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Despite Bumpy Couple of Years, Lessons Learned Stand Life ILS Market in Good Stead

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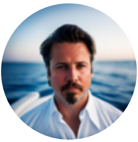

Chris Wells
Managing Editor
Life Risk News

Both the Covid-19 pandemic and the recent changing macroeconomic environment have had something of a longer-term impact on the life ILS market, in terms of deal activity particularly. *Greg Winterton* spoke to **Craig Gillespie**, Head of Life and Alternative Credit at **Leadenhall Capital Partners**, and **Luca Tres**, Head of Strategic Risk and Capital Life Solutions, EMEA at **Guy Carpenter**, toget their thoughts on the topic in *Despite Bumpy Couple of Years, Lessons Learned Stand Life ILS Market in Good Stead*.

Nearly seven million Americans over 65 had Alzheimer's dementia in 2023, according to figures from the US Alzheimer's Association (USAZ), which estimates that this accounts for one in nine of the total population in this age group. *Aaron Woolner* spoke to **Prachi Patkee**, Life & Health R&D Analyst at **Swiss Re**, and **Dr Logan DuBose**, Resident Physician at **The George Washington University Hospital** and co-founder of **Olera**, to learn more about treatments, managing the disease and the outlook for a cure in *Researchers Make Slow Progress in Search for Effective Alzheimer's Treatments.*

In May last year The Netherlands Future of Pensions Act was approved by lawmakers and came into force on 1st July 2023 but November elections in the country brought in a new coalition government made-up of four parties, three of which campaigned on manifestos containing pledges to make major changes to the act. *Aaron Woolner* spoke to **Tim Burggraaf**, Rewards and Benefits Consulting Leader for **EY** in the Netherlands, to get his views on the potential impact of the regulations on the country's pension risk transfer market in *Uncertainty Over Dutch Pension Reforms 'Impact on PRT Activity*.

The life settlement industry has historically taken some criticism from certain quarters in terms of the morality of the asset class. **James W. Maxson**, Partner at law firm **EM3 Law**, steps up to challenge the naysayers in *The Moral Case for Life Settlements.*

Last month, **Roger Lawrence**, Managing Director at **WL Consulting**, penned an analysis piece focusing on 2022's developments in surrenders, new business and solvency from the ACLI's Life Insurance Fact Book. *Stability Evident in US Life Insurer Ownership, Size and Solvency* is a follow-up piece this month.

As investors increasingly seek investments that align with their values, the life settlement industry has found itself under the spotlight, presenting a unique challenge and opportunity at the intersection of finance and ethical considerations. **Hanna Persson**, Head of Sales and Investor Relations at **Ress Capital**, offers some thoughts on this topic in *Navigating the Intersection of ESG and Life Settlements*.

The past few years have been arguably the most significant ever to those studying longevity and mortality, with a range of issues impacting the field, and consequently, actuaries and risk holders. *Greg Winterton* spoke to **Nicola Oliver**, Director of Life and Health at **Medical Intelligence**, to get her thoughts on the current state of the space in this month's *Q&A*.

The reverse mortgage market in the US has had a tough time of it in recent years but a recent announcement from Ginnie Mae has provided cause for optimism for those in the space. *Greg Winterton* spoke to **Michael McCully** and **Joe Kelly**, both Partners at **New View Advisors**, to get their views on this development in *Potential New Securitisation Product a Welcome Development for US Reverse Mortgage Industry*.

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

Despite Bumpy Couple of Years, Lessons Learned Stand Life ILS Market in Good Stead

Author:
Greg Winterton
Contributing Editor
Life Risk News

The alternative credit industry experienced something of an up-and-down year in 2023. On one hand, fundraising pulled back as investors rotated into more liquid, higher yielding credit investments, and on the other, existing funds, particularly in the private debt space, with floating rate loans enjoyed higher returns.

The impact of higher interest rates was certainly felt keenly in the life ILS corner of the alternative credit space last year, in both capital raising and deal activity. In the former, the reasons were consistent with the alternative credit market at large.

But in deal flow, certain trades experienced a retraction in activity. One example is value in force (VIF) deals, a transaction where asset managers pay a discounted upfront cash sum to an insurer in return for the payment stream of a block of insurance policies.

> **"Insurance businesses that still have a need for capital or liquidity have had to pay up the increased all in rates of financing. There's been something of a flight to quality, where we've focused on working selectively with the best counterparties and pipeline opportunities in the market"**
> **- Craig Gillespie, Leadenhall Capital Partners**

"The rise in interest rates in conjunction with a widening of risk spreads has led to higher absolute costs of financing which has presented challenges to investment counterparties. That higher cost of financing has an impact on the appetite for certain VIF structures because sellers and suppliers of risk are having to pay more than in the past. Some counterparties are questioning whether or not they're comfortable printing at the top of the cycle," says Craig Gillespie, Head of Life and Alternative Credit at investment manager, Leadenhall Capital Partners.

But whilst there may be a contraction in the supply of VIF transactions, higher rates are providing an opportunity for managers in the space to be more selective with regards to the deals that they do underwrite.

"Insurance businesses that still have a need for capital or liquidity have had to pay up the increased all in rates of financing. There's been something of a flight to quality, where we've focused on working selectively with the best counterparties and pipeline opportunities in the market – there's the opportunity to earn an increased spread whilst taking less risk than in recent periods. We're being more prescriptive in terms of where we allocate capital," added Gillespie.

In January, the US Federal Reserve kept its Federal Funds Rate flat for the fourth consecutive time, and the European Central Bank's three main interest rates also remained constant. The UK's Bank of England hasn't increased its Base Rate since last August. Couple this with falling inflation adds up to encouragement in consumer and political circles that the recent rising interest rate regime has plateaued. But, even if markets are now at the top of the interest rate cycle, and at some point this year, interest rates began to fall, the floodgates won't necessarily re-open.

That's because both the Covid-19 pandemic and the recent macroeconomic environment have had something of a longer-term impact on the life ILS market, conspiring together to force investors in the market to re-evaluate certain aspects of their deal origination function.

"Covid underlined the fact that, from an actuarial perspective, populations are not created equally. During the pandemic, certain socio-economic groups were impacted by excess mortality more than others. General population mortality-based investment structures haven't fared very well in the past few years, which means that our underwriting efforts are being further refined according to the underlying population exposure," says Gillespie.

Recent macroeconomic events and the stronger volatility and uncertainty have also had an impact on how insurance companies approach capital solutions.

"In general, we see a strong increase in derisking and capital management activity in the European life insurance landscape. The bulk of the risk goes to the reinsurance industry but clearly Life ILS can play an increasingly relevant role moving

forward. Whereas in the past the role of Life ILS was predominantly on the financing front, the end investors often now require ILS managers to revert to more biometric risk-driven investments or, 'back to basics' as they like to say," says Luca Tres, Head of Strategic Risk and Capital Life Solutions, EMEA at insurance consulting firm, Guy Carpenter.

However, there is still, and will always be, appetite for financing solutions from the life insurance segment.

"This development in itself hasn't changed the investment case for life ILS. The demand from life insurers and other life-linked insurance businesses for financing solutions is there. The supply of capital is there because investors need and want medium to long-dated exposures that offer differentiated risk-return profiles to the main capital markets. If anything, the events of the past few years have served to strengthen the offering by making the investment processes that underpin it more robust."

> **"The Life ILS market introduces a differentiated capacity in the financing space, specifically for opportunities with a strong biometrical or lapse component. Therefore, it is clear that Life ILS will continue to be a strategic partner for the life (re)insurance industry"**
> **- Luca Tres, Guy Carpenter**

"Sitting in-between capital markets and the life (re)insurance industry, the Life ILS market introduces a differentiated capacity in the financing space, specifically for opportunities with a strong biometrical or lapse component. Therefore, it is clear that Life ILS will continue to be a strategic partner for the life (re)insurance industry", adds Tres.

There's a saying in the family office space that when you've met one family office, you've met one family office. The same could be said for the life ILS industry; not all asset managers enter into the same types of transactions, leading to less homogeneity within the space when compared to, say, the non-life ILS catastrophe bond market. The complexity of insurance-linked transactions when compared to other alternative credit strategies means that investor education is ongoing, and macroeconomic cyclicality has impacted the space like it has many private markets strategies.

But for Gillespie, the lessons of the past few years will prove beneficial in the medium to longer term, and overall, the message to investors remains.

"The life ILS space has actually been around for many years, but for the first 10, it was a relatively benign market. We've had two major tests in the last five years that have put certain investment structures to the test. These tests have helped the life ILS market to understand where the true risk premiums should lie, and whether these are aligned to the actual losses that could materialise when an event happens," he says.

Researchers Make Slow Progress in Search for Effective Alzheimer's Treatments

Author:
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Life Risk News

Nearly seven million Americans over 65 had Alzheimer's dementia in 2023, according to figures from the US Alzheimer's Association (USAZ).

USAZ estimates this accounts for one in nine of the total population in this age group, a figure that rises sharply as people get older with one third of those over the age of 85 having some form of the disease.

According to Swiss Re's 2023, 'Future of life expectancy' report, Alzheimer's accounts for up to 80% of the total number of dementia sufferers, a group that the firm predicts will expand in size as societies age.

Despite over $40bn of cumulative private expenditure on clinical stage Alzheimer's treatment R&D being invested since 1995 results so far have been slight.

The US Food and Drug Administration (FDA) has only approved acetylcholinesterase inhibitors such as donepezil, rivastigmine, galantamine and memantine which only aim to reduce cognitive decline and don't halt progression of the disease.

> **"The challenge at the moment, is that there is little available which treats the underlying condition in Alzheimer's disease"**
> **- Prachi Patkee, Swiss Re**

There are treatments which are intended to halt the disease's progress, but treating the root cause has thus far proven difficult.

"The challenge at the moment, is that there is little available which treats the underlying condition in Alzheimer's disease," says Prachi Patkee, Life & Health R&D Analyst at Swiss Re and one of the report's authors.

"This often means that by the time somebody gets this diagnosis they are symptomatic, and the disease has really cemented itself within their brain. It almost requires a miracle drug to undo the damage," Patkee adds.

But what actually is Alzheimer's?

"The neuropathological hallmarks of Alzheimer's are a consequence of the abnormal aggregation of two different proteins, amyloid which causes plaques, and tau which leads to neurofibrillary tangles on the brain.

"Ultimately these changes result in neuronal loss which impacts cognition and functioning," says Patkee.

According to Patkee, medications, such as acetylcholinesterase inhibitors, can't reverse the disease, but are attempts to improve quality of life by improving the day-to-day functioning and providing symptomatic relief.

"It's trying to treat the symptoms such as memory loss but does not address the underlying cause," she says.

The complex pathophysiology of Alzheimer's presents challenges for breakthroughs in curative treatments and extending life expectancy says Dr Logan DuBose, Resident Physician at The George Washington University Hospital and co-founder of Olera, a tech platform for old age care provision.

DuBose says the problems start with how to diagnose Alzheimer's.

"While we do test for beta amyloid plaques to differentiate markers on a biophysical level that distinguish this sort of Alzheimer's, we don't make that distinction in common clinical practice only in very thorough research."

There are two additional barriers to diagnosing Alzheimer's, says DuBose. Sufferers have low insight over their condition which typically means a carer needs to bring symptoms to a doctor's attention.

"The second red herring is called spotlighting. People perform when the spotlight is on them. Alzheimer's sufferers are very intelligent individuals. It's just they're a little slower. They know their stage and they will play to the spotlight. Their low insight over their condition means they can deny having it and they are able to fool a clinician on a 15-to-20-minute visit."

There is some cause for optimism, however. Patkee says that while the current generation of medicine may fall short it does demonstrate progress towards finding effective treatments.

"We're on the right path in terms of finding a way to treat Alzheimer's and there is something in scope in a field where previously there was nothing."

Development of Alzheimer's treatments is still at the early stages and Patkee says that even if drugs which clear the underlying pathology develop it will be 10 to 15 years before medications which slow down the speed at which Alzheimer's develops appear.

She instead points to other developments which could improve the disease's treatment.

"Diagnosing Alzheimer's earlier would help us give someone a better quality of life."

"Everybody's talking about these expensive medicines that are being tested like they are the answer but the proper treatment for Alzheimer's is a good environment. It's social activity and wellness. It's exercising and meaningful relationships. It's sun during the day and dark during the night. It's good food, not poor food. It's no alcohol or drugs. It's really basic stuff"
- Dr Logan DuBose, The George Washington University Hospital

Patkee adds focusing on an individual's underlying health would be worthwhile in potentially reducing the risks faced by Alzheimer's sufferers. This includes factors such as a positive metabolic health profile including a controlled diet and weight, the absence of high blood pressure, cholesterol levels and smoking.

"Maintaining a healthy physical lifestyle and mental wellbeing ultimately helps to keep you living longer and healthier, ensuring that you avoid developing other comorbidities such as diabetes or cardiovascular disease which add to the potential burden that may result in an Alzheimer's diagnosis. At this stage, that's the best that an individual can do for themselves," she says.

DuBose echoes Patkee's thoughts and says that while there is a large expectation around potential breakthroughs in Alzheimer's treatments, a more productive approach would be to look at patients' overall wellness.

"Everybody's talking about these expensive medicines that are being tested like they are the answer but the proper treatment for Alzheimer's is a good environment.

"It's social activity and wellness. It's exercising and meaningful relationships. It's sun during the day and dark during the night. It's good food, not poor food. It's no alcohol or drugs. It's really basic stuff."

USAZ hosts an annual event called the 'Race to end Alzheimer's', which aims to raise enough money to fund research which will eliminate the disease but DuBose says that improving support networks for Alzheimer's sufferers could bring more tangible benefits.

"Ending Alzheimer's is a nice idea but it's just not a realistic goal. We instead need to focus all of our efforts in developing the social infrastructure.

This would help to address the Alzheimer's situation, that isn't to say that therapeutics should be ignored, but instead, as much money, if not more, should be put into our long-term care infrastructure, because that's where we're going to start extending life," says DuBose.

Uncertainty Over Dutch Pension Reforms' Impact on PRT Activity

Author:
Aaron Woolner
Contributing Editor
Life Risk News

In May last year The Netherlands Future of Pensions Act was approved by lawmakers and came into force on 1st July 2023. The new law heralds a step-change in the Dutch pension industry and a wholesale switch away from a defined benefit-based system.

Subject to a four-year transition period, all pension providers in the Netherlands need to switch from defined benefit (DB) model to a defined contribution (DC) one by 1st January 2027.

But November elections in the country brought in a new coalition government made-up of four parties, three of which campaigned on manifestos containing pledges to make major changes to the act.

> **"Let's assume that the law will remain unchanged, at least for the most significant pieces. What that means is that most of the existing compulsory industry wide DB plans will switch to a DC basis"**
> **- Tim Burggraaf, EY**

According to IPE, Socialist Party MP Bart van Kent kicked off a recent parliamentary debate by saying that pension funds should stop preparing for the DC transition because of the change in the Dutch political landscape.

Tim Burggraaf, Rewards and Benefits Consulting Leader for EY in the Netherlands spoke to Life Risk News the day after the parliamentary debate and he is working to the assumption that the planned changes will go ahead.

"There's a very significant change in how the current legislature thinks about the retirement plan that was put in place last year, and as a result there is a lot of political debate going on. But let's assume that the law will remain unchanged, at least for the most significant pieces. What that means is that most of the existing compulsory industry wide DB plans will switch to a DC basis," he says.

"And even pensioners will have variable annuities after they retire, that are aligned with changes in the economics. If the solvency rate of the fund goes down, then payments are adjusted accordingly. If the solvency ratio goes up payments increase. These changes will be made on an annual basis," Burggraaf adds.

The resurgent bulk purchase annuity market in the UK and the US has been a by-product of the wholesale shuttering of DB pension plans.

Burggraaf says, however, that the outlook for the Dutch pension risk transfer market is unclear.

"If every fund takes the default approach as set out in the legislation then there will be very little room left for longevity swaps because there won't be fixed payments anymore in the pension sector. This will only be a feature of the insurance industry."

A caveat is that while the standard approach won't leave any room for longevity swaps, and an absence of fixed benefits would also undermine the main demand driver for pension funds to strike buy-in deals with insurers, this route is not the only option.

And funds which don't opt for the standard approach could in turn later move towards a buy-in.

"Pension funds can decide not to follow the default route in the legislation. There's all kinds of reasons why that may not be a good idea. And then they could do a buy-out of the whole pension fund to an insurance company," Burggraaf says.

"There could be a number of funds that opt not to make the switch and EY estimates that currently about one third of pension funds in the Netherlands will not be moving their assets into a new DC plan. These will essentially all be closed plans. For this segment I can imagine that a buy-out may be interesting."

Burggraaf says that as these funds mature and reduce in size they could also opt for buy-out.

"It is likely that a significant group will retain the DB plan in the fund, set-up a new fund and then slowly unwind the legacy scheme. And for those where there's not enough assets left in their DB fund it is likely they will go into buyout mode.

"If the legacy fund is significant, some funds will continue to the point where they say, 'now it's too small, it's no longer viable, the cost ratio is not okay and we are spending too much money on a small

group of pensioners'. That is probably the moment these schemes will look to a buy-out. Some may be at that point now and others will reach it in a few years."

The Dutch pension fund sector is huge, containing $1.3trn of assets under management – significantly bigger than the country's 2022 GDP which was just shy of one trillion dollars.

This means that even if only a portion of the Dutch pension sector eventually moves towards a buy-out it could be too large for the domestic market to handle. Burggraaf says at this point Dutch pension fund assets could find their way to the global reinsurance market.

"If large buy-outs come into play it could well be that the market isn't able to swallow all of it. Then it becomes quite likely that insurance companies will be looking to reinsure part of that. It really depends on the amount of buy-out deals that come onto the market."

Burggraaf says that Dutch lawyers have already warned that this could potentially swamp the domestic legal system with cases from unhappy pension scheme members and he has his own doubts about the plan.

"Changing a DB system to DC in this way has never been done before. So that means, either we as Dutch are brilliant and have figured out something that the whole world hasn't yet. Or we are extremely stupid. And I don't know which of the two it's going to be.

"I'm hesitant. My usual starting point is if the whole world hasn't figured something out yet then maybe it's not a good idea."

> **"If large buy-outs come into play it could well be that the market isn't able to swallow all of it. Then it becomes quite likely that insurance companies will be looking to reinsure part of that. It really depends on the amount of buy-out deals that come onto the market"**
> **- Tim Burggraaf, EY**

While there is still a cloud of political uncertainty hanging over the Dutch pension fund sector, if the plans do go ahead in full, the Netherlands will become the first country to switch from a DB to a DC model without gaining the consent of scheme members.

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The Moral Case for Life Settlements

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Most articles advocating in favor of life settlements[1] do so with a hat tip toward compassion and fairness, but generally focus primarily on the economic benefits that a life settlement offers policy owners. Conversely, detractors of life settlements transactions frequently point to abuses, real and perceived, suffered by the sick and/or older individuals who are the primary sellers of life insurance policies. While there are reasonable bases for both positions, life settlements transactions present a person who no longer wants or needs their life insurance the opportunity to monetize an otherwise illiquid asset. While life settlements transactions undeniably benefit policy sellers, rarely is the question asked - are life settlement transactions ethically and morally justified? Put another way, are the benefits of these transactions outweighed by any potential moral injury done to society by permitting such transactions?

In the context of analyzing whether life settlements are ethical and moral, it must be noted that there is no dispute as to whether such transactions are legal[2]. In the last three decades, 45 of the 50 United States[3], as well as Puerto Rico and the District of Columbia, have passed legislation regulating life settlements transactions and enacting protections for the sellers of policies and the lives insured thereunder. Life settlements laws address the mechanics of these transactions, requiring, among other things, that policy sellers and insureds receive certain disclosures about the consequences of selling a policy and putting in place safeguards to ensure policy sellers receive the proceeds from the sale in a timely manner. It is, however, axiomatic that just because something is legal, it is not necessarily moral or ethical.

> **"While life settlements transactions undeniably benefit policy sellers, rarely is the question asked - are life settlement transactions ethically and morally justified? Put another way, are the benefits of these transactions outweighed by any potential moral injury done to society by permitting such transactions?"**

The arguments that life settlements transactions are neither moral nor ethical can be grouped into two general categories: First, the fact that anyone, and particularly an investor, could profit from the death of another human being increases the probability of foul play befalling an insured and is inherently immoral and unethical;[4] and, second, that life settlements transactions erode fundamental principles of mutual dignity and respect because at the core of these transactions is the commoditization of human life, thereby undercutting the natural respect and dignity of persons[5].

While these arguments are worth considering, the first is quickly disposed of as unsupported by any empirical data. The second assertion places undue emphasis on what its proponents perceive as an erosion of the common bonds that tie a society together and gives insufficient weight to a more fundamental aspect of a moral and ethical society: autonomy. Before proceeding further, it is useful to set out an analytical framework for how the concept of autonomy is relevant to the question of whether life settlements are ethical and moral transactions. Questions of ethics and morality are by their very nature relative to the moral schema to which a society subscribes. The renowned British philosopher, A.N. Whitehead, reportedly once commented on the writings of Plato, that: "The safest general characterization of the European philosophical tradition is that it consists of a series of footnotes to Plato," or, more colloquially, "all Western philosophy is but a footnote to Plato." It is obviously impossible to know how Plato, or his most renowned student, Aristotle, would view life settlements transactions (the first life insurance policy was not issued until approximately two millennia after their births). And, while it might not occur to most to use their philosophies as a lens to view life settlements transactions, given the ubiquity and pervasive influence of their teachings in in Western philosophy, using their works as the departure point for this analysis is relevant and useful.

A final layer of cultural relevance to this discussion is the fact that, due to the comparatively unique structure of life insurance products sold in the United States and the American commitment to buying and selling anything, the life settlements market in its current form exists almost exclusively in the U.S.[6] That is to say, the

> **"The freedom to sell a life insurance policy allows policyholders to determine the best use of their own assets, particularly when they are making decisions about how they wish to spend the final years of their life. It acknowledges their right to allocate resources according to their individual needs and priorities"**

analysis below is applicable to current American society and life settlements market, and might not be appropriate or applicable for every cultural framework.

Autonomy, in Western ethics and political philosophy, can generally be characterized as the state or condition of self-governance, or leading one's life according to reasons, values, or desires that are authentically one's own. The term is derived from the ancient Greek words, autos, meaning "self," and nomos, meaning "rule". The roots of autonomy as self-determination can be found in Plato's assertion that the most essentially human part of the soul is the rational part, that which exercises autonomy by deciding what is best for oneself in the context in which one lives. Plato associated the ideal for humanity with self-sufficiency and a lack of dependency on others. For Aristotle, self-sufficiency is an essential ingredient of happiness, and involves a lack of dependence upon external conditions for happiness. The best human will be one who is ruled by reason and is not dependent upon others for his or her happiness.

One criticism that those who believe life settlements transactions are immoral and unethical might proffer to the concept of autonomy underpinning a moral and ethical justification of life settlements, is that the concept of autonomy, taken to its extreme, could lead to a state of solipsism[7], in which the individual good is the only good unmoored from the community. Put another way, one could believe that a life settlement is the right choice for one's self, but at the same time be unaware of or affirmatively uncaring if that choice visits moral violence on the larger community by commoditizing and cheapening human life.

That view is, however, divorced from the reality of the complicated and interwoven cloth of the communities in which we exist. While each individual is little more than a single thread, it is the loom of community that weaves us together as a whole. Aristotle recognized that human beings are not and cannot be perfectly self-sufficient, and are hence incapable of fully developing self-understanding and exercising autonomy at will. Human beings need other human beings in order to establish cooperative roles in larger communities in order for society to function properly. Essentially, autonomy is bound with the self-sufficiency and well-being of the community.

How, then, do life settlements transactions enhance individual autonomy and, commensurately, the beneficial functioning of the community? The freedom to sell a life insurance policy allows policyholders to determine the best use of their own assets, particularly when they are making decisions about how they wish to spend the final years of their life. It acknowledges their right to allocate resources according to their individual needs and priorities. This autonomy not only respects the dignity of individuals but also recognizes their capacity to make rational decisions regarding their well-being, financial and otherwise. Looked at from this perspective, the argument that the existence of life settlements transactions cheapens and commoditizes human life is turned squarely on its head. In fact, it is recognizing the autonomy of individuals to make decisions in their own best interests that ultimately strengthens, rather than frays, the threads of community that bind us together.

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[1]The term "life settlement" is used herein to mean both traditional viatical settlements (where the insured has a terminal or chronic illness resulting in a life expectancy of 24 months or less) and "senior settlements" (the insured is 65 years of age or older with health impairments, butimpairments but has a life expectancy of longer than 24 months).

[2]In Grigsby v. Russell, 222 U.S. 149, 156 (1911), the U.S. Supreme Court affirmed that a life insurance policy is an asset that may be sold by its owner, holding that "as far as reasonable safety permits, it is desirable to give life policies the ordinary characteristics of property."

[3]In the five states with no legislation, life settlement transactions are legal but unregulated.

[4]Lurid and apocryphal tales aside, it has been over a century since the U.S. Supreme Court decided the Grigsby case, and there has been no documented case or prosecution associated with an investor being involved in the death of an insured life purchased in a life settlements transaction.

[5]A summary of these arguments can be found in What Is So Morbid about Viaticals? An Examination of the Ethics of Economic Ideas and Economic, Business and Professional Ethics Journal 31:3-4 (2012) pp. 453-473, Glac, Katherina, Skirry, Jason D., Vang, David

[6]For instance, while not specifically enacted to prohibit life settlements most Canadian provinces have laws on their books that prohibit "trafficking" in life insurance policies, which effectively outlaws life settlements transactions. See, Study Paper on Viatical Settlements, Canadian Centre of Elder Law Studies, CCEL Study Paper No. 1, BCLI Report No. 43, May 2006.

[7]Generally, "solipsism" can be defined as a state in which someone is so focused on their own wants and needs that they don't think about other people at all – it is a form of extreme selfishness in which the wants, needs or even existence of such concepts related to other humans are, at best, abstract.

Stability Evident in US Life Insurer Ownership, Size and Solvency

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In early November last year, industry group the American Council of Life Insurers (ACLI) published its annual Life Insurers Fact Book, the organisation's deep dive into a range of sub-categories of the US life insurance industry. Last month, we looked at 2022's developments in surrenders, new business and solvency; this month, we're taking a look at the US life insurance market as a whole: Its health; size and outlook.

Ownership Trends

For a long while, US-based insurers have been, and remain, owned primarily by US investors and corporations. The percentage that is US-owned tends to hover around the 85-90% mark. In 2007, overseas ownership was at 10% with European and Canadian owners dominating that group. In 2015, a surge in Japanese ownership began which counteracted a slow retreat by European proprietors. Although the total number of US life insurers has steadily declined, from 1,009 in 2007 to 727 in 2022, the proportion in foreign ownership has remained fairly steady, although in 2022, there was a surprise uptick from 12.6% to 14.0%.

Measured by insurance liabilities, stock companies make up the largest share (61%), followed by mutuals (37%). A small amount of fraternal entities and other miscellaneous entities make up the remaining 2%. The proportion of companies which can easily have foreign owners is therefore lower (eg: not mutuals), meaning that foreign penetration into the US market is probably nearer 20%.

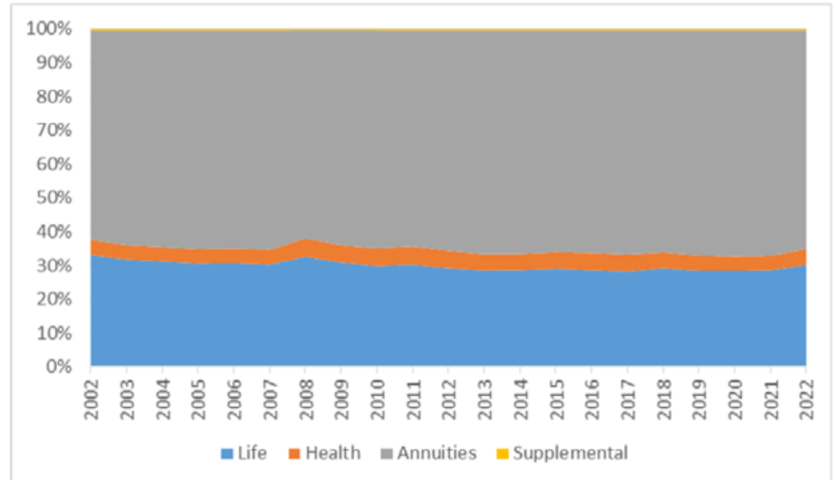
Among foreign owners, Canadian entities are the largest category by location with 25 proprietorships, which is to be expected, given the proximity and similar product structures between the US and Canadian markets. Then comes the next largest Western economy to the US, namely Japan (15), then a variety of Europeans which are as one might expect: Germany (5), France (3), Switzerland (10), Netherlands (2) and the UK (7). The rest tend to be tax havens in various Caribbean Islands and Central America. What stands out particularly, both this year and last, is the rise in Bermudan owned companies. In 2020 it was 14, in 2021 it was 17 and in 2022 it was 24. In 2010, before the first real surge in Bermudan ownership, it was just five.

> "In the UK, where companies fall under the Solvency II regime, there has been a steady drift towards insurers in the country using Bermuda, either for subsidiaries or captive reinsurers. This is particularly so for annuity business, which is the boom product line presently as corporations seek to de-risk their own pension liabilities with buy-outs or risk share arrangements"

In the UK, where companies fall under the Solvency II regime, there has been a steady drift towards insurers in the country using Bermuda, either for subsidiaries or captive reinsurers. This is particularly so for annuity business, which is the boom product line presently as corporations seek to de-risk their own pension liabilities with buy-outs or risk share arrangements. Although insurers can benefit from the Matching Adjustment concession within Solvency II, the regulations treat annuity business particularly harshly in their capital requirements. Bermuda is no soft touch but has a more flexible and responsive approach which the UK, and increasingly, European authorities, will acknowledge as having acceptable equivalence.

> **"Whilst US regulators maintain a watching eye over a potential emerging threat, nearly a third of reinsurance cessions in the US went to Bermuda in 2022"**

Figure 1: Composition of US Life Insurance (by value of liabilities) 2002 - 2022



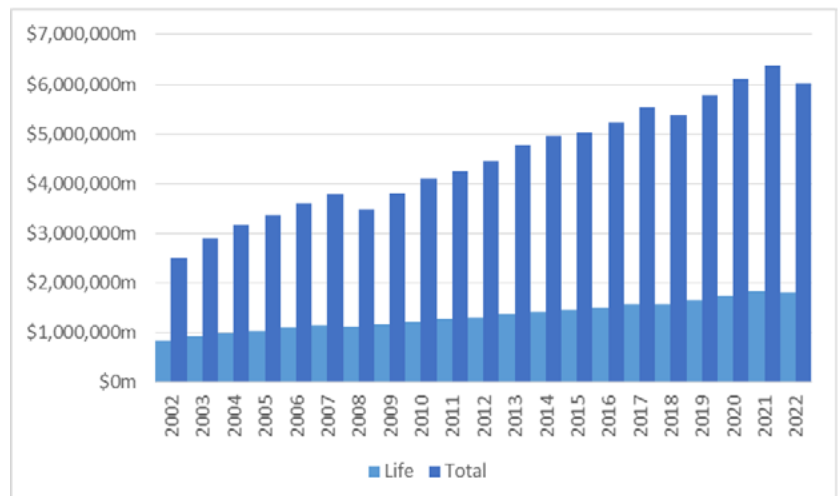
Source: ACLI Factbook 2023

Well, the Brits aren't alone. US annuity business liabilities as a proportion of total liabilities are not much different from how they were in the year 2000, unlike in the UK, but for similar reasons of capital efficiency, the same pattern is emerging for the US. Whilst US regulators maintain a watching eye over a potential emerging threat, nearly a third of reinsurance cessions in the US went to Bermuda in 2022. Bermudan insurers and reinsurers, many of which are actually US or European owned, generally benefit from the additional normal business flow but they themselves are often platforms for acquiring US (and European) businesses as well. XL Capital, for example, which is now owned by AXA, has been buying up primary insurance businesses around the world, including in the US.

US Life Insurance Market Size (by Liabilities)

Liabilities fell in 2022, largely as a result of a rise in bond yields increasing valuation discount rates. However, as the graph below shows, the rise in both total liabilities and life insurance liabilities has generally been growing over the past 20 years.

Figure 2: Life Insurance Liabilities 2002 - 2022



Source: ACLI Factbook 2023

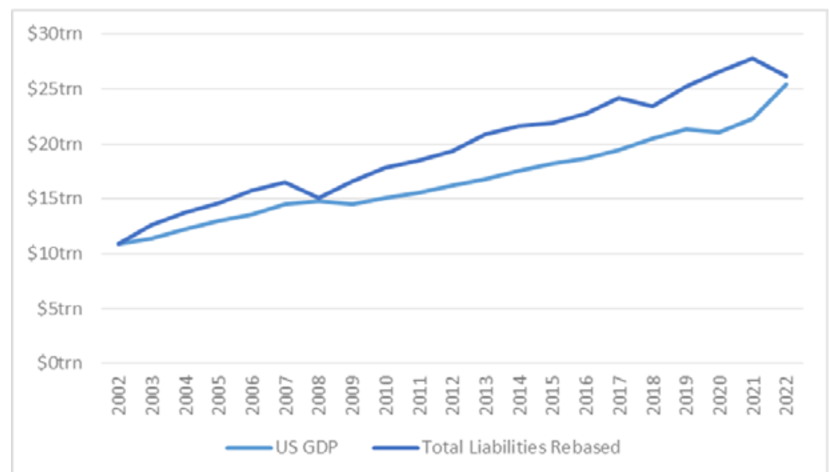
> “Comparing the insurance liability totals with US GDP, we see the continuing, strong correlation – although, not a perfect one, especially during the Covid pandemic period when GDP fell. But insurance liabilities continued to be supported by all of the additional QE supplied by the Fed”

Over the period from 2002, the compound rate of growth was 4.5%pa overall, although for the life segment there was some lag at 4.0%pa. Compared with the growth in US GDP over the same time period of 4.3%, these rates of business growth are not unexpected. There is no obvious sign of any change in that trend which might arise from changes in the fiscal framework in which they operate, or through societal developments.

There are some notable disjoints in the growth trajectory, notably in 2008 and in 2022. Measuring the market size by liabilities is imperfect because the liabilities themselves change, not just due to a change in the size of the business book itself, but due to a change in the discount rates used in their valuation - which themselves are affected by prevailing credit asset yields, particularly that on Treasuries or in swaps markets. The end of 2008 was deep amidst the financial crisis that year when asset values fell and yields spiked, and in 2022 we saw another system shock caused by the transition from quantitative easing-suppressed interest rates to higher rates driven by the outbreak of inflation.

Comparing the insurance liability totals with US GDP, we see the continuing, strong correlation – although, not a perfect one, especially during the Covid pandemic period when GDP fell. But insurance liabilities continued to be supported by all of the additional QE supplied by the Fed. In this chart, insurance liabilities have been rebased to the GDP value in 2002.

Figure 3: Life Insurance Liabilities (rebased 2002), US GDP 2002 - 2022



Source: ACLI Factbook 2023, World Bank

The insurance market continues to track the economy as a whole, which is a reassuring sign that it remains important to the US economy and is therefore recognised as such. The potential for political interference, such as the introduction of a disadvantageous tax change is always a threat, but history suggests that the industry maintains full government support across the political spectrum. The slightly lower growth rate of the life sector is a curious one and is probably explained by changing demographics, but because it is frequently a voluntary purchase, can be subject to ephemeral personal economic circumstances, with policies cancelled or allowed to lapse in times of hardship.

Solvency

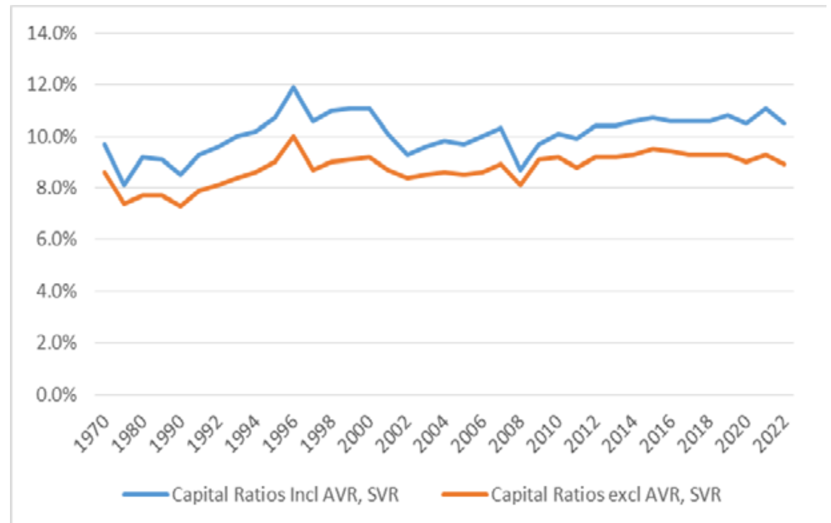
The health of insurers is of vital importance to secondary investors such as life settlement and life ILS funds as well as individuals who want to buy new policies for protection purposes - and needing their insurer to be there when the fateful moment arrives.

Here, the ACLI Factbooks provide a historic record of aggregate solvency levels for the industry. Solvency can be measured in numerous ways, with different measures of ‘surplus’ capital and different benchmarks to compare against.

> "Regulators prescribe a mechanism for determining what they consider the minimum capital for an insurer to be able to operate safely, and breaching this is usually that trigger, so measuring the actual available capital against that regulatory minimum (the Risk Based Capital (RBC) Ratio) gives the stakeholder a view on how likely it is that a breach may occur"

The simplest are insurers' capital ratios, either with the Asset Valuation Reserve and the Securities Valuation Reserve (two specific reserves to, in essence, smooth against temporarily depressed market values of assets) included or excluded. These ratios are insurers' own capital and surplus and divided by their general account reserves.

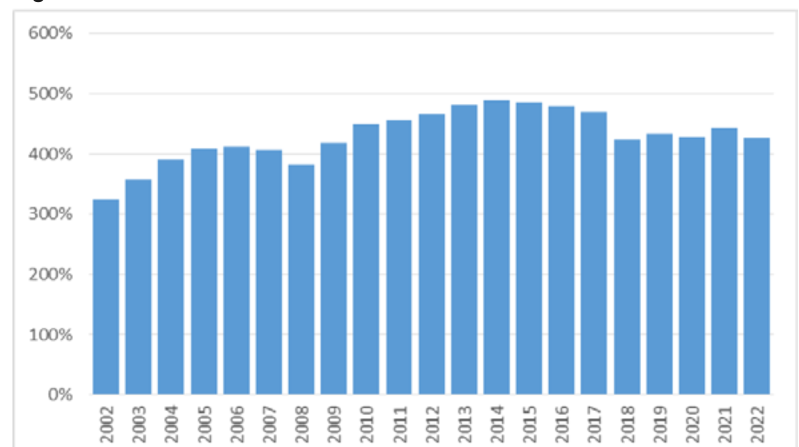
Figure 4: Life Insurance Broad Capital Ratios, 1970 - 2022



Source: ACLI Factbook 2023

Perhaps a more meaningful ratio is one which might tell you if insurers are on the verge of triggering some sort of regulatory intervention, such as a cessation of new business or a full wind-down. Regulators prescribe a mechanism for determining what they consider the minimum capital for an insurer to be able to operate safely, and breaching this is usually that trigger, so measuring the actual available capital against that regulatory minimum (the Risk Based Capital (RBC) Ratio) gives the stakeholder a view on how likely it is that a breach may occur. This comparison has an added advantage in that regulatory capital calculations will flex with economic conditions, so at times of asset stress or buoyancy, the capital requirement will move with the assets – to an extent.

Figure 5: Life Insurance RBC Ratios 2002 - 2022



Source: ACLI Factbook 2023

Both charts show a degree of ebb and flow over the years with the financial crisis unsurprisingly being a stress event and the ratios for recent years also showing reductions when compared to the decade post-GFC. However, the ratio is remarkably stable and paints a picture of continuing health of the industry as a whole.

Navigating the Intersection of ESG and Life Settlements

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Ress Capital

The integration of Environmental, Social, and Governance (ESG) factors within the financial industry has undergone a transformative evolution. Originally a niche concept, ESG gained momentum as investors recognised the need to align financial strategies with broader societal and environmental goals. In recent years, ESG considerations have shifted from mere compliance to becoming integral components of investment decision-making. Institutional and retail investors increasingly prioritise companies demonstrating sustainable practices, ethical governance, and positive social impact. Regulatory frameworks, such as the Sustainable Finance Disclosure Regulation (SFDR) in Europe, further propelled ESG's mainstream adoption. Today, ESG has transitioned from a trend to a fundamental aspect of risk management and value creation, reshaping the financial landscape by fostering a more responsible and sustainable approach to investing.

The evolving regulatory landscape reflects a global commitment to addressing ESG risks, enhancing transparency, and aligning financial markets with sustainable development goals. These regulatory developments aim to provide investors with the necessary information to make informed decisions and promote the integration of ESG factors.

As investors increasingly seek investments that align with their values, the life settlement industry has found itself under the spotlight, presenting a unique challenge and opportunity at the intersection of finance and ethical considerations. Life settlements have, unfortunately, earned a mixed reputation, due to a combination of ethical concerns and a perceived lack of transparency.

Life settlements involve the sale of life insurance policies by policyholders to third-party investors. Individuals selling their policies are usually retirees who no longer have the need for life insurance coverage. Investors purchase these policies at a discounted rate, taking over the premium payments and ultimately receiving the death benefit when the insured passes away.

ESG principles serve as a framework for evaluating the societal and environmental impact of investments and applying them to life settlements requires careful consideration. On the environmental front, life settlements have a minimal direct impact. However, when viewed through social and governance lenses, questions arise regarding the ethical dimensions of investing in products where returns are positively correlated with an earlier demise.

"ESG principles serve as a framework for evaluating the societal and environmental impact of investments and applying them to life settlements requires careful consideration. On the environmental front, life settlements have a minimal direct impact. However, when viewed through social and governance lenses, questions arise regarding the ethical dimensions of investing in products where returns are positively correlated with an earlier demise"

From a social perspective, a secondary market for US life insurance benefits seniors greatly by allowing them to sell their insurance policy they no longer want or need and be fairly compensated for the inherent value of the policy. Since the life insurance policy has a positive financial value, the individual policy holder owns a financial asset worth a considerable amount of money. Investors in life insurance policies are therefore allowing the policy holder to capitalize on this asset and receive a fair value.

This can be particularly beneficial for individuals struggling with healthcare costs. It can also be used as an additional alternative funding option for retirement. On the other hand, critics argue that there is potential for exploitation, as vulnerable individuals may be persuaded into selling their policies for unfavourable terms. Furthermore, concerns have been raised about the impact on beneficiaries who may see their expected inheritance reduced due to the sale of a life insurance policy. We therefore believe that it is of great importance that the sale of a life insurance policy occurs in a way that safeguards the interests of the whole household.

> **"To navigate the intersection of ESG and life settlements, stakeholders must continue to collaboratively address the challenges presented. The industry could benefit from a further increased level of transparency and commitment to ethical business practices"**

The governance aspect of ESG introduces questions about transparency, regulation, and industry practices within the life settlement market. The US life settlement market operates within a regulatory framework that exists primarily at the state level. These regulations provide oversight to standardise life settlement transactions, ensure transparency, prevent fraud, and protect policyholders' interests. The development of standardised regulations and oversight safeguards consumer interest both financially and ethically. With this clear framework, the risk within the industry should be minimised.

The secondary market for life insurance is technically a transfer of payment streams between two parties. As discussed above, both parties can benefit from this transaction. Longevity and mortality will, of course, be a part of the equation. This can be compared to a defined benefit pension fund or for a financial institution issuing annuities to clients. Members who live a shorter life than expected will subsidise members who live longer than expected. Thus, a steady pay-out to older members can only be possible if some members have a shorter life. Clearly, this business model is not regarded as immoral. In essence, any product that promises cash-flows linked to longevity will be facing a situation where some clients are benefitting relatively more from the product than other clients.

To navigate the intersection of ESG and life settlements, stakeholders must continue to collaboratively address the challenges presented. The industry could benefit from a further increased level of transparency and commitment to ethical business practices. In addition to industry-wide initiatives, investor education plays a pivotal role in aligning life settlements with ESG principles. Investors needs to be informed about the potential ethical challenges associated with this asset and what has been done to address these. By fostering a better understanding of the social benefits and governance practices surrounding life settlements, investors can integrate ESG considerations into their decision-making processes.

While life settlements provide liquidity for seniors and offer returns for investors, it is crucial for the industry to continue to collaborate to ensure that ethical processes and transparency through standardised regulations and industry best practices mitigate the negative reputation associated with life settlements. Efforts to enhance consumer protection, educate stakeholders, and establish ethical guidelines can contribute to reshaping the industry's image over time.

The secondary market for life insurance policies, when approached with ethical considerations, can be a transformative force, unlocking significant financial value for retirees and empowering them to make informed decisions.

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Life ILS Conference 2024

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TUESDAY 21ST MAY 2024

LONDON, UK

Q&A

Nicola Oliver
Director of Life and Health, Medical Intelligence

The past few years have been arguably the most significant ever to those studying longevity and mortality, with a range of issues impacting the field, and consequently, actuaries and risk holders. Greg Winterton spoke to Nicola Oliver, Director of Life and Health at consulting firm Medical Intelligence, to get her thoughts on the current state of the space.

GW: Nicola, you advise actuaries and companies about the impact of the provision of healthcare on longevity and mortality. So, let's start with Covid-19. What are some of the hangovers in terms of the provision of healthcare that the industry is still reeling from?

NO: Healthcare provision in the UK, for example, was already under strain even before the onset of the pandemic which made the impact of the pandemic so much worse. This was driven by declining bed stock, staff shortages, and lengthening waiting times.

A lack of system capacity meant all but the most urgent of non-Covid care had to be cancelled, including many cancer treatments.

As a consequence, there was no robust built-in preparedness; indeed, many clinical areas were running at close to or even over 100% capacity prior to the pandemic.

If we look at waiting lists, which serve as good barometer for how well the NHS is coping with workload, analysis by the Health Foundation shows that the waiting list for routine hospital treatment ('elective care') in England could rise to over eight million by mid-2024 regardless of whether NHS industrial action continues.

The knock-on effect from this alone could mean delayed identification of chronic diseases that rely on timely diagnosis to ensure an optimum outcome such as cancer and heart disease. This could mean more advanced disease at diagnosis leading to increased mortality rates at younger ages, an increase in premature mortality is possible.

GW: There has been coverage in the news media in recent weeks and months about the persistence of excess deaths. What are some of the drivers of this and are these short, medium or long-term issues?

NO: The drivers for persistent excess mortality are indeed multiple and complex to disentangle. As mentioned above, it is likely that some of it is driven by the immense pressure on the NHS, as well as the ongoing impact of Covid. Deaths from cardiovascular causes show a relative excess greater than that seen in deaths from all-causes. This could be as a result of both NHS pressures and the direct effect of Covid. It is known that the virus responsible for Covid is able to damage the cells of the heart and blood vessels.

The impact of both NHS pressures and Covid are likely to play out into the long-term.

GW: You wrote a guest article last year for Life Risk News where you analysed the impact of climate change on mortality. Have you seen any increase in how actuaries consider this issue when modelling mortality, or is it still one where not enough folks are paying attention to it?

NO: I think that awareness is increasing; and this is being translated into action, albeit gradually. The message needs to keep being sent; we're seeing climate change in action here in the UK, there is really no excuse for a head-in-the-sand approach any longer.

GW: The recent – maybe even ongoing – cost of living crisis is also very relevant to the provision of healthcare. Is consumer finance and debt currently having a significant impact on mortality or is it less of an issue than others?

NO: The effects of recessions on health differ across different health conditions, as well as by mortality and morbidity. There is also the time frame to consider; short-term events seem to have a positive impact on health on a population wide scale, whereas longer-term recessions are shown to be negative. There is no doubt, however, that psychological and physical health are affected by debt as well as by increased financial concern. These impacts are clearly socioeconomically driven. Those in poorer circumstances do not have wealth resilience and will suffer the most.

GW: Lastly, Nicola, at a previous Life ILS Conference, you discussed developments in wearable technology in the health space. Is that still an exciting area in terms of how it could impact the public health arena, or has it plateaued at all?

NO: Yes, I would say this is still an exciting area, particularly when partnered with big data analytics. Wearables not only encompass those devices which we traditionally think about as being associated with this area, such as fitness trackers and specific clinical devices such as continuous glucose monitors, but also the humble smartphone. Complementary metal-oxide-semiconductor (CMOS) image sensors that are in smartphones may be used to monitor heart, eye, and skin-related diseases. Heart rhythm disorders can be identified and even symptoms of Parkinson's disease.

Potential New Securitisation Product a Welcome Development for US Reverse Mortgage Industry

Author:
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Life Risk News

The reverse mortgage market in the US has had a tough time of it in recent years. The volume of HECM loans in the primary market has been steadily falling over time, from more than 100,000 mortgages annually in the market's heyday of 2007-2009, to approximately 33,000 in HUD's fiscal year 2023.

The rising interest rate environment of the past two years has been a contributing factor in the dampening of demand, which, should rates start to come down again in the next year or so, could pick up. But other events have hurt the industry of late. In the autumn of 2022, for example, Ginnie Mae took over a portfolio of HMBS from Reverse Mortgage Funding, a large player in the market that filed for Chapter 11 bankruptcy.

**"Having a new Ginnie Mae wrap (HMBS II) that securitizes HECM loans with balances above 98% of the MCA will reduce negative carry, stabilise the securitisation market, and improve liquidity"
- Michael McCully, New View Advisors**

Those in the space looking for some good news have now received it. On 16th January, Ginnie Mae announced that it is: "Exploring development of a new securitisation product as part of its efforts to enhance and expand its existing Home Equity Conversion Mortgage (HECM) mortgage-backed securities (HMBS) program".

Key to the new product is that it would accept HECM loans with balances above 98 percent of FHA's Maximum Claim Amount (MCA). According to Michael McCully, Partner at advisory firm, New View Advisors, that's a win.

"The original program - where a reverse mortgage can be assigned to HUD once the loan balance reaches 98% of the original appraisal or MCA limit – functioned fairly well, until it didn't. As rates rose, the volume of loans passing the 98% trigger overwhelmed warehouse lenders, sharply increasing buyout financing costs.

"Having a new Ginnie Mae wrap (HMBS II) that securitizes HECM loans with balances above 98% of the MCA will reduce negative carry, stabilise the securitisation market, and improve liquidity," McCully said.

As in many other markets, the securitisation market in the reverse mortgage industry is critical to the success of the industry at large. Unlike the UK, where the funding model involves life insurers issuing mortgages and holding them to maturity on their own balance sheet, the US market has specialist lenders operating in much the same way as the main mortgage market.

Consequently, a rising interest rate environment decreases liquidity and profitability, almost forcing the regulator to act. Those in the market rejoicing at the mid-January announcement shouldn't get too excited yet, however.

"Ginnie Mae doesn't want another lender to go bankrupt," says McCully. "It's a strong signal to the markets Ginnie Mae was willing to announce publicly they are working on the new program. But, the timeline for a new product launch will be measured in months, not weeks. Ginnie Mae has only 140 employees, responsible for a $2.2 trillion portfolio. It's going to take time."

At the time of publication, specific details of the new product were not publicly available. But for the reverse mortgage market to get back to the halcyon days of 2007-2009, more needs to be done.

"The industry needs two silver bullets," said Joe Kelly, also a Partner at New View Advisors.

"First is HMBS II, second is a restructuring of the mortgage insurance premium (MIP). The Initial MIP is 2% of the appraised value or MCA, which is way too front loaded. It's killing volume. FHA should reduce the upfront MIP, change the basis for the initial MIP from the home value to the loan balance, and increase the ongoing monthly MIP. They can maintain the present value of the total MIP charged over time but fix it so that it's less of a hit to the consumer at the start."

The change to which Kelly refers is feasible, in the sense that the regulator has the power to alter that structure. But even if that were to happen, the golden goose for the industry would be a scenario where the big banks decided to re-enter the market.

"The industry will be challenged to grow materially unless big banks re-enter the market.

Years ago, potential borrowers could go into a local bank branch, and see leaflets for reverse mortgages. That customer is gone. It is very difficult for private credit investors to fill that void; consumers want to borrow from a recognised brand," says McCully.

Still, beggars can't be choosers, and Ginnie Mae's recent announcement will have to suffice as the industry's piece of good news du jour. Assuming lenders have no other new products with which to work, that's good enough – for now.

> **"Despite current challenges facing the market, this news is still to be welcomed. It's in everyone's interest for these issues to be solved. If the industry has an HMBS II program, a restructured HECM MIP, and assuming interest rates cooperate, the outlook for the US reverse mortgage industry will be much improved"**
> **- Joe Kelly, New View Advisors**

"Despite current challenges facing the market, this news is still to be welcomed," said Kelly. "It's in everyone's interest for these issues to be solved. If the industry has an HMBS II program, a restructured HECM MIP, and assuming interest rates cooperate, the outlook for the US reverse mortgage industry will be much improved."

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