twelve months and will continue to do so as they remain elevated when compared to the post-GFC decade. Perhaps no impact, however, is greater than that of the German secondary life insurance policy market, which, due to its structure, is now largely defunct. *Greg Winterton* spoke to **Anna Bailey**, a Board member at trade group **BVZL**, for her views on the likelihood of the market returning in *The US Now The Last Remaining Traded Life Policy Market*.

The US Securities and Exchange Commission established a Life Settlement Task Force in 2009 to examine then-emerging issues in the life settlement market and advise whether market practices and regulatory oversight could be improved. Fourteen years later, the task force is yet to deliver its recommendations to Congress. *Jeffrey Davis* spoke to **JoAnn M. Strasser**, Partner and Chair, Investment Management at **Thompson Hine LLP** and **Ron S. Geffner**, Founding Partner at **Sadis & Goldberg LLP**, for their thoughts as to why in *Re-Visiting the SEC Life Settlements Task Force More Than a Decade Later*.

Life insurance companies have a reputation for being something akin to an oil tanker – big, and slow. But their approach to incorporating generative AI (GenAI) into various functions of their businesses can hardly be claimed to be thus. A snap poll conducted by technology consulting firm, Celent, in July this year revealed that 10% of life insurers in the United States were already using GenAI in production. Greg Winterton spoke to **Keith Raymond**, Principal Analyst, Insurance at **Celent** to learn more about this trend in *Generative AI Set to Transform Life Insurance Industry*.

Many investors in the life settlements asset class do not fully grasp the complexities underlying the asset before making the decision to invest in it; life settlements are more complicated to acquire and manage than other comparable discounted cash flow assets. **Maurizio Pellegrini**, Life ILS Manager at **Azimut Investments**, explains three areas that investors should pay close attention to before deploying capital in the space in *The Critical Nature of Life Insurance Policy Due Diligence in the Life Settlement Asset Class*, our first commentary article this month.

The UK's Continuous Mortality Investigation (CMI) carries out research into mortality and morbidity experience and produces practical tools that are widely used by actuaries. It published its most recent set of projections in July, showing lower life expectancies. So, for August's poll, we asked, 'How Significant Will the Impact of the Latest CMI Data on UK Life Expectancy Be on Life Risk Markets?'

The US Centers for Disease and Control (CDC) tracks all causes of death and has published provisional summary for 2022 deaths, including Covid-19 related deaths. However, the life insurance subset is generally a higher economic demographic subset with longer than average life expectancies, and **John Lynch**, Director of Actuarial & Underwriting Services, **Longevity Holdings**, takes a closer look at where Covid-19 and life settlements meet in *Covid-19 Excess Mortality Analysis*, our second commentary piece this month.

The involvement of the capital markets in terms of its capability to absorb longevity risk has been talked about for years, but action has been largely absent. *Greg Winterton* caught up with **David Blake**, Professor of Finance & Director of the Pensions Institute, **Bayes Business School**, to get his thoughts on the current state of the longevity financing conundrum in this month's Q&A.

Participants in the UK equity release market – insurance companies, advisers and consultants – generally agree that the industry has something of an awareness challenge. But the current macroeconomic environment is changing that, and *Greg Winterton* spoke to **Rudy Khaitan**, Managing Partner at **Senior Capital**, **Ben Grainger**, Partner at **EY**, and **Steve Kyle**, Secretary General of **European Pensions and Property Asset Release Group**, to get their views on the outlook for growth in the market in *Equity Release Fundamentals Underpin Growth Opportunity*.

Spotlight Falls on US Life Insurers' Private Debt Investments

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Life Risk News

The US pension risk transfer (PRT) market saw a record volume and number of deals take place in 2022. This year is set to break more records as the rapid rise in interest rates makes offloading schemes more affordable and new players entering the market has increased competitiveness.

Last year, the US recorded over $50bn worth of PRT deals, a big jump on the $38.1bn that actuarial consultants Milliman recorded for the market in 2021. The same trend is being seen in other countries, with Canada and the UK seeing an upshot in the amount of deals being struck as pension fund trustees look to take advantage of a change in fortunes after a decade of ultra-low interest rates skewed the pricing on transfer deals.

> **"As private markets have expanded over the last decade, far outpacing the growth of public markets, private equity firms have reshaped their business models and increased involvement in the life insurance sector. Previously, the focus of private equity was largely on buy-outs. Now, some private equity firms are increasingly pivoting their business objective to the private credit market"**

Firms have not been slow to recognise the opportunity and enter - or in some cases re-enter - the PRT market. In 2022, Reinsurance Group of America, Global Atlantic and American National all said that they were looking to write business in the PRT market and in July this year, Fidelity, the world's third largest money manager, announced that it was entering the sector via a Bermuda domiciled reinsurance entity, Soteria Re.

Another trend which has emerged alongside the growth of the US PRT sector has been an increase in private equity activity in the market. According to a report by consultants McKinsey, private investors now own over $900bn of life and annuity assets in Western Europe and North America.

According to McKinsey, all of the five largest private equity firms by assets have interests in life insurers with exposures ranging from 15 to 50% of their total assets under management.

This trend has not gone unnoticed. At the start of August this year, Democrat Senator Sherrod Brown, Chairman of the US Senate Committee on Banking, Housing, and Urban Affairs, released two letters questioning the role of private equity in insuring pension payments.

According to figures from the Treasury Federal Insurance Office (FIO) at year-end 2020, the cash and invested assets of US-domiciled private equity-owned life insurers were over $471bn; 12 months later the figure stood at over $800bn.

But what is concerning both Senator Brown and the FIO is the evolving risk profile of the life insurance sector under private equity stewardship.

"As private markets have expanded over the last decade, far outpacing the growth of public markets, private equity firms have reshaped their business models and increased involvement in the life insurance sector. Previously, the focus of private equity was largely on buy-outs. Now, some private equity firms are increasingly pivoting their business objective to the private credit market," the FIO said in a reply to Senator Brown's questions on the role of private funds in the PRT sector.

The emergence of private credit has been one of the post Financial Crisis success stories.

Figures from Preqin show that allocations to the sector have shot up from less than $50bn in 2010 to over $200bn in 2021. Charles Decker, a researcher at the UNITE HERE trade union, which put out a press release in May questioning the role of private equity in the PRT sector, says that private equity-backed firms have invested heavily in private debt but that the asset class remains untested in a high interest rate environment.

"The whole private debt sector has grown hand-in-hand with the low interest rate environment and there are reasons to be concerned about an asset class which has not been tested by either a period of prolonged high interest rates, or a major recession. But Unite Here's greatest concern is just how opaque these assets are, it's very difficult to find out exactly what these private equity-backed insurers are investing in," says Decker.

Decker's concern is that US insurance regulation is conducted at a state level via the National Association of Insurance Commissioners (NAIC), and while pensions are underwritten federally via the Pension Benefit Guarantee Corporation, once an insurer takes over a scheme it then falls under the purview of individual states which don't have uniform regulations.

> **"Regarding structured securities, insurers have a long history of investing in that asset class, and the NAIC is currently adjusting its accounting and capital rules in response to the natural development of new structured products"**

"While pensions are federally guaranteed, annuities are not; each state has its own version of a guaranty association, each with different levels of coverage providing annuitants with varying levels of compensation if the insurer behind it goes bust. Most of them have lifetime caps which are typically lower than the level of pension obligations," he says.

Decker adds that Unite Here, which represents over 300,000 workers across both the US and Canada, is concerned that the economy was changing faster than regulators are capable of keeping up with, particularly given the existing US PRT rulebook has been in place since the mid-1990s.

Decker's criticism was rejected by Joe Engelhard, Senior Counsel, US Policy & Regulation at the Alternative Investment Management Association (AIMA), which acts for the industry globally.

"In the US, the pension risk transfer market is regulated at both the federal and state levels, and insurers have a great track record over many decades of providing benefits to annuitants," says Engelhard.

Regulators appear wise to the potential threat of untested assets. The NAIC caused consternation in the industry with its April plan to provide alternative credit ratings for securities insurers have invested in and Engelhard said that the authorities were looking to mitigate potential risks by adjusting the regulatory framework.

"Regarding structured securities, insurers have a long history of investing in that asset class, and the NAIC is currently adjusting its accounting and capital rules in response to the natural development of new structured products," says Engelhard.

The debate is likely to continue. McKinsey's report says that private capital's interest in the insurance industry goes back more than 50 years, citing the 1967 acquisition of National Indemnity by Berkshire Hathaway as one of the earliest examples of this trend.

The consultant's explanation for private firms' continued interest in life insurers is because ownership of a carrier gives access to what McKinsey calls, 'permanent capital'; funds which don't have to be returned to investors on a specific timetable.

McKinsey estimates that private firms can increase the returns on equity on life insurers assets by up to seven percentage points annually by altering the asset allocation, meaning life insurers and the PRT market are likely to remain attractive to private capital.

"The core attraction is straightforward. The balance sheets of life and annuities companies are well stocked with assets...but until payout, these assets need to be invested to generate returns. And in many cases, the cost of servicing the liabilities is significantly lower than the potential investment return. The spread represents an attractive margin," says McKinsey.

The US Now The Last Remaining Traded Life Policy Market

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The US is now the only remaining nationwide secondary market for consumer life insurance policies.

That's because the German Traded Life Policy (TLP) market has gone the way of the Traded Endowment Policy (TEP) market in the UK – i.e., it is now largely defunct. Unlike the TEP market, however, it's the macroeconomic environment, not the regulatory one, that is responsible for the demise.

Higher interest rates have essentially put paid to an entire industry that was, essentially, an interest rate arbitrage play. Policies paying interest rates of, say, 3%, were purchased during the era of central bank zero interest rate policy (ZIRP) using leverage that often cost next to nothing, with the investor pocketing the difference.

Not anymore. Recent rises in rates by the European Central Bank that began in the summer of 2022 have had the effect of eliminating the arbitrage strategy.

> **"Interest rates are now at a point where the leverage that the investor previously used to buy these policies is now more expensive than the return on the policies – which is fixed. There's no play here for investors, at least, at the moment."**

"It really is as straightforward as it sounds," said Anna Bailey, a Board Member at German TLP trade association, Bundesverband Vermoegensanlagen im Zweitmarkt Lebensversicherungen (BVZL). "Interest rates are now at a point where the leverage that the investor previously used to buy these policies is now more expensive than the return on the policies – which is fixed. There's no play here for investors, at least, at the moment."

The development deprives Germans of an opportunity to access liquidity. Germany has, like many western countries, suffered from significantly higher inflation in the past 12-18 months when compared to the previous decade or so, meaning that its citizens have been feeling the pinch. Previously, selling a life insurance policy would have been one route for them to realise liquidity from an otherwise illiquid asset. Unlike in the UK, there's no equity release mortgage market, meaning that regular savings and investments will need to be accessible enough should they need it. And it's not as if Germans don't want to sell.

"Deal flow is certainly there. Germans are facing the same challenges like everyone else, and want to access cash. It's just that no one is buying," said Bailey.

It also deprives investors of returns. Like US whole life insurance policies, German policies have a surrender value, but also similar to the US, it's lower than the insured would receive if they sold on the secondary market. Investors are dumping portfolios by returning them to the carriers because doing so not only minimises losses but frees up this capital to deploy into much higher interest-yielding opportunities elsewhere, whether that be government bonds, or alternative investments, like private debt, which are much more appealing now from a yield perspective than they were in the decade or so post-GFC.

The UK TEP market would require an about-turn from the British Government in order to make a comeback, something which is unlikely. But for the German TLP market, it's not the case that all that needs to happen is for interest rates to come down below the interest rate paid by the policies for the market to resume.

"I highly doubt the market will return - at least to the volume it once was - because the insurance carriers are developing new products that do not have the same guarantees as policies from the 1980s and 1990s. The policies being issued now are not attractive to investors," said Bailey.

There are other markets where consumers can sell their life insurance policy. Alberta in Canada is one, but Canada doesn't have a nationwide market, and the largest province by population, Ontario, bans the market entirely. Those investors that are seeking uncorrelated returns from life risk exposure are now down to one market – the US. Fortunately, that's a growing one.

"The German market was only ever a few hundred million Euros, so it wasn't nearly as large as the US life settlement market," said Bailey. "And unlike the US market, where there are specialist asset managers in the space, few, if any, investors were focused solely on the German market, so it's not as if there has been a significant event here. The disappointment is more that the consumer no longer has this option. It's a real shame."

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Re-Visiting the SEC Life Settlements Task Force More Than a Decade Later

Author:
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Life Risk News

The US Securities and Exchange Commission established a Life Settlement Task Force in 2009 to examine then-emerging issues in the life settlement market and advise whether market practices and regulatory oversight could be improved. Fourteen years later, the task force is yet to deliver its recommendations to Congress.

Life Risk News reached out to attorneys and others in the industry for insights as to why.

"I don't have an opinion on why more has not been done, other than to observe that the task force recommended that Congress change the definition of security to include life settlements, but getting any law changed is difficult," said JoAnn M. Strasser, Partner and Chair, Investment Management, with the Columbus, Ohio, office of law firm Thompson Hine LLP. "The SEC staff does not seem to have any interest in this topic, and [SEC Commissioner Gary] Gensler has the staff extremely busy with rule making and enforcement, so anything outside of Gensler's agenda is, in my opinion, not possible for the staff."

> "There does not appear to be anything sinister in the lack of SEC action related to the life settlement industry. People often forget that the government has limited resources. In an effort to best utilize those limited resources, it is not surprising that the SEC would focus on the private fund industry"

Strasser's view is echoed by Ron S. Geffner, Founding Partner at law firm Sadis & Goldberg LLP in New York City.

"There does not appear to be anything sinister in the lack of SEC action related to the life settlement industry," he said. "People often forget that the government has limited resources. In an effort to best utilize those limited resources, it is not surprising that the SEC would focus on the private fund industry which, as of 2022, had over $26trn in assets. Also, given the hyperbolic growth in the cryptocurrency industry, it is reasonable that the SEC is trying to best determine how to protect the public by focusing on that at this moment."

Others pointed to the complexity behind the redefinition of an asset as a security and the possibility of relying on alternatives, such as updating regulations at the state level.

"The problem with the task force's recommendations is that redefining the asset as a security won't protect investors," added an industry executive who asked to remain anonymous. "If whole policies become securities, nearly everyone in the industry would either be out of business or have to comply with a host of regulations and rules that could stop the industry cold for a very long period of time."

The process started in August of 2009 when then-SEC Chairman Mary L. Schapiro established the Life Settlements Task Force, noting that the market for life settlements had grown over the previous decade, raising questions about its regulation and oversight.

On July 22, 2010, the SEC released a staff report recommending that life settlements be clearly defined as securities so that the investors in these transactions are protected under the federal securities laws.

In particular, the report noted the inconsistent regulation of participants in the life settlements market, including those who arrange for the buying and selling of policies and those who provide estimates of an insured's life expectancy. In addition, the report noted that investors in individual life settlement transactions, or pools of life settlements, would benefit from the application of baseline standards of conduct to market participants.

"The life settlements market calls out for enhanced and coordinated regulatory oversight to protect the emerging class of investors interested in this market, as well as the many seniors who consider selling their life insurance policies," Schapiro said in a 2010 news release. "Standards can be improved to ensure that those participating in this market are given a fair deal and are provided the information they need to evaluate such a consequential decision."

In the Life Settlements Task Force report, the staff outlined its findings about the life settlements market, making a series of recommendations it claimed would improve transparency, oversight, and investor protections.

One of the key recommendations put forward by the task force was the amendment of the definition of security under federal securities laws to explicitly include life settlements. The task force said this change would provide a consistent regulatory framework for life settlements, bridging the gap between federal and state securities laws. By doing so, market intermediaries operating within the life settlements space would be subject to SEC and FINRA oversight, further safeguarding investors from potential abusive practices, according to the report.

> **“In the Life Settlements Task Force report, the staff outlined its findings about the life settlements market, making a series of recommendations it claimed would improve transparency, oversight, and investor protections”**

The second recommendation emphasized the need for continued monitoring of legal standards of conduct by brokers and providers in the life settlements market. This would entail rigorous examination and enforcement efforts to ensure compliance with federal securities laws and FINRA rules.

It also recommended that the Commission instruct the staff to monitor for the development of a life settlement securitization market and encourage Congress and state legislators to consider more significant and consistent regulation of life expectancy underwriters.

The final recommendation sought to enhance investor education by considering the issuance of an Investor Bulletin focused on life settlements. This informational resource would help potential investors understand the complexities and potential risks associated with life settlements. By providing investors with the tools to make informed decisions, the SEC said at the time that it aims to reduce the likelihood of investment misunderstandings and losses.

Generative AI Set to Transform Life Insurance Industry

Author:
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Life insurance companies have a reputation for being something akin to an oil tanker – big, and slow. But their approach to incorporating generative AI (GenAI) into various functions of their businesses can hardly be claimed to be thus.

A snap poll conducted by technology research and consulting firm, Celent, in June this year revealed that nearly 10% of life insurers in the United States were already using GenAI in production. And 50% said that they would be either using GenAI in a live environment or in a test environment before the year is out.

The technology is being used mainly in customer experience, sales and marketing functions, for a few reasons. Chatbots, for example, are arguably already embedded in these front office functions in many industries, not only insurance, so it's not unusual for consumers to interact with GenAI through this medium.

But the tech is being used less so in middle and back-office functions, such as underwriting. According to Keith Raymond, Principal Analyst, Insurance at Celent, that's because of the uncertainty around legal risk.

> **"Underwriting is a risk area for insurance companies when using AI. Large language models are trained with data that can be biased. Biases in underwriting rules are a key point for mitigation, all humans are biased, consciously or not"**

"Underwriting is a risk area for insurance companies when using AI," he said. "Large language models are trained with data that can be biased. Biases in underwriting rules are a key point for mitigation, all humans are biased, consciously or not."

The pace of change in the AI space has always been significant, but the release of GenAI provider ChatGPT in late November 2022 arguably thrust the technology into the public consciousness almost overnight.

Government responses vary widely across the globe although most are looking for interoperability they have differing opinions on how to balance risk verse innovation. In the United States, the Biden-Harris administration convened leaders of seven major AI providers in July to secure voluntary commitments from them around safety and transparency, and Vice President Harris convened civil rights leaders earlier in July to discuss risks posed by the technology in terms of discrimination.

These meetings were not insurance specific. But life insurers in the United States do have a yardstick by which to measure compliance when it comes to their use of AI. Back in 2020, the National Association of Insurance Commissioners (NAIC) published a document setting out principles which insurance companies should consider as they look to incorporate the technology into their businesses. But more recently, in July 2023, the NAIC published a Model Bulletin which specifically focuses on the use of large language models.

"The NAIC model bulletin is a big leap forward in terms of structure and guidelines for life insurers and their use of AI," said Raymond.

These guidelines have been helpful, but best practice isn't the law. And if Celent's snap poll results turn out to be true – that half of all life insurers will have GenAI either working in a live environment at year end – then the customer experience, sales and marketing functions will still be the areas that see most of the investment, not just because of the efficiency gains this technology provides, but because of the lower regulatory risk.

And the middle and back office is arguably where the most gains are to be made from incorporating GenAI into a life insurer's technology stack. While the front-end use might help a life insurer to shift a few more policies or save money on headcount due to the ability of the GenAI system to do a good enough job to replace a sales representative, the significant benefit lies with the underwriting function, and the ability for GenAI to mitigate mortality risk.

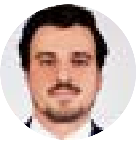
"Mortality risk is obviously a significant risk that life insurers are exposed to," said Raymond. "Using GenAI in the underwriting process means that insurers will be able to manage mortality risk more effectively because they'll be able to price policies more accurately. It's an area of significant impact for an insurer."

The full potential of GenAI is unknown, but what is known is that this is more a freight train than an oil tanker, hurtling onwards at high speed.

"The previous decade in the insurance technology space was all about the cloud – basically, migrating systems for efficiency reasons," said Raymond. "But the next decade will be all about AI. For life insurance companies and regulators, this is a seismic change and it's not slowing down. It could, in some ways, end up being the 'forever decade' for life insurers because of the enormity of the opportunity and the impact of it on not only the life insurance industry, but other industries that depend on it."

> **"The next decade will be all about AI. For life insurance companies and regulators, this is a seismic change and it's not slowing down. It could, in some ways, end up being the 'forever decade' for life insurers because of the enormity of the opportunity and the impact of it on not only the life insurance industry, but other industries that depend on it"**

The Critical Nature of Life Insurance Policy Due Diligence in the Life Settlement Asset Class



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"the market shows some level of sensitivity to the COI-increase risk component and guaranteed products tend, everything else being equal, to trade at more aggressive IRR levels, even if these "IRR corrections", may be misleading. We recognise the value of guarantees, especially taking into consideration the long-term nature of an investment into a life insurance policy, which often entails a decade(s)-long horizon"

Many investors in the life settlements asset class do not fully grasp the complexities underlying the asset before making the decision to invest in it. On its face, a life settlement appears relatively simple – it is effectively a negative carry, discounted cash flow asset that matures at some future point – not dissimilar to a zero-coupon bond. A closer look, however, reveals that life settlements are more complicated to acquire and manage than other comparable discounted cash flow assets. Hence, it is critical that careful diligence be undertaken before an investor makes the decision to invest in life settlements and begins deploying capital.

There are three important due diligence topics associated with the life settlement asset class that a prudent investor should address with the fund manager in order to gain a better understanding of the life settlement asset class.

Guaranteed/Non-guaranteed Cost Of Insurance (COI)

From a financial viewpoint, a life insurance policy is composed of two "legs," - the "face value leg" on the assets side and the "premiums leg" on the liabilities side. While these elements are already stochastic in nature, as the actual reception/payment depends on the future realizations of a random variable (length of the reference life), buying non-guaranteed products that will be carried on a current assumptions basis adds a source of uncertainty to the investment.

Universal life insurance products, which are overwhelmingly the most purchased life settlement asset, were launched in the US in the 1980s as a more flexible (and cheaper) form of permanent life insurance as compared to whole life insurance products. While whole life products have fixed premium payments that are calculated by the insurance carrier to build up substantial cash value over time, universal life products leave it to the policy owners to decide whether they wish to build up cash value in the policy (reducing the net amount at risk and therefore premiums due in the future) or not.

Most importantly, though, for universal life products, the COI rates applied by the carrier (referred to as "current assumptions COIs") are generally lower, and in certain cases much lower, than the guaranteed maximum COIs that are written in the policy contract. Insurance carriers may, under certain conditions and subject to regulatory supervision, adjust their COI rates upwards. (The market recognized this, especially after the COIs increase waves of the mid/late 2010s, when dozens of universal life insurance products experienced COI increases imposed by insurance carriers that in certain circumstances exceeded +200%, therefore causing the impacted products to lose value significantly or even entirely.)

As mentioned, the market shows some level of sensitivity to the COI-increase risk component and guaranteed products tend, everything else being equal, to trade at more aggressive IRR levels, even if these "IRR corrections", may be misleading. We recognise the value of guarantees, especially taking into consideration the long-term nature of an investment into a life insurance policy, which often entails a decade(s)-long horizon.

> “Medical underwriting of the insured life – and the life expectancy estimate of that life – is the most important variable in determining whether a life settlement policy has value - and if so, how much. A significant portion of the life insurance policies shopped on the secondary market show meaningful differences in value that are derived from relatively small variations in life expectancy assumptions. The variability around life expectancy estimates is a key indicator of the riskiness of the transaction, and this variability must be specifically analysed”

There are different due diligence procedures that we follow to reduce the risk of suffering losses as a result of a COI increase on policies purchased and kept in force on a current assumptions COI basis.

Among these, when buying policies on a non-guaranteed basis, we look for the existence of secondary guarantees in the policy contract. While these secondary guarantees may be less attractive on a present value basis as compared to keeping the policy in force on the basis of current assumptions COI rates, they represent an option that can be exercised (i.e., the option to switch from current assumption-based premium optimization to secondary guarantee-based premium optimisation) should a COI increase be implemented in the future. This would provide a better “backstop” as compared to the one foreseen under the policy contract for the “main account”, the maximum (guaranteed) COI rates.

While it is true that in previous COI increase waves, very few products were the subject of COI increases implemented by carriers to the fullest extent possible (applying maximum contractual COI rates), the option of switching to secondary, guarantees-based premiums proved valuable for increases that weren’t close to the maximum possible, which increases the importance of looking for these carefully during due diligence, even if the policy is being purchased on a non-guaranteed basis.

Medical Underwriting and Life Expectancies

Medical underwriting of the insured life – and the life expectancy estimate of that life – is the most important variable in determining whether a life settlement policy has value - and if so, how much. A significant portion of the life insurance policies shopped on the secondary market show meaningful differences in value that are derived from relatively small variations in life expectancy assumptions. The variability around life expectancy estimates is a key indicator of the riskiness of the transaction, and this variability must be specifically analysed. However, having a clear perception of said variability is often problematic, and getting a proper reward for this risk (i.e., being able to purchase at appropriate discounts) is even more so.

This problem is aggravated for investors by the sophisticated “life expectancies selection mechanism” sourcing that intermediaries have developed over time, combined with the fact that in most cases, only one life expectancy is actually presented to the market during the bidding process, even for cases that are underwritten clinically, i.e., even when the life expectancy estimate is highly sensitive to the underwriter’s judgement and therefore a secondary, additional source of uncertainty is added to the game.

Currently, a handful of life expectancy underwriters account for more than 90% of the life expectancy underwriting market. They employ different proprietary mortality tables (meaning one life expectancy underwriter could assign a 90-month life expectancy, and another an 80-month life expectancy to the same 89-year-old, non-smoking male) and different proprietary underwriting manuals, hence, they often end up with different views (i.e., different mortality multipliers and life expectancies) on the same life, even starting with the same medical information set.

For example, the combination of different tables and views on the same life (given the same medical information set) could generate a range of “potentially admissible values” that ranges from $20,000 to $250,000 on a policy with a face value of $400,000. Absurd as it might seem, this scenario is not rare. This situation embeds a high level of risk in addition to the possibility of excess longevity risk (i.e., the risk of seeing the individual surviving beyond the life expectancy, assuming the life expectancy was correctly underwritten), and

“The industry’s standard valuation methodology relies on a discounted cash flow model that weighs future cash flows on the basis of an actuarial array that is fitted to the specific life, by the application of a mortality multiplier that forces the probability distribution to have an expected value (the expected duration of the reference life) equal to that of the life expectancy report(s) obtained from third party life expectancy underwriters. Probability-weighted cash flows should then be discounted at an appropriate discount rate”

simply taking the average of the extremes does not provide any appropriate reward for the extra risk, especially when in presence of a potential life expectancies selection bias. In these circumstances, greater control by the investor of the medical underwriting, however achieved, is essential.

Another interesting area is that of lives that are underwritten by life expectancy underwriters at close-to-standard mortality ratings (up to 150-175%). It appears there is a sourcing/sell-side’s push to make policies viable that might not really “price” (i.e., they would not normally be a candidate for a life settlement), and this needs to be taken into consideration each time these cases are reviewed. In the end, sourcing policies is a tough and costly job: once an intermediary has worked several weeks on a file, after many calls to the potential sellers (likely many of them ending up in the voicemail) to try to obtain medical records, illustrations, policy contracts and so on, it is understandable that they will try all available routes to make the case work.

For these policies, on top of all the other due diligence steps and the analysis of the insured’s health status, a closer look at the history of the life policy itself, including issuing assumptions, product type and vintage as well as the initial table ratings, is prudent and necessary. As an example, life insurance policies issued at super preferred mortality rates to wealthy individuals in California will likely price – even if these life insurance policies weren’t originally issued several years prior – if valued at a 150%-or-so rating applied on a table that’s based on nationwide, non-wealth specific historical survivorship data.

However, this isn’t necessarily a no-loss, stochastic arbitrage. Also, in this case, we believe that looking at how the present value of the policy behaves by changing life expectancy assumptions helps in understanding the riskiness of the transaction. Although the industry seems to lack a “unifying theory” about life insurance policies valuation and riskiness, certain aspects should, in our opinion, at least be considered in a practical way. Life insurance policies whose present value (at the buyer’s representative IRR) varies by, say, –50% or more in dollar terms for a small variation in the life expectancy (in particular, the mortality multiplier assigned by the underwriter) are in our view very risky and should, in our opinion, be avoided unless the price can be adjusted to embed a proper remuneration for such a coin flip-like game. This scenario is all but uncommon in our experience and the best way to deal with it is in our opinion to always have the ability to ditch all the cases that show similar characteristics without embedding a proper reward.

IRRs and Model Sensitivity

The industry’s standard valuation methodology relies on a discounted cash flow model that weighs future cash flows on the basis of an actuarial array that is fitted to the specific life, by the application of a mortality multiplier that forces the probability distribution to have an expected value (the expected duration of the reference life) equal to that of the life expectancy report(s) obtained from third party life expectancy underwriters. Probability-weighted cash flows should then be discounted at an appropriate discount rate.

As mentioned above, a naked investment into a life settlement policy generally implies an exposure to one single, stochastically distributed positive inflow (the death benefit, on the asset side) and to a series of outflows (the premiums due, on the liability side). On policies that are kept in-force on a current assumptions basis following a minimum premium approach, liabilities tend to significantly increase over time. However, if the selected discount rate is high enough and the LE employed is short enough, the pricing model “won’t see” distant liabilities clearly enough to properly reflect them into pricing until they become closer, i.e., after years of carrying. In short, the exponentials employed in the discounted cash flows model may amplify the effects of wrong assumptions.

Interestingly, while when using a discounted cash flows model to price an asset-only instrument (i.e., embedding only positive projected cash flows, like in bonds) adding the right amount of basis points to the base discount rate could

“Life insurance companies have been very profitable because the actuaries who design the products that are their stock in trade have a deep and comprehensive understanding of mortality and statistics. It is, therefore, advisable for investors in life settlements to also have an understanding of these disciplines and their application to the asset class”

be an effective way to better reflect volatility/riskiness in the projected future cash flows. And when a discounted cash flows model is employed to price liabilities, adding basis points to the base discount rate reduces the present value of the liabilities and therefore results in a more aggressive, and not more conservative, estimate of such liabilities.

If a single level discount rate is employed across assets and liabilities to value life settlement policies without making distinctions between their assets and liabilities components, a net mixed result is obtained. How misleading the net mixed result will depend on several characteristics of the life settlement policy at hand, and in our opinion a key variable is the shape of the projected premium streams. In our view, therefore, transaction-implied IRRs (level across assets and liabilities) should be handled with care, especially if one wants to use them to compare the relative value of life insurance policies that embed drastically different features. This is, of course, also true when it comes to ongoing book valuations.

Life insurance policies and the mathematical formulae upon which they are based, are inherently and surprisingly complicated. Policies are designed by insurance actuaries, who spend years studying mortality and other risks using mathematics, statistics, and financial theories, and who then must take a series of tests that extend over several years to become a certified actuary. Life insurance companies have been very profitable because the actuaries who design the products that are their stock in trade have a deep and comprehensive understanding of mortality and statistics. It is, therefore, advisable for investors in life settlements to also have an understanding of these disciplines and their application to the asset class.

September 2023 Poll Results

How Significant Will the Impact of the Latest CMI Data on UK Life Expectancy Be on Life Risk Markets?

Author:
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The UK's Continuous Mortality Investigation (CMI) carries out research into mortality and morbidity experience and produces practical tools that are widely used by actuaries. It published its most recent set of projections in July, showing lower life expectancies.

So, for August's poll, we asked, 'How Significant Will the Impact of the Latest CMI Data on UK Life Expectancy Be on Life Risk Markets?'

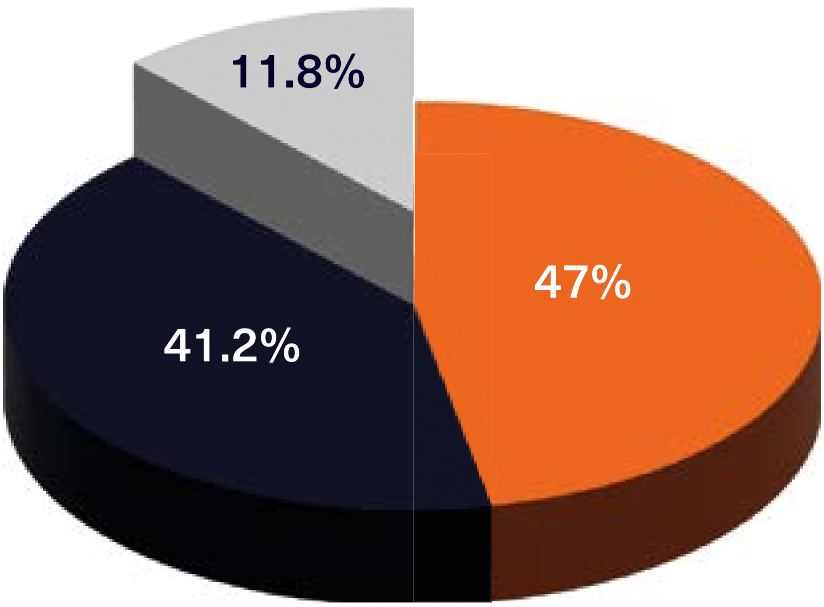
Our readers were split. 47% said they thought that the latest report was 'very significant' because we've not seen changes like this in some time, but 41.2% said that it wasn't significant, because many other factors are considered when structuring a deal in the life risk markets.

Which cohort is correct remains to be seen – and in some cases, it'll take years to learn the answer.

Very Significant
We've not seen changes like this in some time.

Not Significant
Many other factors are considered when constructing a deal.

Unsure
It's a concerning trend but too early to say if it's a medium term one.



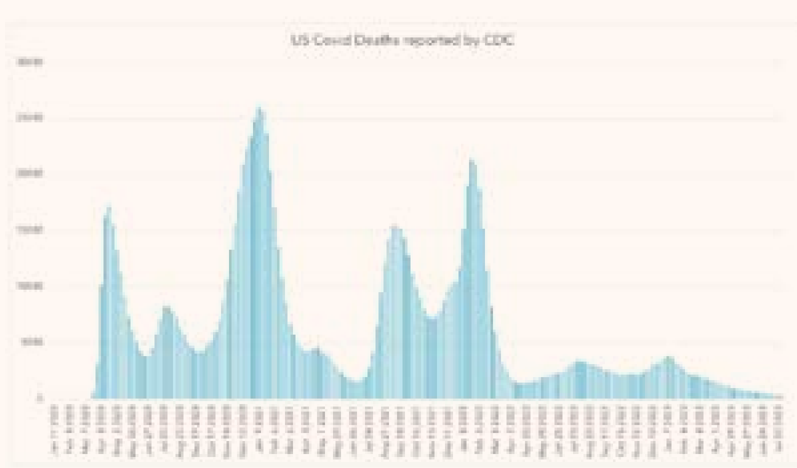
Covid-19 Excess Mortality Analysis

Author:
John Lynch
Director of Actuarial & Underwriting Services
Longevity Holdings

The World Health Organization (WHO) declared an end to the public health emergency due to COVID-19 on May 11th of this year. The Centers for Disease and Control (CDC) tracks all causes of death and has published provisional summary for 2022 deaths including COVID-19 related deaths. The data below highlights the sporadic increase in COVID-19 deaths during the multiple waves of the pandemic.

It remains to be seen if a new COVID-19 wave will emerge in late 2023, but all indications point to COVID now being a lower-level endemic.

"It remains to be seen if a new COVID-19 wave will emerge in late 2023, but all indications point to COVID now being a lower-level endemic"



Source: https://covid.cdc.gov/covid-data-tracker/#trends_weeklydeaths_select_00

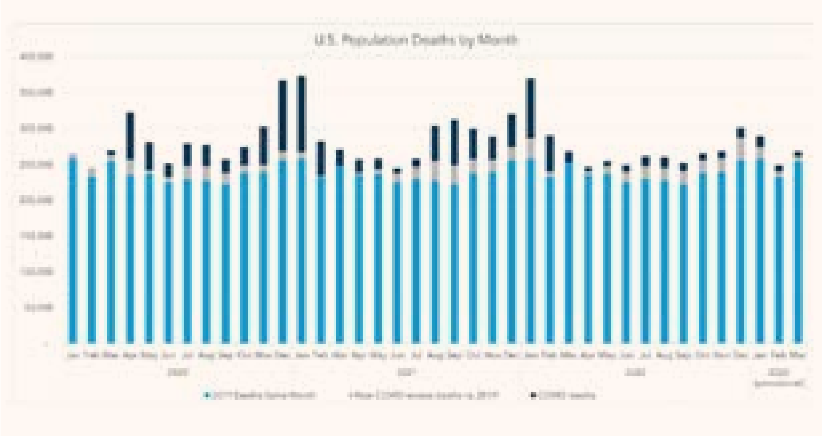
COVID-19 was associated with approximately 246,000 deaths in the United States during January-December 2022. The above weekly graph from the CDC [1] shows provisional COVID-19 deaths on a standalone basis since the start of the pandemic. It highlights five separate and distinct waves from 2020 through to end of April 2022. Since May 2022, the trend has oscillated between 1,500 and 4,000 COVID-19 deaths per week. But since the start of this year, 2023 has been trending towards zero.

The methodology for analyzing the impact of COVID-19 for this report is using a simplified approach of comparing the actual death counts for each month of the pandemic vs. same month in 2019, prior to the pandemic. Note: this is not an actual to expected analysis, as there is no mortality table assumption involved; subsequent reports in this series will have Actual to Expected analyses. This analysis is trying to identify the excess mortality assuming similar mortality trends extending from 2019 into future years.

[1] https://www.cdc.gov/nchs/nvss/vsrr/COVID19/index.htm as of 8/2023

> “The non-COVID excess deaths in 2022 are running 7% higher than 2019 pre-pandemic levels. This is being driven by higher heart disease, diabetes-related diseases, and accidents such as suicide and overdose. These appear to be indirect, secondary impacts relating to the pandemic and downstream effects of lost wages and loneliness which were more impactful on the lower end of the economic demographics”

The graph below highlights the higher winter deaths and lower summer deaths in the light blue color, which has been evident for decades in population data. This phenomenon accounts for roughly a 7-10% increase in winter deaths vs. summer deaths and was evident in all 3 datasets. COVID-19 had waves that occurred in all seasons, coming and going for different lengths in different time periods across various quarters. Therefore, analyzing monthly instead of quarterly or annual allows for a better focused analysis of the true excess mortality due to COVID-19 within each wave. Monthly comparisons allow for a lateral comparison neutralizing seasonal impacts of mortality.



The non-COVID excess deaths in 2022 shown above in gray are running 7% higher than 2019 pre-pandemic levels. This is being driven by higher heart disease, diabetes-related diseases, and accidents such as suicide and overdose. These appear to be indirect, secondary impacts relating to the pandemic and downstream effects of lost wages and loneliness which were more impactful on the lower end of the economic demographics. This highlights the incremental impact of both official COVID-19 recorded deaths and other excess deaths which may or may not be due to secondary impacts of COVID-19.

The question remains, how many (if any) of these secondary impacts will migrate up the economic ladder into the life settlement risk pool?

Life Settlement Mortality

Using the CDC Wonder database is great for monitoring population mortality. The life insurance subset is generally a higher economic demographic subset with longer than average life expectancies (We will explore this effect more in a future report).

The life settlement pool is a subset of life insurance pool, and the ‘standard’ life expectancy is even longer. Hence one might expect the effect of COVID-19 to follow similar patterns. Let’s dig into our Longevity mortality datasets to see what extent COVID-19 impacted similar and different as compared to population mortality.

The below graph takes data that was created from the Fasano life settlement underwritings for the Life Expectancy (LE) product, covering over 65,000 lives underwritten by Fasano during the past 22 years.

Deaths are plotted by month and compared to the same number of deaths in 2019, the year prior to COVID-19, as a baseline. Significant excess deaths are assumed to be due to COVID-19. The data shows significant spikes in mortality during the 1st and 2nd waves of COVID-19, and one significant month of excess deaths during the early stages of the Omicron wave. September of 2021 had the largest month of increased deaths; +49% vs. 2019 same month.

> “The life settlement pool is a subset of life insurance pool, and the ‘standard’ life expectancy is even longer. Hence one might expect the effect of COVID-19 to follow similar patterns”

A summary of relative impact for each wave of the COVID-19 pandemic range from 20-30% in line with the population COVID-19 increases.

Wave	Time Period	Increase vs. 2019
1	Feb - May 2020	+24%
2	Nov 2020 - Feb 2020	+28%
3	July - Sept 2021	+19%

Additional deaths from October 2021 forward can be attributable to the aging of the dataset. The below graph takes data that was created from the TwentyFirst underwritings for the Life Expectancy (LE) product, covering over 98,000 lives underwritten by TwentyFirst during the past 20 years. The actual life settlement deaths in the 21st underwriting dataset do not indicate any recent excess in the past 20 months compared to the first year of the COVID-19 pandemic. The pronounced spikes in March 2020 and winter of 2020/21 highlight COVID-19’s impact during the first two waves of the pandemic.

A summary of relative impact for each wave of the COVID-19 pandemic range from 20-30% in line with the population COVID-19 increases.

Wave	Time Period	Increase vs. 2019
1	Feb - May 2020	+29%
2	Nov 2020 - Feb 2020	+29%
3	July - Sept 2021	+19%

> “Excess mortality due to COVID-19 hit the life settlement industry by the same scale as the population excess mortality for the early stages of the pandemic”

Conclusion

Excess mortality due to COVID-19 hit the life settlement industry by the same scale as the population excess mortality for the early stages of the pandemic. By the end of 2021, the excess mortality effect has mostly subsided versus excess mortality persisted for the population well into 2023.

Based upon the review of COVID-19 mortality since inception of the pandemic to present day, it has been determined to not make assumption changes to the base mortality tables for our LE businesses due to COVID-19. Small debit adjustments have been made to account for long-COVID and other active COVID-19 conditions on a case-by-case basis.

Q&A

David Blake
Professor of Finance & Director of Pensions Institute
Bayes Business School

The involvement of the capital markets in terms of its capability to absorb longevity risk has been talked about for years, but action has been largely absent. Life Risk News' Greg Winterton caught up with David Blake, Professor of Finance & Director of the Pensions Institute, Bayes Business School, to get his thoughts on the current state of the longevity financing conundrum.

GW: David, let's start with mortality. The CMI recently incorporated Covid-19 data into its mortality projections, the result being lower life expectancies. What's your view of the impact here?

DB: In July 2023, the CMI reported that deaths in the UK in June 2023 were 5% higher than in pre-pandemic June 2019. Across the UK, there have been 200,100 more deaths from all causes than expected from the start of the pandemic to 30 June 2023. Of these, 75,600 were in 2020, 56,600 in 2021, 39,400 in 2022 and 28,500 in the first half of 2023. Pension liabilities would be £8bn lower than three years previously anticipated for schemes going through their triennial valuation between September 2022 and September 2023, according to The Pensions Regulator.

This longevity slowdown when combined with the significant reductions in liabilities as a result of rising interest rates over the past 18 months is likely to lead to larger pension fund surpluses and bring forward planned de-risking strategies, including buy-outs, buy-ins and longevity swaps.

GW: In early September, the 18th edition of your annual Longevity conference took place. What's been the most notable trend, from the perspective of the capital markets, in the past nearly two decades of the event?

DB: We held our first Longevity conference in February 2005, just after the European Investment Bank and BNP Paribas announced the launch of a longevity bond to hedge systematic longevity risk. Unfortunately, the bond failed to attract sufficient interest to get launched. But it did encourage investment banks to introduce less capital-intensive solutions, such as longevity swaps. These were just beginning to gain traction when the Global Financial Crisis struck, and, in the aftermath of the Dodd-Frank Act, investment banks pulled out of this market. This left insurance companies to take over the longevity risk transfer market with their buy-outs and buy-ins. They laid off the longevity risk with global reinsurers via longevity swaps. But none of these products have any real liquidity, so they cannot easily be transferred to third parties.

The transfer market has grown rapidly in the last few years and it is becoming increasingly clear that there is insufficient capacity in the global insurance/reinsurance market to absorb all this risk. This led to attempts to bring in new sources of third-party capital. A key example is the reinsurance sidecar – which is a way to share risks with new investors when the latter are concerned about the ceding reinsurer having an informational advantage. Formally, a reinsurance sidecar is a financial structure established to allow external investors to take on the risk and benefit from the return of specific books of insurance or reinsurance business. It is typically set up by existing (re)insurers that are looking to either partner with another source of capital or set up an entity to enable them to accept capital from third-party investors.

It is established as a special purpose vehicle (SPV), with a maturity of two to three years. It is capitalised by specialist insurance funds, usually by preference shares, though sometimes in the form of debt instruments. It reinsures a defined pre-agreed book of business or category of risk. Liability is limited to the assets of the SPV and the vehicle is unrated. The benefit to insurers is that sidecars can provide protection against exposure to peak longevity risks, help with capital management by providing additional capacity without the need for permanent capital, and can provide an additional source of income by leveraging underwriting expertise.

The benefit to investors is that they enjoy targeted non-correlated returns relating to specific short-horizon risks and have an agreed procedure for exiting; investors can also take advantage of temporary price hikes, but without facing legacy issues that could affect an investment in a typical insurer. By 2021, more than $20bn in third-party capital from sidecar investors had been deployed to support around $400bn worth of life and annuity book transfers.

So the history of the last 20 years has been one of ups and downs for the capital markets when it comes having a significant role in the market for longevity risk transfers. Early successes were followed by a virtual withdrawal from the market as insurers took over. But things could be changing… and soon.

GW: Some would argue that it's taking a long time – too long – for solutions to emerge that will encourage more participation by the capital markets in longevity risk. Why is it taking so long, and what's the solution?

DB: Yes, it has taken far too long for sustainable capital markets solutions to emerge. But the reason for this is clear from my earlier answers. There is no real liquidity in existing longevity risk hedging solutions: buy-ins, buy-outs, longevity swaps or reinsurance sidecars.

This also explains why reinsurance sidecars only have maturities of up to three years: third-party investors do not currently want to be committed for longer periods. A key reason for the lack of liquidity in existing solutions is that they are customised to the specific hedging needs of different pension funds and so are based on the specific mortality experience of these funds.

The solution is to introduce a longevity or life market to create liquidity in longevity-linked products by facilitating the exchange of these products between third-party investors. This, in turn, requires standardisation of these products. This implies that they have to be linked to an index based on national population mortality data. This, in turn, introduces two challenges that need to be circumvented.

The first challenge is basis risk, the risk that the specific mortality experience of a pension fund diverges from the mortality experience of the national population. The second challenge is capital relief, the allowance that the financial regulator grants to hedge providers such as insurance companies when determining the level of capital that they must raise in order to conduct risk taking activities.

These challenges are linked, since the lower the basis risk, the more effective the hedge and hence the greater the capital relief. Naturally, insurers want to minimise the amount of capital they devote to their risk-taking activities.

Hedging solutions, involving options linked to national population mortality indices, have been invented in recent years in order to minimise basis risk. But these solutions have failed to gain the capital relief hoped for in the countries in which they have been introduced.

A group of us (*David Blake, Professor Andrew Cairns of Heriot-Watt University, Avery Michaelson and David Schrager of Longitude Solutions, and Douglas Anderson and Steven Baxter of Club Vita*) felt that the regulator needed to have more and better information about the benefits of index-based hedges. This is why we have recently established the Index Longevity Market Action Committee (ILMAC). The aim of ILMAC is to 'build a consensus on a framework, ideally a market standard (to be incorporated into regulations such as Solvency UK or Solvency II, and related guidance) for basis risk quantification, combined with a set of principles for the development of an internal model for institutions seeking to use their own approach to basis risk quantification. This is intended to provide clarity on the capital relief that a regulated (re)insurer would achieve from using an index-based hedging structure'. To date we have had one meeting with the UK Prudential Regulation Authority (PRA). We are currently working on a realistic case study that calculates the capital relief for a pension fund that uses an index-based longevity hedge with minimal basis risk.

GW: Back in 2015, you warned about the risks to the insurance industry in terms of its exposure to systematic longevity risk. In the past eight years, however, the volume of PRT deals has grown substantially. Are we at risk of a situation where something will only change when a disaster occurs – something akin to Basel III as a response to the global financial crisis?

DB: Over the last eight years a significant amount of systematic longevity risk has been concentrated in a small number of global reinsurers. This has attracted the attention of the PRA which in January 2023 wrote to UK insurance companies warning them that: 'In light of the multiple external uncertainties facing insurers, it is important that firms take proactive steps to assess the adequacy of their risk management and control frameworks. Firms should be able to respond to market and credit risk conditions different from those that prevailed for a long time.

Firms need to be prepared for novel risks, changes in risk correlations and increases in distressed assets. ... We are paying close attention to whether the continued high level of longevity reinsurance reduces the protection UK policyholders should have, beyond the risk tolerance. In particular, we see the potential for offshored counterparty concentration risk to arise from rapidly growing levels of reinsurance'.

The best way to avoid a crisis is to introduce a regulator-approved capital market for longevity risk transfers and this will help to reduce concentration risk. This is because the risk will be spread across the whole capital market, in particular long-term investors – such as sovereign wealth funds and endowments – that seek returns that are uncorrelated with traditional bond and equity assets.

GW: Lastly, David, let's try and put a crystal ball in here. Fast forward five years; where do you hope the longevity risk asset class will be? What's the best-case scenario here?

DB: I am very positive about developments in the longevity risk space over the next five years. Although the longevity risk transfer market began in the early 2000s, this year (2023) was the first year that we (via ILMAC) have started to have serious discussions with a regulator about capital relief on index-based longevity hedges. Last year, the Longitude Exchange was established in Bermuda as the first digital marketplace for trading longevity risk in index-based format. It aims to connect hedgers and investors on a platform optimised for trading longevity risk and hence build an efficient and deep market for trading longevity risk.

So, if we can regulatory support for our approach to capital relief, then this could lead to a regulator-approved capital market for longevity risk transfers taking off over the next few years – fulfilling ambitions that go back two decades.

Equity Release Fundamentals Underpin Growth Opportunity

Author:
Greg Winterton
Senior
Contributing Editor
Life Risk News

Participants in the UK equity release market – insurance companies, advisers and consultants – generally agree that the industry has something of an awareness challenge. Despite industry efforts in terms of media advertising, many in the over-55 cohort – those homeowners who can take out an equity release mortgage – either don't know that the option exists, or might have come across it in passing, but haven't taken the time to explore the nuances of the option.

The current macroeconomic environment is changing that, however. And, according to Rudy Khaitan, Managing Partner at UK-based later life lender Senior Capital, there's an obvious reason.

"Homeowners who qualify for an equity release mortgage in the UK – those aged 55 years or more – that are coming to the end of their fixed-rate mortgages are faced with remortgaging into much higher interest rates than they've been paying in the past few years," he said. "Equity release mortgages are less burdensome in terms of cash flow as the interest rolls up, and it isn't usually repaid each month like a regular mortgage. This helps enormously with the cost-of-living challenges we're seeing right now."

> **"Equity release mortgages are less burdensome in terms of cash flow as the interest rolls up, and it isn't usually repaid each month like a regular mortgage. This helps enormously with the cost-of-living challenges we're seeing right now"**

Equity release market bulls say that the UK has the fundamentals for a sustained period of growth. The country has an aging population, with generally increasing house prices over time. Additionally, although many of the 55+ homeowning population are asset rich, they often have either low levels of cash savings or small pensions in the context of their remaining life. Activity in the space is driven mainly by a needs-based situation, like the requirement to access cash, or financial planning. Whilst the latter is more sensitive to macroeconomic factors, Khaitan says that overall, demand is fairly inelastic.

"Financial planning reasons generally include parents looking to accelerate the transfer of wealth to their children via a tax efficient mechanism, for example to help fund a deposit for their first property. This use case is more sensitive to interest rates because borrowers are able to release less cash in a higher rate environment relative to when interest rates are low. There remains an element of demand inelasticity however as interest on equity release doesn't need to be serviced and there is always the option to refinance when rates come down."

Investors such as hedge funds and private equity funds don't play in the equity release space because of duration constraints, they can't compete on price with insurers, and there isn't a sufficiently developed secondary market to support trading liquidity. But the existing funding supply is currently dominated by UK life insurers because equity release mortgages are one of the few long-term assets that meet their particular investment objectives. There is a clear benefit to an insurer from investing in equity release mortgages, particularly when they are in the form of structured, matching adjustment eligible, rated notes when compared to other similar duration assets.

"Equity release mortgage-backed notes, when structured appropriately, not only offer attractive risk adjusted yields but crucially, much coveted long duration cash flows that align with insurers' liabilities and regulatory requirements," said Khaitan.

Insurers in the UK currently securitise their equity release mortgages exposure so that they can issue fixed cash flow notes in order to benefit from the Solvency II matching adjustment. The residual risk component of the securitisation sits in the 'own funds' section of the balance sheet, which requires an additional layer of capital capacity from a regulatory accounting perspective.

Securitising ERM portfolios externally is one area of potential growth which would release even more capital for even more deals. A third party sells the matching adjustment compliant notes to the insurer and holds the residual risk on their balance sheet. More activity in this area could be added fuel for the industry.

"This method of structuring equity release mortgages means that you're not using the shareholder funds to absorb the capital requirements from holding the residual notes that aren't compliant with the matching adjustment. An external party is the ultimate risk retainer, and this frees up that capital for other uses," said Khaitan.

This is still all UK-based, however. What about Europe? Many countries in western Europe don't really have much of an equity release market, if at all. There's some activity in Spain and Sweden, but little anywhere else, and the activity that does happen isn't structured the same in each country. Steve Kyle, Secretary General of trade body European Pensions and Property Asset Release Group (EPPARG), says that efforts are underway to try to grow the market overseas.

"The total size of the ERM market in the UK is around £6bn. But I think that can go to £10bn soon – years, not decades – so there is room for growth. And the explosion in bulk annuity risk transfer deals means there will be plenty of funding available to absorb the growth"

"The European equity release market tends to vary in each nation state. There are common elements and EPPARG members are as one in terms of looking to proactively put in place proportionate and relevant consumer protections and processes. Many of our European members see huge untapped growth potential and some of the cultural challenges now appear less significant, since an increasing number of homeowners are cash rich and income poor. In some markets the momentum for equity release is picking up, but greater awareness and funding would help. The current global economic issues have proved to be a double-edged sword, pushing up some demand, but increasing some of other risks. Our members remain positive regarding prospects for the medium term, and, in their home markets, many partners, customers and regulators welcome the direction of travel."

As Kyle alludes, the demographics in western European countries are very similar in the sense of an ageing population. And there are cost of living challenges, albeit not as pronounced as in the UK. On the surface, western Europe would certainly seem like fertile ground for such a market, but according to Ben Grainger, a Partner at EY in London, it's important that the anticipated growth in the market on the continent is driven by an effective model, something that's not necessarily easy to implement.

"The funding models for equity release don't exist in Europe the same way as they do in the UK. We have a good funding model in the UK, and it's a case of engaging with stakeholders overseas to adopt something similar. It's not a straightforward process to get everyone aligned," he said.

There is a market in the US, of course. 'Reverse mortgages' have been a feature of the financial planning market in the US for many years. But for those in Europe, it's a case of continuing to focus on the UK market for the time being.

"The total size of the ERM market in the UK is around £6bn," said Khaitan. "But I think that can go to £10bn soon – years, not decades – so there is room for growth. And the explosion in bulk annuity risk transfer deals means there will be plenty of funding available to absorb the growth. There's a mild dislocation in terms of supply at the moment because of the higher interest rate environment, but the fundamentals remain. More and more of the 55+ demographic will turn to their home in the coming years to access cash."

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