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New Insights Into Life Settlement Providers Shows Market Offering Solid Asset Manager and Consumer Choice

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Editor's Letter, Volume 2, Issue 12, December 2023

Chris Wells
Managing Editor
Life Risk News

Industry group the European Life Settlement Association (ELSA, publisher of Life Risk News) published new information recently that provides insight into the number and activities of the life settlement provider market. *Greg Winterton* spoke to **John Dallas**, President of **Berkshire Settlements** and incoming Chair at the **Life Insurance Settlement Association**, and myself for our thoughts on the topic in *New Insights Into Life Settlement Providers Shows Market Offering Solid Asset Manager and Consumer Choice.*

Much has been written about the higher interest rate environment contributing to the improved funding status of defined benefit pension funds, but the chaos in the UK gilt market in October 2022 has also been a significant driver of pension risk transfer (PRT) activity in 2023. *Aaron Woolner* spoke to **Shelly Beard**, Partner at **WTW**, to find out more in *LDI Crisis Spurs UK's Pension Risk Transfer Market in 2023*.

2024 will be the first year when UK insurers report full year results under the IFRS 17 regime, and the country's Solvency UK reforms will also continue to progress during the year. *Greg Winterton* spoke to **Anthony Coughlan**, Partner, and **Jignesh Mistry**, Director at **PwC** to get their thoughts on this topic in *Despite Interesting Nuances, IFRS 17 Impact on UK Bulk Annuity Market Less Than Solvency UK*.

For a life settlements underwriter, dementia is a condition commonly seen due to older lives being underwritten and the increasing prevalence of the disease. Many factors need to be taken into account when assessing these risks, as explained by **Dr. Jyotsna Kamble**, Medical Underwriter at **CG Analysts,** in *Dementia: An Increasing Global Problem and a Complex Underwriting Condition for the Life Settlement Industry*, a guest article this month.

The equity release market in the UK returned to growth in Q3 this year, the first time in 12 months, according to British industry group, the **Equity Release Council**. So, for this month's poll, we wanted to know whether our readers thought this was a turning point for the industry. The results indicate that there are a lot of bulls out there.

Many philosophies and theories about LEs have been proffered by life expectancy providers and virtually every type of participant in the life settlement market has contributed to the discussion on actual to expected analysis. **Vince Granieri**, Founder at **Predictive Resources**, in *Actual-to-Expected Apocrypha*, adds his views in our second commentary piece.

Our Q&A this month features **Chris Conway**, Chief Development Office at life expectancy underwriting firm, **ISC Services**. Conway gives his thoughts on how the life settlement market has performed in 2023, and what he plans to be involved in now that he has been appointed to ELSA's Executive Board.

Whilst 2023 is not quite in the books just yet, it has been another busy year in the UK PRT market. But those in the UK licking their lips at the prospect for 2024 bringing ever more deals might want to rein in their excitement, as the regulator is paying ever closer attention. *Greg Winterton* spoke to **Avery Michaelson**, CEO, and **David Schrager**, CFO, at **Longitude Exchange** to get their views on the long-term outlook for the space in *Reinsurance Concentration Risks Point to Inevitable Future for Longevity Risk Transfer Market*.

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

New Insights Into Life Settlement Providers Shows Market Offering Solid Asset Manager and Consumer Choice

Author:
Greg Winterton
Senior
Contributing Editor
Life Risk News

Industry group the European Life Settlement Association (ELSA) published new information recently that provides insight into the status of the regulatory environment of the life settlement industry's secondary market.

The *Secondary Market Regulation* 'fact sheet' shows which states have a regulatory regime, which don't, which types of companies are regulated (and where), and a list of life settlement providers in each state; ELSA has created what it calls the 'Licensed Provider Matrix' (LPM) to illustrate this.

The LPM contains 36 licensed providers; 27 of which are licensed in more than one state, and nine of which are licensed in just one. Life settlement providers play a mandatory role in the industry's secondary market, as they are involved in every (regulated) transaction. They are the buyer on record of the insured's life insurance policy, purchasing this either for a life settlement asset manager, or for their own account. Both of the model acts used in the life settlement industry (either the NCOIL or NAIC) mandate the involvement of these firms. Consequently, the genesis of the endeavour was to better understand where these firms are active, and where they're not.

"The states where most of the transactions occur in the secondary market enjoy plenty of choice for both the asset manager and the consumer. While there are some states where the number of active providers is fewer, competition is still healthy enough that market forces can deliver a fair price"

"We wanted to produce a useful tool not only for the industry, but for the consumer as well," said Chris Wells, Executive Director at ELSA. "It's particularly important for the consumer to know that the firms that they are looking to transact with, whether that be through an intermediary, or directly, are licensed."

Some interesting observations immediately come to mind, including that those who have a policy issued by either an Alaska or Puerto Rico-based life insurer can only sell their policy to one provider (Coventry First and Institutional Life Services, respectively). Another is that there are no states where all 36 providers are licensed.

But according to John Dallas, President of Berkshire Settlements and incoming Chair at the Life Insurance Settlement Association, the main takeaway is that the provider market is well distributed and serves the main corners of the market healthily.

"The states where most of the transactions occur in the secondary market enjoy plenty of choice for both the asset manager and the consumer. While there are some states where the number of active providers is fewer, competition is still healthy enough that market forces can deliver a fair price," he said.

Another unsurprising observation is that, when cross-referencing the providers that completed the most deals in 2022 with the number of states they are licensed in, there's a strong correlation.

What will be interesting to the market is how this data will evolve over time. ELSA's LPM is the only known document mapping the provider market but had this fact sheet been published ten years ago, it would have shown many more providers. Some have gone away because of M&A activity, and some have gone away as a result of simply exiting the market. But the space has been experiencing some consolidation.

"The provider market has definitely seen some contraction in terms of numbers in the past decade," said Wells. "But I'd still say that the data shows that this is a deep market."

The life settlement market has seen little in the way of regulatory change for a few years. US regulator the Securities and Exchange Commission launched a task force back in 2009 to look at the market, and while the Staff did submit a report with recommendations to the Commission, ultimately no regulatory changes resulted. And most of the legal and regulatory noise in the market is generated by litigation at the policy level, whether that be related to cost of insurance increases imposed by carriers, the validity of the insurable interest in a policy, or something else. Providers have, arguably, the most settled market from a regulatory perspective that they have ever had. So, it's unlikely that regulatory change will drive any fundamental developments in the market.

That's not to say that nothing will change in the next few years, however. There is currently significant growth in the direct-to-consumer segment of the provider market, where media advertising is raising awareness among consumers and driving them to transact directly with a provider; whether this growth translates to a further concentration of the dominance of the firms at the top of The Life Settlement Report's annual provider league table remains to be seen. Also, life settlement provider, Abacus Life Settlements, listed on the stock exchange earlier in 2023, the first provider to do so; their results will no doubt provide additional colour into the workings of these firms and might be a catalyst for change.

What will be most interesting to the broader life settlement industry is how this data changes over time. But for now, Dallas says that the data points to a solid market, serving not only the consumer, but the end investor well.

"Providers build relationships and source deals through the intermediated market and some drive deal flow into our space from the direct market. Regardless of the channel, there is a healthy amount of competition in all states, and certainly in those where most of the transaction activity in the secondary market takes place. End investors should be encouraged that the asset managers that they have allocated to are active in a market with many potential counterparties, which helps them from diversification, risk management, and alpha generation perspectives."

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LDI Crisis Spurs UK's Pension Risk Transfer Market in 2023

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A report published by Legal & General at the end of the first half of 2023 predicted the UK's pension risk transfer (PRT) market was on course for one of its busiest years on record and activity has continued at a hectic pace since.

On one day in November two transactions worth a combined $11bn were announced: a $6bn transfer from pharmacy chain Boots' pension fund to Legal & General, and a $5bn bulk annuity deal between retailer Co-op and Rothesay Life.

The background to the high level of activity in the UK's PRT market is the series of 14 interest rate rises by the Bank of England which started in November 2021.

These have moved the base rate from 0.1% to 5.25% and have had the knock-on effect of improving UK pension scheme funding levels.

The explanation is that while rate rises depress asset values they reduce pension scheme liabilities even more, with UK corporate accounting standards discounting pension liabilities using - now elevated - AA corporate bond yields.

> **"Given that the cash contribution to fully settle obligations has moved down with the rise in risk- free rates, the result has been a number of transactions where sponsors have recognised that not having a DB pension scheme on their corporate balance sheet is helpful for their business strategy"**

The UK Pension Protection Fund says a rule of thumb is that while a 0.3% rise in gilt yields reduces scheme asset values by 2.6%, the same increase will see liabilities fall by 5.2%.

But according to Shelly Beard, London-based partner at WTW, it was chaos in the UK gilt market in October 2022 which has been a significant driver of PRT activity in 2023, rather than the overall improvement in scheme funding levels.

A September 2022 budget statement by the UK government spooked the markets, driving a 120bps gilt yield spike in just three days at the start of October. This prompted a panic for pension funds with large liability driven investment (LDI) portfolios which scrambled to meet margin calls on their positions.

"Following the LDI crisis there's been an increased focus on the risks linked to DB pension schemes, leading sponsors to say: 'although we have de-risked the scheme it's still exposed to left field events'," she says

"Given that the cash contribution to fully settle obligations has moved down with the rise in risk-free rates, the result has been a number of transactions where sponsors have recognised that not having a DB pension scheme on their corporate balance sheet is helpful for their business strategy," Beard adds.

Several trends have emerged among the UK PRT sector as sponsors look to de-risk.

One feature of publicly-announced deals is the high number of repeat transactions. One example of this is the Deutsche Bank UK Pension Fund.

The scheme struck a PRT agreement with Legal & General in November. The $610m deal was the second one signed by the bank's pension fund in 2023, after it agreed a $500m transaction with Aviva in April.

It was the scheme's third PRT in total, following a 2021 transaction with Legal & General.

Beard says that schemes which have already completed transactions will have done the preparatory work such as outlining benefit specifications and cleaning up their data.

"Schemes which have previously completed deals will be viewed by the market as having a lower execution risk because they already have the knowledge and governance in place.

It could also be that schemes which were better placed to react post the LDI crisis were the ones which have transacted before. Next year we could see pension funds which haven't previously completed bulk annuities come to market," she says.

The UK's Pension Regulator warned in its annual funding report that the rapid increase in pension scheme funding levels meant that demand for buyouts could potentially outstrip supply in 2023.

Beard says that so far this has not been the case, but while there is sufficient financial resources available the pool of people needed to execute buyout deals is more limited.

"The reinsurance, the assets, and the capital are there. Human resources is the biggest pressure point at the moment and while the market has coped with this, the biggest capacity restraint is currently the availability of people."

Beard also says that one knock-on effect of the strain in human resources has been slow progress by insurers in integrating technology into the buy-out process.

"The pool of schemes that Superfunds appeal to has definitely reduced since 2018, but it is still big enough to support the existing player, and potentially new entrants. Getting the first deal done, combined with the government strongly reconfirming its support for the concept was important. It's a valuable alternative option, albeit now for a smaller part of the market"

She says the sheer number of deals happening in 2023 limited the amount of time that specialists can dedicate to developing this aspect of the business.

According to the managing director, the idiosyncratic nature of pension schemes makes developing standardised tech products for the PRT market difficult. Pension schemes often have a long history and pay different levels of benefits to members.

Add the difference in size from ones containing a handful of members to others which number tens of thousands, and the task of developing a standardised technology solution which can be rolled out across the market becomes more complex.

"If you took 100 pension schemes and asked them for their membership data you would receive 100 different extracts. There's no simple way of adapting processes to allow for that and while the sector wants to use more technology it will be a while before that happens."

Away from the pure bulk annuity sector there have also been some major longevity swap transactions in 2023, such as the $6.4bn deal between the Reinsurance Group of America and the telecoms firm BT in August.

While on a slightly smaller scale Zurich UK and Prudential Financial teamed up to provide a $2.1bn swap for the pension fund of lender Nationwide two months earlier.

Beard points to two drivers for funds opting to strike a longevity swap instead of a bulk purchase annuity.

The first comes from schemes which have not yet reached their buy-out funding target but which have already de-risked their interest rate and inflation risk. This group is looking to stabilise their longevity exposure until it's possible to offload a scheme to an insurer.

Secondly she says that certain pension funds have the scale and in-house infrastructure to manage their DB pension fund and simply do not aspire to buy-out.

"Some of the schemes which have done longevity swaps in recent years are large and capable of running themselves. Because there are fewer of these funds, the longevity swap sector won't take off in the same way as the bulk annuity market, but I expect steady volumes of about £10bn a year will continue."

Another non-bulk annuity pension de-risking deal happened in November, when Clara Pensions signed the first Superfund transaction, which saw retailer Sears transfer 9,600 pension scheme members to the start-up.

The Superfund concept emerged in 2018, and was a UK government initiative intended to form a bridge to insurance buyouts for a pension sector which was then hampered by low interest rates.

Given the recent rapid rise in rates, and in consequence sector-wide funding levels, over the last 18 months the Superfund concept could appear to be past its sell-by-date even before a second deal has been struck.

But Beard says that there are still enough pension funds in need of a transition mechanism and that further players could enter the Superfund sector.

"The pool of schemes that Superfunds appeal to has definitely reduced since 2018, but it is still big enough to support the existing player, and potentially new entrants.

Getting the first deal done, combined with the government strongly reconfirming its support for the concept was important. It's a valuable alternative option, albeit now for a smaller part of the market."

Despite Interesting Nuances, IFRS 17 Impact on UK Bulk Annuity Market Less Than Solvency UK

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Despite Interesting Nuances, IFRS 17 Impact on UK Bulk Annuity Market Less Than Solvency UK

The UK life insurance industry is currently in a period of rapid change.

Not only are life insurers furiously pricing and bidding on bulk annuity contracts from defined benefit pension funds, but they are also trying to find the talent to beef up their teams to support growth in this market.

And not only are they figuring out how to integrate the array of insurtech products now available to them, but they are also in the midst of a sea change in terms of incorporating generative AI into their businesses.

"It took the insurance industry from 1997 to 2020 to get a global accounting standard - 23 years in the making. It's been a long journey to get here, and it's complex and most insurers have faced challenges to differing degrees. It has been quite a challenging process because of the need to set up more systems and infrastructure, particularly to deal with the granular data requirements. Insurers have spent a lot of money on it"

Not only are they having to spend hours in the weeds of spreadsheets and systems to model their asset management strategy because of the planned changes to Solvency II, they are simultaneously dealing with IFRS 17, the first global accounting standards initiative for the insurance industry.

This past year marked the first that UK insurers had to report interim results under the IFRS 17 regime, with divergent practices in terms of the disclosures included at HY 23 and the level of detail included in these disclosures. That's not surprising, given the bigger picture.

"It took the insurance industry from 1997 to 2020 to get a global accounting standard - 23 years in the making. It's been a long journey to get here, and it's complex and most insurers have faced challenges to differing degrees. It has been quite a challenging process because of the need to set up more systems and infrastructure, particularly to deal with the granular data requirements. Insurers have spent a lot of money on it," said Anthony Coughlan, Partner at PwC in London.

But now, here we are, and the beginning of 2024 will see life insurers start to report full year accounts under the new regime for the first time.

One immediate impact of IFRS 17 on the UK's bulk annuity market is at the transparency level, according to Jignesh Mistry, Director at PwC in Bristol, UK, which could lead to a medium-term impact on the asset side.

"Insurers will have to disclose onerous - i.e., unprofitable - business separately from profitable business and the distinction will be based on the premium they charge at outset for the buy-in / buy-out of the scheme. If premiums ultimately aren't enough to cover the liabilities, then insurers will have to report those schemes as onerous. This might help to refine the market in terms of the assets that back a pension transaction and how these deals are constructed," he said.

Additionally, IFRS 17 requires insurers and reinsurers to recognise profits during the course of the contract, as opposed to booking the majority up front (the existing model). However, the impact of longevity assumptions are calculated at the locked-in interest rate at the time the deal is completed rather than at the current discount rate at the time the assumption changes are made, so it's likely that the profitability – or not – of individual schemes will fluctuate.

"To the extent that the current discount rate is different from the locked in rate, this can cause unintuitive volatility in the current year and can be difficult to predict without good information on the locked in rates by year of scheme inception compared to current interest rates. This won't always be systematically more volatile - there could be years where the current rate and locked-in rate are well aligned or where changes in assumptions and the impact due to differences between current and locked-in rates offset, but profitability will be less intuitive and more difficult to predict," said Coughlan.

Mistry refers to the potential for a refining of the assets that back a pension buy-out. The prevailing

interest rate regime has seen some insurers tweak their asset allocation model in the past 18 months as the greater available yield on liquid fixed income makes the risk / return profile of these investments more attractive, at least to an extent, when compared to illiquid credit opportunities.

> **"The Solvency UK reforms will have a much bigger impact on the asset management function of a life insurer than IFRS 17. That's partly because for IFRS 17, a global standard, the UK government has little influence, but with Solvency UK, it has a lot of influence"**

"Some insurers either on adoption of IFRS 17 or through new investments have classified certain assets for accounting purposes so that unrealised gains or losses are not immediately recognised in profit. This is to achieve a better match to the IFRS 17 liabilities (technically, the contractual service margin) with no impact on Solvency II," said Coughlan.

Value in force reinsurance transactions might also see diminished activity as profits will now be deferred, as opposed to being recognised up front.

"The IFRS 17 changes will make VIF securitisation and similar structures less attractive across all lines of business, from an accounting perspective," said Mistry. "However, they may still be attractive from an economic perspective."

Which brings in the proverbial elephant in the room. The UK Government's planned reforms to Solvency II – Solvency UK – call for significant changes that British politicians hope will divert investments into long term assets such as infrastructure and green energy. Whether that happens in the short term or not remains to be seen and ultimately, it's the lawmakers that will have more of a say in how life insurers construct their asset portfolios in the next decade than the accountants will.

"The Solvency UK reforms will have a much bigger impact on the asset management function of a life insurer than IFRS 17," said Mistry. "That's partly because for IFRS 17, a global standard, the UK government has little influence, but with Solvency UK, it has a lot of influence."

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Dementia: An Increasing Global Problem and a Complex Underwriting Condition for the Life Settlement Industry

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The Centers for Disease Control and Prevention emphasises that dementia is not just a specific ailment. It is a broad descriptor for the impairment of cognitive functions such as memory, thinking, and decision-making, which can disrupt daily activities. While dementia predominantly affects the elderly, it is not a natural mode of ageing process. Typical ageing-related changes are physical factors, like muscle and bone weakening, arterial and vessel stiffening, with some minor memory alterations, which tend to leave one's accumulated knowledge, life experiences, old memories, and language capabilities unaltered[1].

When underwriting new applications for a conventional life insurance policy, medical underwriters will not normally come across dementia. This is because the need for life insurance is generally far less by the time someone has reached the age the disease is usually diagnosed (65+), or symptoms begin and medical assistance is sought. Also, from a legal point of view, the application form would need to be completed by the insured (not a Power of Attorney or other third party) so this would often preclude the insurance cover being accepted for someone already suffering from dementia who is unable to complete the relevant documents.

For a life settlements underwriter however, dementia is a condition commonly seen due to older lives being underwritten and the increasing prevalence of the disease. Many factors need to be taken into account when assessing these risks. This article aims to provide a useful overview of the condition and what one needs to be mindful of during the underwriting process.

An increasing global problem

Dementia presents a striking statistical landscape, characterised by a new case emerging approximately every three seconds on a global scale. In 2020, the worldwide count of individuals living with dementia exceeded 55 million, with projections indicating a remarkable near doubling of this figure every two decades. Estimates point towards an increase in case numbers to 78 million by 2030, rising to a staggering 139 million by 2050. This surge is not primarily attributed to an increase in the prevalence of dementia with age but rather to the combined effects of population growth and aging. Nevertheless, research suggests that lifestyle factors may contribute to nearly seven million cases by 2050, with a significant portion of this increase concentrated in developing nations. Currently, 60% of dementia cases are located in low and middle-income countries, a statistic expected to climb to 71% by 2050[2].

> "Dementia presents a striking statistical landscape, characterised by a new case emerging approximately every three seconds on a global scale. In 2020, the worldwide count of individuals living with dementia exceeded 55 million, with projections indicating a remarkable near doubling of this figure every two decades"

According to several studies reported at the 2022 Alzheimer's Association International Conference, socioeconomic deprivation, including neighbourhood disadvantages and persistent low wages, are associated with higher dementia risk, lower cognitive performance, and faster memory decline.

Epidemiologic studies have shown that higher education attainment (as a cognitive-stimulating activity) and household income (permitting more opportunities for healthy lifestyle) are protective for dementia. Conversely, low

[1] What Is Dementia? | CDC
[2] Dementia |WHO
[3] Highlights from AAIC 2022 | Alzheimer's Association

> "In 2015, the estimated global cost of dementia stood at an astounding US$818 billion, constituting approximately 1.09% of the global GDP at that time. Presently, the annual worldwide cost of dementia has surged beyond US$1.3 trillion, with forecasts indicating an impending escalation to US$2.8 trillion by 2030"

occupational employment was found to be associated with increased dementia risk[3].

Spiralling costs

The economic implications of this escalating challenge are substantial. In 2015, the estimated global cost of dementia stood at an astounding US$818 billion, constituting approximately 1.09% of the global GDP at that time. Presently, the annual worldwide cost of dementia has surged beyond US$1.3 trillion, with forecasts indicating an impending escalation to US$2.8 trillion by 2030. Dementia has now become the 7th leading cause of death and a major contributor to disability and dependency among older individuals on a global scale[4].

Different types of dementia

Various types of dementia exist, with the most prevalent including Alzheimer's disease, dementia with Lewy bodies, vascular dementia, fronto-temporal dementia, and young onset dementia.

- Alzheimer's, which comprises approximately 55-70% of all cases, is named after Alois Alzheimer, who first documented the condition, and leads to the destruction of brain cells and disrupts nerve transmissions, particularly those associated with memory storage.
- Vascular dementia is the second most prevalent form and can manifest subsequent to a stroke, or more commonly, several mini-strokes where arteries in the brain become obstructed. The impact on cognitive functions following a stroke is proportional to the severity, number, and locations of the stroke.
- Dementia with Lewy bodies, accounting for approximately 10-15% of dementia cases, shares similarities with Alzheimer's. It arises from abnormal protein accumulations in brain cells, causing disruptions in brain chemistry and nerve cell death. This condition is characterised by the presence of Lewy bodies, which are abnormal protein clusters in brain nerve cells. Lewy body dementia results in complex symptoms, including hallucinations, alterations in alertness and sleep disturbances, often affecting cognitive and motor functions. Memory impairment is typically less severe compared to early-stage Alzheimer's. Two subtypes of Lewy body dementia exist, differing in the onset of symptoms:
  - Dementia with Lewy bodies: Initial symptoms include changes in thinking, visual perception, and sleep, with movement issues occurring simultaneously or later.
  - Parkinson's disease dementia: Initial Parkinson's symptoms precede cognitive changes, although not all individuals with Parkinson's will develop dementia; however, their risk is elevated.
- Frontal lobe dementia shares a similar progressive decline pattern with Alzheimer's but involves more localised brain cell damage, primarily affecting the frontal lobe with a characteristic clinical pattern.
- Young onset dementia affects people before the age of 65.

[4] Dementia statistics | Alzheimer's Disease International (ADI)

> "It is essential to recognise that the presentation of signs and symptoms and the progression can vary from one person to another. By obtaining and assessing this information, along with more general health data, the underwriter will hopefully be able to build a good, overall picture of the insured's health status and provide an accurate life expectancy estimation"

Each person's dementia experience is unique, with similar symptoms across age groups; however, younger individuals with dementia have distinct needs, with the impact on their lives likely to be significantly greater than those of older lives.

Risk factors

There are numerous risk factors that affect the likelihood of developing one or more kinds of dementia. These include the following:

- Age - risk increases with age, usually over the age of 65.
- Genetics/family history - researchers have discovered several genes that increase the risk of developing Alzheimer's disease. Having a family history of Alzheimer's disease is generally considered to be a risk factor for developing the disease, however, many people who have relatives with Alzheimer's disease never develop the disease, and many without a family history of the disease do get it.
- Social risk factors - including smoking, alcohol use, lack of exercise and social isolation.
- Diseases causing atherosclerosis - this can be a significant risk factor for vascular dementia, as it interferes with blood supply to the brain and can lead to strokes. High cholesterol levels, smoking, untreated hypertension, and diabetes are the most common risk factors for atherosclerosis.

Signs and symptoms

The signs and symptoms of dementia can vary depending on the specific type of dementia as each type affects different areas of the brain. These can include the following:

- Memory loss.
- Impaired judgment/confusion.
- Communication challenges.
- Disorientation.
- Financial/daily functioning issues.
- Repetitive behaviours.
- Prolonged task completion.
- Diminished interest.
- Hallucinations/delusions.
- Altered behaviour/impulsivity.
- Motor and balance impairments.

It is essential to recognise that the presentation of signs and symptoms and the progression can vary from one person to another. By obtaining and assessing this information, along with more general health data, the underwriter will hopefully be able to build a good, overall picture of the insured's health status and provide an accurate life expectancy estimation.

Stages of dementia

Dementia is a progressive condition that gradually gets worse over time. The disease affects everyone differently; however, it will generally progress in the following stages:

Early stage
In the initial phase of dementia, often referred to as early or mild dementia, individuals begin to manifest symptoms. These early indicators can sometimes go unnoticed. During this stage, individuals typically retain a degree of

> "Individuals in the late or advanced stage of dementia, often referred to as severe dementia, generally necessitate around-the-clock care, whether in a home setting or within a nursing facility. This stage is associated with a significant reduction in life expectancy"

independence, but they may encounter memory lapses that impact their daily lives, such as difficulties recalling words or locating objects.

Common symptoms associated with early-stage dementia include:

- Early memory impairment, leading to the forgetfulness of recent events
- Alterations in personality, characterised by increased introversion or withdrawal
- Occasional disorientation or difficulties in familiar surroundings
- Challenges with complex problem-solving and tasks, including financial management
- Impaired ability to organise thoughts and express them clearly

Individuals in early phase may also experience heightened feelings of irritation, anxiety, or frustration due to their changing abilities.

Middle stage
Individuals in the middle or intermediate stage of dementia, often referred to as moderate dementia, encounter more pronounced symptoms. The performance of everyday tasks, including dressing, eating, and bathing, become increasingly challenging.

Many individuals may need daily assistance from a caregiver within their home environment. Alternatively, some opt to transition to assisted living facilities that specialise in dementia care.

Key indicators of middle-stage dementia include:

- Confusion and impaired judgement
- Increasing forgetfulness, extending to names of close friends and family members
- Worsened short-term memory loss, often characterised by repetitive behaviours
- Growing long-term memory lapses, leading to the forgetting of events from the distant past
- Occurrence of delirium, paranoia, or hallucinations

Moreover, personality and behavioural alterations may become more frequent, often driven by agitation and unfounded suspicions. These changes may be evident in the following:

- Disturbances in sleep patterns, such as daytime drowsiness and night-time restlessness
- Episodes of screaming, yelling, or shouting
- Sundowning, a state of confusion, disorientation, or restlessness during the evening
- Expressing inappropriate or socially unacceptable statements

The middle stage of dementia typically extends over the longest duration, lasting an average of two to four years.

Late stage
Individuals in the late or advanced stage of dementia, often referred to as severe dementia, generally necessitate around-the-clock care, whether in a home setting or within a nursing facility.

This stage is associated with a significant reduction in life expectancy.

Noteworthy symptoms during this late stage of dementia may include:

- Profound communication impairment, sometimes limited to speaking in one's childhood language or inarticulate sounds

> "Within the realm of Alzheimer's disease, the FDA (Food and Drug Administration) has granted approval to medications that fall into two distinctive categories: The drugs that change disease progression and the drugs that may temporarily mitigate some symptoms of Alzheimer's dementia"

- Distorted perception of time, leading to a distorted sense of temporal reality
- Complete reliance on others for all daily activities, including eating, dressing, and bathing
- Inability to recognize familiar faces, including those of friends, family, or even their own reflection in a mirror
- Severe loss of physical abilities, encompassing the inability to walk, sit, swallow, or support one's head
- Incontinence, resulting in a lack of control over bladder and bowel functions
- Susceptibility to infections, such as pneumonia

The late stage of dementia is typically the shortest phase in the progression of the condition, spanning an average duration of one to two years.

End stage in Dementia
Individuals in the end stage of dementia face an increased vulnerability to numerous medical complications, primarily due to their limited mobility. Individuals are particularly susceptible to specific conditions, including urinary tract infections (UTIs) and pneumonia, which can be attributed to their immobility. Additionally, they may experience skin breakdown, pressure ulcers and an increased risk of blood clots.

Challenges with swallowing, eating, and drinking often result in weight loss, dehydration, and malnutrition, further elevating the risk of infections. Ultimately, a majority of individuals in the late stage of dementia die due to the underlying dementia itself or complications related to the condition.

Available treatments

Within the realm of Alzheimer's disease, the FDA (Food and Drug Administration) has granted approval to medications that fall into two distinctive categories: The drugs that change disease progression and the drugs that may temporarily mitigate some symptoms of Alzheimer's dementia.

Disease Progression-modifying medications
These are treatments that are tailored to slow the progression of Alzheimer's by targeting the underlying biological mechanisms of the disease. Their aim is to decelerate the decline in memory, cognitive abilities, and overall functioning among individuals living.

- **Amyloid-Targeting Approaches**
  These treatments are focused on the removal of beta-amyloid, a protein that accumulates into plaques in the brain. Various treatments within this category target beta-amyloid at different stages of plaque formation. The meaningful impact of these therapies is evident in the early stages of Alzheimer's, allowing affected individuals more time to engage in daily activities and maintaining independent living. Clinical trials have shown that participants receiving anti-amyloid treatments experienced a reduction in cognitive decline as measured by cognitive and functional assessments. Aducanumab and Lecanemab received FDA approval for treatment of early Alzheimer's disease, for individuals with mild cognitive impairment or mild dementia. These have proven to effectively reduce cognitive and functional decline in individuals with early-stage Alzheimer's. Each works differently and targets beta-amyloid at a different stage of plaque formation.

Symptom-alleviating medications
These medications primarily target cognitive symptoms, such as memory and thinking. As the disease progresses, it leads to the loss of brain cells and connections. These medicines don't halt the fundamental damage caused, but

> **"In any form of medical underwriting, the underwriter needs to build up a clear picture of the insured's health status. No one person is the same, so gathering as much information as possible will provide the underwriter with a holistic overview in order to gauge the extent of cognitive and physical deterioration"**

they can temporarily mitigate or stabilise cognitive symptoms by influencing certain chemicals crucial for inter-neuronal communication.

- **Cholinesterase Inhibitors**
  These prevent the breakdown of acetylcholine, a key chemical messenger important for memory and learning. By supporting communication between nerve cells, they address various aspects of memory, thinking, language, judgement, and other cognitive processes.

  Notable cholinesterase inhibitors include Donepezil (approved for all stages of Alzheimer's disease), Rivastigmine (approved for mild-to-moderate Alzheimer's as well as mild-to-moderate dementia associated with Parkinson's disease), and Galantamine (approved for mild-to-moderate stages of Alzheimer's disease).
- **Glutamate Regulators**
  These types of medications are designed to enhance memory, attention, reasoning, language, and the ability to perform simple tasks by regulating glutamate activity. Glutamate is a critical chemical messenger, sending messages between nerve cells in the brain and essential for the brain to function properly. Memantine is an FDA approved glutamate regulator, licensed for use in moderate-to-severe Alzheimer's disease.
- **Deep Brain stimulation**
  Brain stimulation therapies involve the use of electrical currents to either activate or deactivate specific brain functions.

The final cause of death in dementia patients

Dementia is a serious, progressive condition which is eventually terminal. Dementia itself may not be the ultimate cause of death, however, complications of the condition frequently are. The following are often noted to be final causes of death in people suffering with dementia:

- Accidents and incidents (can lead to an increased danger of falls and fractures)
- Food and frailty (inability to eat)
- Aspiration and infections (inability to coordinate breathing and swallowing)
- Co-existing illnesses (dementia can cause complications to other chronic conditions)

The potential impact of Artificial Intelligence (AI) in the diagnosis and treatment of dementia

AI has become part of our lives in many ways, not least in the world of medicine.

Some areas where AI could have a positive impact on dementia are listed below:

- Reduce the financial burden
  - quicker diagnosis and at a lower cost
  - better management of the condition and reduction in the overall financial cost
- Reduced risk of misdiagnosis
- Early detection which would improve the quality of life for those affected
- More efficient treatment
- Assistance with clinical trials
- Machine learning and deep learning methods for dementia diagnosis and progression detection

"As the population continues to age and the prevalence of dementia rises, we anticipate a corresponding increase in underwriting demands for this condition. Therefore, ensuring underwriting guidelines and predicted survival rates are maintained and updated, when necessary, will be essential"

- Overall better information/literature for doctors

What to look for when underwriting a dementia case

In any form of medical underwriting, the underwriter needs to build up a clear picture of the insured's health status. No one person is the same, so gathering as much information as possible will provide the underwriter with a holistic overview in order to gauge the extent of cognitive and physical deterioration. The most recent neurological reviews will provide an up-to-date clinical overview and any details pertaining to the insured's ability to carry out *ADLs/IADLs will be very useful.

This will assist in deciding which stage of dementia the insured has reached and what their future life expectancy may be. Underwriting considerations should include the following:

- Is there a strong family and care support system?
- Is the insured still socially active?
- Which ADLs and IADLs is the insured still capable of doing?
- Is the insured still mobile and doing regular exercise?
- Is the insured bedridden?
- Is there a history of falls and, if so, how frequent are they?
- Is the insured in a sheltered care facility?
- When was dementia first diagnosed?
- How quickly is the insured declining?
- What form of treatment is the insured receiving?
- How good is the nursing care received?
- What other medical conditions are present?
- Is there a 'Do not resuscitate' order in place?

*ADLs - Activities of daily living, for example washing and dressing

IADLs - Instrumental activities of daily living, for example managing medications or finances

Conclusion

Dementia is very complicated in every aspect, from diagnosis to treatment and management. While some elements, like age and genetic predisposition are beyond our control, other factors, such as lifestyle choices and the management of chronic conditions, offer possibilities for potential risk reduction. Understanding the relationship of these factors is crucial in developing effective strategies for dementia prevention and intervention.

Recent news from the NHS (the UK's National Health Service) states that scientists are to begin piloting simple blood tests for dementia that could revolutionise detection of the disease and, within five years, lead to people being diagnosed in seconds. Earlier detection could result in earlier treatment and possibly increased longevity. The trialling of new drugs which could potentially improve the cognitive functioning of dementia sufferers could also have a positive impact on longevity. Remaining up to date with these advancements in order to maintain accurate life estimations is, obviously, critically important.

As the population continues to age and the prevalence of dementia rises, we anticipate a corresponding increase in underwriting demands for this condition. Therefore, ensuring underwriting guidelines and predicted survival rates are maintained and updated, when necessary, will be essential.

November 2023 Poll Results

Is the Recent Uptick in UK Equity Release Activity Sustainable?

Author:
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The equity release market in the UK returned to growth in Q3 this year, the first time in 12 months, according to British industry group, the Equity Release Council.

So, for this month's poll, we wanted to know whether our readers thought this was a turning point for the industry.

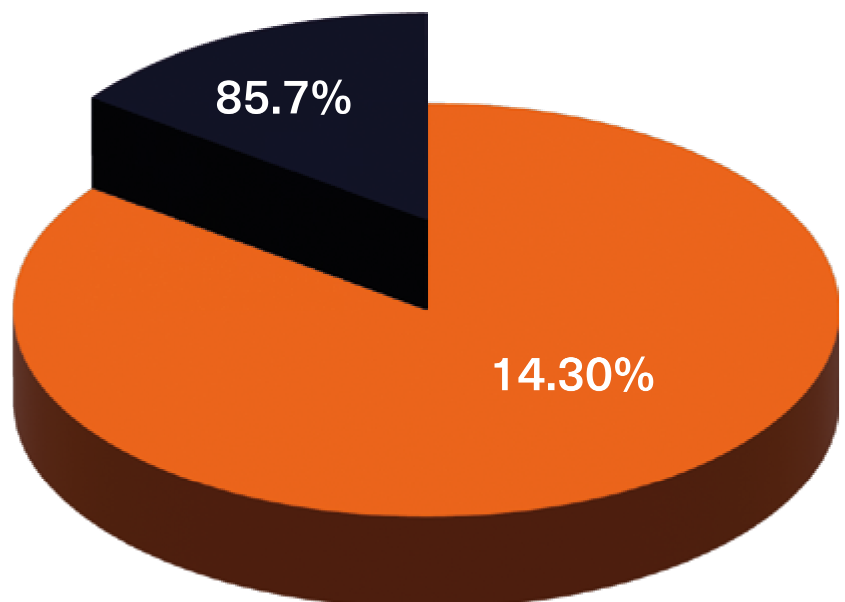
Clearly, there are a lot of bulls out there, as 85.7% of survey respondents thought that the recent growth was sustainable. Only 14.29% were unsure, and nobody thought that the news was a flash in the pan.

The Equity Release Council publishes market statistics each quarter. We'll have to wait until the end of January/early February to see who is right.

Yes – Interest Rates Are Plateauing; Pent Up Demand Will Drive the Market

No – people simply can't afford or justify the costs

Unsure – the macroeconomic outlook is too unclear at the moment



Actual-to-Expected Apocrypha

Author:
Vince Granieri
CEO
Predictive Resources

"The key to unlocking the value of A-to-E is in breaking it down: by age, by gender, by smoking status, by impairment, by mortality multiplier, by year of underwriting, etc. If we turn that single number into many numbers, true insights can be obtained"

Actual-to-Expected Apocrypha

A few months ago, Life Risk News published my commentary article regarding life expectancy (LE) apocrypha. Given the positive feedback I received, I decided to write a follow-up, focusing on industry suppositions about actual to expected analysis (A-to-E), no stranger to controversy over the years.

Although many philosophies and theories about LEs have been proffered by life expectancy providers, virtually every type of participant in the life settlement market has contributed to the apocrypha surrounding actual to expected analysis.

Let's first define actual to expected analysis. According to the actuarial profession, it is the process of calculating and analyzing A/E ratios over a selected time period, (i.e., actual deaths in a group of lives being evaluated, over a specified period divided by the expected deaths, the number of deaths statistically expected over the same period).

With that in mind, consider the following assertions that have been expressed by industry participants, but in my view, are not valid:

A-to-E is a perfect measure of LE provider accuracy

It isn't, at least, if presented as a single number with few or no insights into the methodology behind it. In fact, a single number A-to-E tells us very little (just as using a single number LE instead of the underlying curve can be misleading). An extreme example would be a block of policies where the A-to-E on half of the policies is 150, and the other half is 50; this makes the overall A-to-E 100. Is that perfection? No, it is nowhere near perfect; in fact, it's not even mediocre.

Further, the nature of the A-to-E calculation introduces bias over time. A-to-E trends to 100, even if insureds do not die when expected. For example, an insured who was given a very short LE, say 12 months, lives 75 months and then dies. In month 76, the A-to-E on this policy is 100. That's not helpful.

A-to-E is worthless in assessing LE provider accuracy

Based on the above-noted weaknesses, A-to-E seems worthless. Not true! The key to unlocking the value of A-to-E is in breaking it down: by age, by gender, by smoking status, by impairment, by mortality multiplier, by year of underwriting, etc. If we turn that single number into many numbers, true insights can be obtained.

An A-to-E of 100 is a perfect score

We as an industry did ourselves no favors by proclaiming 100 to be the ideal for A-to-E. The ideal is a consistent A-to-E, when broken down by age, gender, smoking status, etc. Consistency from those specific measurements can be relied upon, and adjustments made to improve accuracy. For example, if an LE provider's A-to-E is 80% across gender, face amount, year underwritten, impairment, multiplier, etc., it is easy to adjust their LEs to eliminate their bias by multiplying each mortality rate by 80%. On the other hand, if there are large differences when these calculations are broken out, it's almost impossible to rely on the LEs or correct for inconsistent bias.

In two recent industry meetings on both sides of the Atlantic, similar questions were asked: If all you LE providers have A-to-Es around 100, why are your individual LEs so different? At the very minimum, it is a result of the fact that the

"Given the importance of the statistic, A-to-E studies should include results with and without IBNR so users of the study can adjust the assumptions should they desire. Unfortunately, many studies do not disclose IBNR, even when it drives the results"

A-to-E statistic, which is an average, bears little resemblance to the individual policies that make it up.

There may be different methods and assumptions employed as well.

Although exploring different A-to-E methodologies is beyond the scope of this commentary, allow me to touch on a particularly important assumption – incurred but not reported deaths (IBNR, for short).

IBNR is a perfect example of good logic gone bad in our business. It's reasonable to expect that when someone dies, that information is not reported for some time. Actuaries have recognized this for decades and that is the genesis of the IBNR assumption. Depending on the time lapse between the period we are studying and the calculation date, most actuaries agree that a 3-5% IBNR is reasonable.

Given the importance of the statistic, A-to-E studies should include results with and without IBNR so users of the study can adjust the assumptions should they desire. Unfortunately, many studies do not disclose IBNR, even when it drives the results. I have heard of IBNR assumptions as high as 60%, although the worst I have actually seen was 38%. All in the name of getting a 100 A-to-E.

How do we make this A-to-E statistic meaningful? By standardizing its calculation, disclosing the underlying methodology and presenting meaningful breakdowns.

A-to-E can be calculated from LEs that do not include a mortality table

Not true. Think about it; if there is no mortality table, how does one calculate expected deaths for a given period? For example, let's assume an LE of 72 months and we want to calculate the A-to-E after 12 months has elapsed. We can easily count the actual deaths. But not the expected deaths.

Some LE providers have used this to their advantage. They never provided a mortality or survival curve with their LEs but insisted that all A-to-E calculations utilize the actual LEs sent to customers. Notice the wording – not the actual survival curves sent to customers, the actual LEs. When it came time to calculate A-to-E, they simply chose a mortality table with low early duration deaths to back solve their LEs into and they could artificially create an A-to-E close to 100.

A lesson learned is customers should require their LE provider to give them the expected survival curves underlying their LEs. Also, they should question any A-to-E results that are not based on the actual survival curves in place at the time the LEs were issued (although there might be a good reason to present a modified analysis along with the historical analysis as seen below).

There are no rules regarding A-to-E calculations

The American Academy of Actuaries set forth rules for calculating A-to-E in what they call Actuarial Standard of Practice (ASOP) Number 48, published in December 2013, to be applied to work done after April 2014. Recognizing that certain misleading practices in calculating A-to-E had crept into the public forum, ASOP 48 was promulgated by the governing actuarial body. Although its official title was Life Settlement Mortality, it contained guidelines for A-to-E calculations too.

ASOP 48 noted two specific bases for use in A-to-E calculations: historical basis and modified basis. Historical basis was the use of a survival curve developed from the base mortality table, mortality improvement factors, mortality multipliers, and other pertinent information for each LE that was used on the original underwriting date. Modified basis was the substitution of any pertinent information other than what was used on the date of original underwriting (for example, a different mortality table or mortality multiplier). Many LE providers calculate A-to-E using their current mortality tables and methods.

Importantly, ASOP 48 clearly states that if a modified basis is presented that the historical basis also be presented if the actuary believes doing so is appropriate. To be fair, this allows some wiggle room, which is unfortunate. However, the

> “A-to-E is imperfect and imperfect analyses of A-to-E will lead to erroneous conclusions. When used properly, A-to-E can be a useful tool in assessing LE provider performance and prescribing modifications to consider when using LE providers’ products”

actuary is required to disclose why those results are not provided, if the historical basis is not presented alongside the modified basis. I cannot think of a good reason why the historical basis results should not be disclosed. I can think of many bad reasons.

The Historical Basis A-to-E is preferable to a modified basis that utilizes current methodology

Some folks suggest that the only meaningful A-to-E statistic is the historical basis, i.e., the mortality table and mortality multiplier that was used to create the LE initially. Certainly, this is important information, and it speaks to the accuracy of an LE provider’s work over a long period of time.

However, a modified basis A-to-E, under the right circumstances, is also very useful. Use of the LE provider’s current mortality table and underwriting debits is particularly valuable in that it indicates whether the modifications the LE provider made to their tables and debiting over time resulted in a more accurate product going forward.

Substituting a VBT will not affect LE accuracy

Advocates of the VBT should not be surprised to find that it overstates deaths vis-à-vis a life settlements mortality table. Therefore, substituting the VBT in a life settlement underwriting will result in an understated LE. The corresponding A-to-E using this approach can be significantly lower – 20 points in our recent calculations.

A-to-E cannot be helpful in determining underwriting changes

Like many other assertions in this paper, under certain circumstances, it could be true, even though under others, it is clearly false. It is true that the single number A-to-E is virtually useless in determining changes. However, as we saw above, more granular breakdowns can provide actionable information. For example, a by impairment or age band breakdown can point to areas of concern.

This brings us to the final topic. Your due diligence should include a discussion with the LE provider on how, how often, and under what circumstances are changes implemented in their LE methodology. Data should be the decider of the timing. Regression models can be utilized to determine changes in the debits and credits, but A-to-E (of the portion of lives in our data base that have no or very minor impairments) could be used to determine if base mortality table changes are warranted.

A-to-E is imperfect and imperfect analyses of A-to-E will lead to erroneous conclusions. When used properly, A-to-E can be a useful tool in assessing LE provider performance and prescribing modifications to consider when using LE providers’ products.

Life ILS Conference 2024

Registration information coming soon.

TUESDAY 21ST MAY 2024

LONDON, UK

Q&A

Chris Conway
Chief Development Officer, ISC Services

ISC Services Chief Development Officer, Chris Conway, has recently joined the Executive Board of industry group, the European Life Settlement Association (ELSA). Greg Winterton spoke to Conway to get his thoughts on the current state of the life settlement market and what his hopes are for 2024.

GW: Chris, let's start with something of a retrospective. How would you describe how 2023 has been for the life settlement industry overall and why?

CC: My sense of the market is that it is continuing to grow, albeit slowly, due to the recent, significant rise in interest rates, which makes raising capital more challenging than it has been the case in the past twenty years. Of course, the perennial issues associated with the lack of awareness among American consumers as to selling their unwanted or unneeded policies, the degree to which the efficiencies that should have been employed by the market in terms of technology that is available and legal but grossly underutilised, and the still pervasive efforts on the part of carriers to impeded that growth in various ways, are challenges. Fortunately, the market not only continues to persist, but it appears to me to be re-tooling its appeal in the current economic environment to remain an attractive alternative to capital markets all over the world.

GW: When we spoke in July 2022, you said that you feel that the end investor doesn't get into the weeds of the life expectancy underwriting part of the industry during their due diligence efforts as much as you think they should. Is that still the case? If so, is there anything that can be done about it?

CC: The number of firms approaching us to conduct formal due diligence hasn't changed since our last conversation. I don't know if that's true for our competitors, but I suspect for the most part it is. It also seems as though there are more internal underwriting resources, meaning for most participants an individual or two with some form of underwriting or medical background, in more places. However, how these personnel are applied is difficult to discern, as is the degree to which they are specifically trained to conduct the underwriting employed by the commercial life expectancy firms.

I do think more due diligence should be done directly with the commercial companies, including ours, but perhaps there are reasons I've yet to hear as to why the few exercises of this sort that are conducted occur after significant sums have already been invested. Having said all this, ours is a very difficult activity to get a firm handle on, and the adage "it's an art and a science," still holds true.

GW: Back in September, you joined the Executive Board of ELSA. You have also served as the Chair of the Life Insurance Settlement Association (LISA) a few years ago. What knowledge from your time at LISA will you be bringing to ELSA?

CC: I hope I am able to contribute to ELSA by bringing my understanding of the different sectors of the marketplace LISA serves, such as the broker community, as well as some ability to liaise between the two groups. I also think there may be a growing need for an increasing degree of legislative and regulatory advocacy work to be conducted in the US and I hope I can assist ELSA's members to understand and support such efforts for the benefit of the global marketplace. I also see ELSA as being a likely gateway for the entry of market participants from outside Europe, and to the degree I am able, I would like to serve as an additional emissary for these parties when they engage with LISA to help them understand the different nature and purpose of both associations and their complementary strengths that support the industry.

GW: Is there anything in particular that you are keen to be more involved in during the three years that you'll be on the ELSA Executive

Board?

CC: As you know, I am generally inclined to volunteer for nearly anything that has the potential to develop, support and further demonstrate the value and legitimacy of the marketplace.

ELSA's more broad view of 'life risk' is something I need to engage with more broadly and I am eager to find ways to not only understand the larger space more fully, but also to try and engage similar parties operating in other markets, both in the US and abroad. I also hope to continue work with Life Risk News, which it has been a sincere pleasure to be a part of.

GW: Finishing up with something of an outlook question, Chris. Fast forward to this time next year. What needs to happen in 2024 for the life settlement industry to consider it a good year?

CC: I think if we can successfully make the case that the life risk asset class, and life settlements in particular, properly managed of course, offers attractive features and benefits regardless of the macro-economic environment du jour, and in so doing continue to attract capital from around the globe, we should consider it a win.

Given how small an industry life settlements still is, and with the world as it is currently, from a variety of perspectives, I'd be happy to see us continue on our present path, and re-demonstrate the persistence of a good idea that's still a bit too much of a secret. In short, every year we endure we grow, and I expect that trend to continue.

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Reinsurance Concentration Risks Point to Inevitable Future for Longevity Risk Transfer Market

Author:
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Life Risk News

Whilst 2023 is not quite in the books just yet, it has been another busy year in the UK pension risk transfer (PRT) market. In October, consulting firm Barnett Waddingham published a blog post suggesting that this year is set to break records in terms of both the number and volume of deals.

Those in the UK licking their lips at the prospect for 2024 bringing ever more deals might want to rein in their excitement, as the regulator is paying close attention.

In mid-November, the Bank of England's Prudential Regulation Authority (PRA) issued a consultation about the funded reinsurance market, in which it identifies four areas of potential risks posed by the funded reinsurance space; probability of recapture, correlated probability of recapture, loss given recapture, and management actions.

> "When an extreme mortality event, like Covid, occurs it is almost certain to produce an offsetting move in a reinsurer's longevity exposures in the form of reduced liabilities. However, in extreme longevity scenarios resulting from broad-based increases in life expectancy, it's less certain to produce significant gains from a reinsurer's mortality business as these are typically shorter duration contracts whose pricing can reset to current expectations about mortality"

The consultation comes on the heels of a letter published in June which the PRA sent to chief risk officers that explained its preliminary thematic review work on funded reinsurance arrangements, and a speech at a conference in April by Charlotte Gerken, Executive Director for Insurance Supervision, in which she expressed concerns about the exposure to illiquid assets during the buy-in or buy-out journey.

Time will tell what the PRA plans to do to address these risks. But another risk looms much larger over the entire industry – that of overall concentration risk.

"What the PRT insurers are doing – in the UK, the Netherlands, the US – to avoid being overly exposed to longevity risk is that they transfer it to reinsurers using longevity swaps. But all of these insurers are hedging their longevity risk with the same limited number of life reinsurers," said David Schrager, CFO at Longitude Exchange.

For life reinsurers, a natural hedge exists on their balance sheet – that of mortality risk. The problem is that, as a hedge, it's not quite as effective as it might appear on the surface, according to Avery Michaelson, CEO at Longitude Exchange.

"When an extreme mortality event, like Covid, occurs it is almost certain to produce an offsetting move in a reinsurer's longevity exposures in the form of reduced liabilities. However, in extreme longevity scenarios resulting from broad-based increases in life expectancy, it's less certain to produce significant gains from a reinsurer's mortality business as these are typically shorter duration contracts whose pricing can reset to current expectations about mortality."

The second problem noted by Michaelson is that the scope for this offset is not unlimited.

"The pension risk transfer market is growing at a blistering rate as higher interest rates have accelerated a structural change that's been underway for over a decade. For those reinsurers that have been writing longevity swaps for that whole period, a good portion of the mortality offset has been used up, and the demand for longevity risk capacity is growing much faster than for mortality."

Those in the market have known about the bigger picture for more than a decade. Back in 2014, Michaelson, then at Société Générale, co-authored a paper entitled, '*Strategy for Increasing the Global Capacity for Longevity Risk Transfer: Developing Transactions that Attract Capital Markets Investors,*' that showed that the entire insurance industry – including non-life – held approximately $3.6trn in assets at the time. Similarly, the approximate retirement obligation of OECD countries was between $60-80trn.

Michaelson and Schrager, along with longevity experts Prof Andrew Cairns and Prof David Blake,

are spearheading a new organisation, the Index Longevity Market Action Committee (ILMAC).

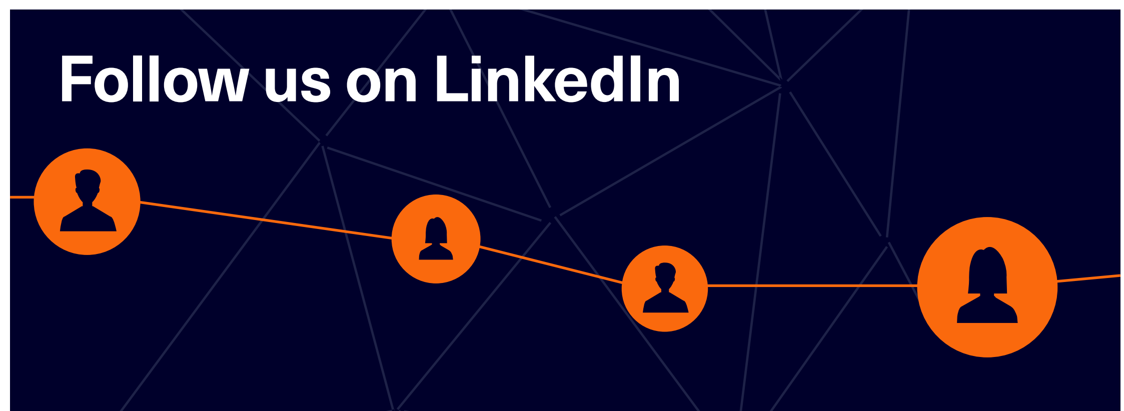
The organisation was formed to promote the use of index-based longevity hedging – enabling greater participation from capital markets investors such as asset managers and sovereign wealth funds as the risk-holder – as an alternative option for pensions and insurers to transfer away longevity risk. In this model, capital markets investors assume the longevity risk over and above a certain level based upon a general-population mortality index. By providing a broad and diversified set of new counterparties, this model would go some way to diluting the concentration risk currently present – and growing – in the market.

“It’s not sustainable to move all of the longevity risk globally to just a few balance sheets – this could introduce a ‘too big to fail’ situation that regulators are right to be concerned about. The natural solution is to encourage greater involvement from the capital markets”

The process to involve the capital markets is not without its challenges, which provided part of the impetus for forming ILMAC. The committee is currently working on a case study that calculates the capital relief a Solvency II insurer could take using an index-based longevity hedge, considering factors like basis risk; this is a key part of the requirement to get regulatory approval for this model.

That could take some time. In the short term, the market will be watching the FundedRe consultation, which closes in February, and any changes that the PRA wishes to implement to de-risk the bulk annuity reinsurance market. But in the long term, for Michaelson and ILMAC, the future is inevitable.

“There could be as much as $500bn of longevity risk transfer demand annually, which is nearly the same size as the entire reinsurance industry,” said Michaelson. “It’s not sustainable to move all of the longevity risk globally to just a few balance sheets – this could introduce a ’too big to fail’ situation that regulators are right to be concerned about. The natural solution is to encourage greater involvement from the capital markets.”



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