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UK Regulators Look To Understand Funded Re Risks

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Editor's Letter, Volume 3, Issue 04, April 2024

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Unsurprisingly, given its growth and potential for capital optimisation, UK regulators have been carefully watching the increased use of funded reinsurance, writing a letter to Chief Risk Officers at insurers in June last year, and following that up in November by issuing a consultation paper. *Aaron Woolner* spoke to **Michael Abramson**, Partner at **Hymans Robertson**, and **Craig Turnbul**l, Partner at **Barnett Waddingham**, to get their thoughts on the current state of the space in *UK Regulators Look To Understand Funded Re Risks*.

At the beginning of February, UK trade group the Equity Release Council (ERC) published data summarising activity in the market for both the fourth quarter of last year and the full year. The bottom line was that 2023 saw the market serve its lowest total number of customers on an annual basis in the last seven years.

Greg Winterton spoke to **Ben Grainger**, Partner at **EY**, and **Nicola Kenyon**, Head of Insurance Investment, and ALM, Insurance and Financial Services at **Hymans Robertson**, for their views on the state of the market now and what might drive an upswing in activity in *Plenty of Interest in UK Equity Release Market Despite Down Year in 2023*.

There has been a concern among some industry commentators in recent years that smaller schemes seeking an insurance solution in the UK's pension risk transfer market may be left on the sidelines. *Greg Winterton* spoke to **Iain Church**, Head of Core Transactions at **Hymans Robertson**, to learn more about why this fear hasn't materialised in *Smaller Schemes Still Finding Appetite Despite Red Hot UK Pension Risk Transfer Market*.

The role played by providers in the life settlement industry benefits both the asset manager and the consumer – and ultimately, the investor allocating capital to the manager. **Bill Corry**, Managing Partner at asset manager **Corry Capital Advisors**, explains the additional benefits that a vertically integrated provider brings to asset management firms in *Understanding Vertically Integrated Providers in the Life Settlement Market*, a guest article.

It's well documented that the pension risk transfer market in the UK has a human capital problem, in the sense that there aren't enough people to fill the vacancies in the space. *Greg Winterton* spoke to **TC Jefferson**, Managing Partner at executive search firm **The Plenum Group**, to get a recruiter's view on exactly what's going on in the hiring market in this month's *Q&A*.

Life insurance in the US comes in a range of types, each with their own nuances. However, the life settlement industry heavily favours a specific type. *Greg Winterton* spoke to **Michael Freedman**, CEO at **Lighthouse Life**, to learn more in *Term Life Insurance in the News but Universal Life Still the Dominant Policy Type in Life Settlement Market.*

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

UK Regulators Look To Understand Funded Re Risks

Author:
Aaron Woolner
Contributing Editor
Life Risk News

Funded Reinsurance (funded re) is not a new concept for life insurers but the upswing in pension risk transfer (PRT) activity in the UK in recent years has prompted an increase in its use.

Insurers are favouring funded re as it helps firms manage the market and longevity risks associated with writing bulk purchase annuity (BPA) business by reducing capital charges and therefore making PRT deals more competitive.

According to WTW, striking a funded re transaction can, in certain cases, even result in negative capital charges on new deals.

Unsurprisingly, given its growth and potential for capital optimisation, UK regulators have been carefully watching the increased use of funded re. In June 2023, the Prudential Regulatory Authority (PRA) sent a 'Dear CRO' letter to heads of risk at UK life insurers.

> **"There's also been the widening of the asset universe in recent years and that broader investment approach is a supervisory topic that the regulators have been looking at closely"**
> **- Craig Turnbull, Barnett Waddingham**

The letter outlined the regulator's two main concerns from a sectoral review which it had carried out.

"One of the key risks arising in funded re is that firms recapture sub-optimal portfolios with depressed values and with limited ability to be transformed effectively to the firms' preferred portfolio," the PRA letter said.

The UK regulator said that the second source of risk within funded re comes from 'recapture' risk - that is when the ceding insurer's assets and liabilities are returned in the event a counterparty is unable to fulfil its contract.

The PRA letter said it had observed an improvement in firms' internal frameworks for dealing with the two risks, but these practices needed to be more closely aligned to the terms of funded re contracts.

Exact figures of the amount of funded re being written in the UK pension risk transfer and life back book markets is unclear. But Craig Turnbull, Partner at actuarial consultants Barnett Waddingham, says that activity levels have been above market norms in recent years.

"Given that there has been an unexpectedly high volume of funded re activity the PRA is concerned that it might be driven by some kind of capital arbitrage between the UK and offshore markets, though other factors such as the differential tax treatments in the UK and offshore markets could also be important drivers," Turnbull said.

"There's also been the widening of the asset universe in recent years and that broader investment approach is a supervisory topic that the regulators have been looking at closely," he added.

The PRA followed up its June letter with a November consultation which closed on 16th February but Turnbull says that the regulator is unlikely to make dramatic changes to the prudential framework.

"The PRA consultation essentially proposes changes to its supervisory expectation which suggest there won't be formal changes in the PRA rulebook but rather guidance on what is expected in terms of risk management.

"But if regulators find these changes don't give them the comfort, they are seeking around how funded reinsurance is used then more action may follow," Turnbull says.

Michael Abramson, Partner at Hymans Robertson, says the funded re consultation has been prompted by similar previous concerns by the UK regulators over longevity de-risking.

In 2020 the PRA ordered a reappraisal of longevity risk transfers following an upswing in transactions in the wake of Solvency II.

"The regulator was worried that some of these longevity contracts were being put with carriers outside the UK. Once they had reviewed the risk controls insurers had put in place they became more comfortable with this exposure," says Abramson.

Funded re, however, poses a bigger challenge than longevity risk transfers. These are typically structured to pay out on the difference between the predicted and the realised life expectancy. With funded re, the whole of the liability is dependent on a third party and is typically much larger than a pure longevity deal.

According to Abramson, if a number of firms are exposed to the same reinsurer, it could pose an industry wide risk in a default scenario.

“The exposure of an individual insurer to a single funded reinsurer might be limited. But if every carrier in the UK is a counterparty of the same firm then that introduces some kind of systemic risk” - Michael Abramson, Hymans Robertson

“The exposure of an individual insurer to a single funded reinsurer might be limited. But if every carrier in the UK is a counterparty of the same firm then that introduces some kind of systemic risk,” says Abramson.

Abramson says the PRA was concerned about recapture risk because of the trend for funded reinsurance deals to be backed with more illiquid types of asset than has previously been standard in the sector.

“The regulator has a number of questions about these assets, the primary one is, ‘are they matching adjustment eligible?’” he says.

The matching adjustment is a list of high quality predictable assets which can be used to ‘match’ insurers long term liabilities. It’s a category of the EU’s Solvency II regulation and a part of the impending Solvency UK regime which is expected to come into force later in 2024.

The Bermuda Monetary Authority is also consulting over its solvency capital regulation which will include a version of a matching adjustment, a move which Turnbull says is also potentially significant for the UK market.

“The Bermuda Monetary Authority is changing its rules on capital requirements for this type of business and this could have as much of an impact on the funded re market as any initiatives from the PRA,” says Turnbull.

Abramson says the BMA’s move is important because a lot of funded re trades are with counterparties based outside the UK, in non-Solvency II jurisdictions such as Bermuda.

The PRAs focus on funded re over the last 12 months has had the knock on effect of raising awareness of the practice among UK pension fund trustees says Turnbull.

He says the trustees are now paying closer attention to the reinsurance arrangements of BPA deals.

“Pension fund trustees take a lot of comfort from the fact that UK insurance firms are effectively regulated by the PRA. These trustees are now starting to take an interest in the use of funded re by buyout firms,” he says.

Abramson echoes Turnbull’s points around increased trustee awareness of funded re and he says it is important that the sector’s risks are fully understood by its potential clients.

“Funded re is an area of risk that pension fund trustees are trying to understand better. It is really important to understand that there is no direct link between a reinsurance treater and one particular policy.

It’s more important to understand the risk exposure of the insurer in aggregate to reinsurance and funded reinsurance,” he says.

Plenty of Interest in UK Equity Release Market Despite Down Year in 2023

Author:
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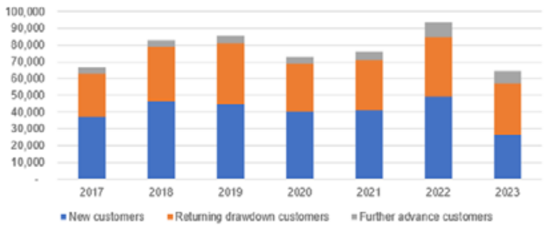
Life Risk News

At the beginning of February, UK trade group the Equity Release Council (ERC) published data summarising activity in the market for both the fourth quarter of last year and the full year.

The bottom line was that 2023 saw the market serve its lowest total number of customers on an annual basis in the last seven years.

Figure 1: Total Equity Release Customers Served Annually 2017–2023



Source: Equity Release Council

Disappointing, but not surprising, given the prevailing interest rate levels in the UK.

"I don't see demand recovering significantly in the short term. Ongoing increases in UK interest rates are resulting in higher interest rates on mortgages and low advances being made available to equity release mortgage customers, impacting customer demand," Ben Grainger, Partner at EY, told Life Risk News back in July last year.

The Bank of England base rate currently stands at 5.25%, the highest level since early 2008. But it has remained there since August 2023, which is the longest period without an increase since rates began rising in December 2021, offering hope to those in the market that an upward turn will take place sooner rather than later.

> "Capital markets outlook for 2024 is more benign because markets are already pricing in future interest rate levels. There is plenty of interest in the ERM space from all participants – funders, originators and advisors – but it will take time for the market to bounce back to 2022 levels"
> - Nicola Kenyon, Hymans Robertson

But an upward turn in the demand curve is unlikely to be steep, according to Nicola Kenyon, Head of Insurance Investment and ALM, Insurance and Financial Services at consultants Hymans Robertson.

"Capital markets outlook for 2024 is more benign because markets are already pricing in future interest rate levels. There is plenty of interest in the ERM space from all participants – funders, originators and advisors – but it will take time for the market to bounce back to 2022 levels," she says.

Still, there is plenty of money available to support the market and absorb any increase in demand. Insurers in the UK are awash with cash from their pension risk transfer activities, and equity release mortgages (ERMs) have attractive characteristics for their asset management function.

"The bulk purchase annuity providers – the main funders of ERMs – are looking for stable, secure, long-term assets to back their annuity portfolios, and equity release mortgages are one asset that tick all of these boxes," says Kenyon.

One of the features of the funding model in the UK is that a securitisation market isn't as necessary as it is in the US, where reverse mortgages are funded by lending firms. Securitising portfolios of mortgages provide lenders with additional capital to recycle back into the market, but insurers in the UK tend to hold the loans to maturity to get the matching adjustment benefit provided by the Solvency II regulatory regime.

There is, however, appetite from the market at large to expand the pool of funders.

"On the topic of securitisations, there have been some in the UK, but it's nothing like the US market. The most likely sources of additional capital for the market would come in the primary market – pension schemes, insurers and reinsurers, for example, are looking at the space," says Kenyon.

The increased interest in the UK's equity release market can be evidenced by the ERC adding three new members just in the first quarter of this year – Hymans Robertson, Royal London, and Spry Finance.

But these firms, and their fellow members at the

ERC, still face challenges in terms of moving the market even if / when interest rates begin to fall.

The 2023 Global Equity Release Roundtable Survey, a report published in late March from trade group the European Pensions and Property Asset Release Group (EPPARG) and consultants EY, asked industry participants in the equity release / reverse mortgage markets around the world about their views on the potential for future growth in the industry, and growth barriers and challenges.

UK respondents said that lack of awareness was the single biggest barrier to growth in their market, but efforts are being made to spread the gospel. The ERC held its inaugural Adviser Summit in November last year, an event specifically curated for financial advisers in the UK, to educate them about the space, to give just one example.

The EY/EPPARG survey suggests that the two largest markets, the US and the UK, will be worth more than $16bn and $8bn in 2035 respectively, both more than double 2023 levels. The confluence of an ageing, homeowning population that is faced with a retirement income gap is the main driver of activity in the market, and for Grainger, despite the current downturn in the UK market, overall, there is a positive outlook.

> **“Supporting growth in the global equity release market has the potential to transform thousands of people’s retirements, and it is positive to see such strong momentum currently”**
> **- Ben Grainger, EY**

“Supporting growth in the global equity release market has the potential to transform thousands of people’s retirements, and it is positive to see such strong momentum currently,” he says.

“Unlocking the global potential further will require deeper cross-border collaboration, achieved by sharing funding models, sources and best practice customer standards. Progress is happening.”

Smaller Schemes Still Finding Appetite Despite Red Hot UK Pension Risk Transfer Market

Author:
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Life Risk News

The UK's pension risk transfer (PRT) market saw transactions totalling approximately £50bn in 2023, according to consultants Hymans Robertson. Last year saw eleven deals worth more than £1bn, according to the firm's Risk Transfer Report, a record for a calendar year.

The big deals headline the activity reports for the market, but beneath the surface, there has been a concern among some industry commentators in recent years that the smaller schemes seeking an insurance solution may be left on the sidelines.

Personnel capacity issues are a very real headwind for the industry, and it's not unusual for smaller value deals to take a similar amount of time to consummate as larger ones, but James Mullins, Head of Risk Transfer at Hymans Robertson, says in a press release that concern didn't come to fruition in 2023.

> **"We also continue to see a healthy and competitive market for smaller schemes that want to transfer risk. For instance, all our buy-ins transactions under £30m received quotations from multiple insurers in 2023"**
> **- James Mullins, Hymans Robertson**

"We also continue to see a healthy and competitive market for smaller schemes that want to transfer risk. For instance, all our buy-ins transactions under £30m received quotations from multiple insurers in 2023."

Good news for trustees of schemes that are yet to embark on their pension buy-in or buy-out journey. And one of the reasons for the smaller end of the market is holding its own is, in part, simply down to a maturing market.

"In recent years, insurers have increased standardisation and streamlined processes for small deals in an attempt to get more out their financial and human resources – resulting in better access to the small end of the market. We expect further developments in 2024, and more insurers could be better able to quote for small schemes," says Claire O'Neill, Risk Transfer Specialist and Head of Operations at Hymans Robertson, in the report.

Still, the capacity issues in the market remain. And smaller plans that are keen to conclude a deal swiftly can help themselves by entering into an exclusive arrangement with an insurer. Indeed, in some cases, they might not have a choice.

"Some insurers are making exclusivity a condition of quoting for a small scheme," says Iain Church, Head of Core Transactions at Hymans Robertson, in the report.

On the surface, that might sound like alarm bells to small scheme trustees. Conducting an auction with the help of a consulting firm to broker the deal surely makes the most sense in terms of securing the best price, so a cynic would say that these schemes are being forced into doing the insurer's bidding. It's a buyer's market, apparently.

But Church says in the report that almost a third of buy-in and buy-out PRT deals in the UK are conducted on an exclusivity basis, and scheme trustees baulking at the exclusivity requirement shouldn't be so concerned.

"In our experience, exclusivity still leads to competitive pricing when done right. Established risk transfer advisers and professional trustees see a lot of market pricing, so they know what excellent pricing looks like. Insurers know that if they don't price appropriately, advisers and professional trustees are unlikely to proceed, and might not use them for exclusive processes in the future. Exclusivity can be powerful for catapulting small schemes up an insurer's priority list – the certainty of selection, if the pricing is right, helps an insurer focus its efforts," he says.

Going the exclusive route isn't simply a case of picking one out of thin air. Different insurers have different strengths and weaknesses, and scheme trustees will need to partner with an insurer that aligns more closely with what's important to them.

Considerations include everything from the financial strength of the insurer and the ability of the insurer to take the asset allocation mix from the scheme, all the way through to the member experience, which the insurer assumes responsibility for in a full buy-out transaction. Church says that schemes should be well prepared before selecting a partner insurer.

"The process of selecting an insurer prior to receiving pricing is an involved one, with many moving parts. Schemes need to have carefully thought through their objectives and weighed up what matters most to them, such as if they need a neat solution to deal with a specific complexity, or if they have a preference to transact with an incumbent insurer. Importantly, schemes need to have confidence their adviser can structure a process accordingly to exert commercial pressure and achieve value for money, without relying on competitive tension from other insurers."

> **"Schemes need to have carefully thought through their objectives and weighed up what matters most to them, such as if they need a neat solution to deal with a specific complexity, or if they have a preference to transact with an incumbent insurer"**
> **- Iain Church, Hymans Robertson**

Another development in 2023 should provide the PRT market's long tail with added capacity. M&G entered the market with two transactions in September last year, increasing the number of players in the space to nine.

Briefly, in March, that number looked like it was set to increase to ten after Royal London announced they were looking at the space, before Lloyds effectively exited the market shortly thereafter with its disposal of its Scottish Widows bulk annuity portfolio.

While these firms will need to grapple with human capital issues, that there is one new firm active in the market, and one potentially entering sooner rather than later, is an added boon to the smaller schemes in terms of the number of available insurers they might be able to work with.

Overall, the outlook for smaller schemes doesn't seem as uncertain as it did a year or so ago.

"With there being over 150 transactions under £100m in 2023, it's pleasing to see that there hasn't been a negative impact so far on well-prepared schemes being able to access the risk transfer market," said Church.

"Insurers are continuing to invest in efficiency, and with new entrants set to join the market, I expect we'll continue to see a healthy and competitive market for schemes of all sizes this year and beyond," he added.

Understanding Vertically Integrated Providers in the Life Settlement Market

Author:
Bill Corry
Managing Partner
Corry Capital Advisors

> "Providers are licensed entities that are required to furnish policyholders and insureds with certain disclosure forms and documents as part of their process in buying a policy. This requirement is a strength of our industry because it provides important information to policyholders in order for them to make an informed decision as well as the reassurance benefit that the insured is selling to an established, licensed, regulated company"

In the 43 states of the US that have a regulatory infrastructure for the life settlement secondary market, a life settlement provider is involved in every transaction.

The reason is because one of the two model acts - the NAIC's Viatical Settlements Model Act and the NCOIL's Life Settlements Model Act – used by states that regulate the space require their presence. Whether the life insurance policy is sourced via the direct-to-consumer channel, or the intermediated channel, the provider is an ever-present market participant.

The role played by providers in our industry benefits both the asset manager and the consumer – and ultimately, the investor allocating capital to the manager.

On the asset manager side, providers are the buyer on record of the life settlement policy, working hard to source these policies for their client(s) either through the direct-to-consumer channel, or through intermediated channels, which often includes life settlement brokers (another licensed entity in both model acts, with a fiduciary duty to the policyholder).

On the consumer protection side, providers are licensed entities that are required to furnish policyholders and insureds with certain disclosure forms and documents as part of their process in buying a policy. This requirement is a strength of our industry because it provides important information to policyholders in order for them to make an informed decision as well as the reassurance benefit that the insured is selling to an established, licensed, regulated company.

Because providers are involved in every transaction, over time, significant information accrues to them. One example is that life settlement providers have more information about a policyholder's health and situation than what's typically available to an asset manager. Similarly, they can aggregate that information to understand policies on a macro level. This helps providers better advise their asset manager clients with regards to the life expectancy of the insured; it provides a second opinion to the external life expectancy underwriting firms that are used commonly in our space.

But the buying process can still be cumbersome. Constant back and forth between policyholders to brokers to providers to asset managers makes for a slow process and has been known to put off both buyers and sellers, leading to a less efficient market, and sunk transaction costs. These costs – both time and money costs – ultimately impact the pension fund, foundation, endowment or insurance company that allocates capital to the asset managers.

That's why it may make sense for investors in the space to align with a manager that owns a provider.

As I mentioned previously, the information that providers obtain during the course of doing business can become a competitive advantage. But other significant benefits accrue to the asset manager – and, in turn, their clients – that owns a life settlement provider.

Deal Flow and Acquisition Costs

Providers can work for multiple asset managers during the bidding process for a policy that comes to market through the broker channel, and this can represent a conflict of interest. Owning a provider – and having that provider work with an asset manager - gives the asset manager direct access to the deal flow generated by the provider, potentially at a lower acquisition cost than relying on external brokers. Additionally, it enables the asset manager to source policies direct from the consumer, another route to market that will enable an asset manager to source policies at lower prices originally than those that come through the broker channel.

Selection and Quality Control:

Asset managers rely on the quality of the policies they buy. Owning a provider allows for more control over the selection process and underwriting standards, potentially leading to a higher quality portfolio.

Streamlined Operations:

There can be efficiencies gained from integrating the acquisition and asset management functions. This could lead to faster deal processing and potentially lower overall costs.

Reputation and Branding:

Owning a life settlement provider allows the asset manager to build their reputation and brand within the industry, potentially giving them an edge in attracting new investment capital.

Owning a provider brings complexity, however. You either need to launch one – which requires you to play the role of venture capitalist, hiring people, going through the licensing process (in multiple states) and building a brand. Or you play the role of private equity or corporate buyer, acquiring an existing provider, which comes with a higher price.

Both of these options require an asset manager to have size and scale, long standing relationships and the ability to access the capital markets competitively. Not only that, but the asset manager needs legal resources to ensure it can navigate the complexities of life settlement provider regulation, which are not insignificant.

But for limited partners that are either currently invested in the space, or those that aren't but are considering it, hiring an asset manager that has the infrastructure to vertically integrate a provider means that the above benefits also filter up to them. Lower acquisition costs means, other things being equal, higher returns. An increased pool of policies to pick from and better quality control means better policies in the portfolio, leading to higher returns. Information asymmetry leads to better policies being acquired, which leads to higher returns. And streamlined operations saves time and money, leading to higher returns.

The life settlement industry has evolved significantly over the past twenty years, becoming a genuine consideration for investors that are looking for a non-correlated asset class that can deliver acceptable, risk-adjusted returns. Partnering with an asset manager that has more control over the number and type of policies they are able to buy, via a vertically integrated provider, means more of those non-correlated, risk-adjusted returns.

"The life settlement industry has evolved significantly over the past twenty years, becoming a genuine consideration for investors that are looking for a non-correlated asset class that can deliver acceptable, risk-adjusted returns"

Q&A

TC Jefferson
Managing Partner, The Plenum Group

It's well documented that the pension risk transfer (PRT) market in the UK has a human capital problem, in the sense that there aren't enough people to fill the vacancies in the space. Greg Winterton spoke to TC Jefferson, Managing Partner at executive search firm The Plenum Group, to learn more about the going on in the space.

GW: TC, there is plenty of coverage in the trade media about this apparent 'challenge' that firms in the pension risk transfer market face when it comes to hiring. Just how 'real' is this issue?

TCJ: Thanks Greg. I can assure you this problem is very real. You only need to look at the volume of deals that happened last year and predictions for this year to know that there is a challenge. Plenum has been working in the pension risk transfer market for many years, but the last six months has seen us spending almost all of our time in this space to try to fill an unprecedented number of vacancies.

GW: Which firms are more impacted – is it the insurers, or the consulting firms, and why?

TCJ: Both are struggling to find and also retain the right people. However, the problem is probably more acutely felt on the consulting side. This tends to be because individuals that work on the provider side feel more at home executing the deals rather than acting as a broker. Similarly, many on the consulting side see little merit in moving to another consulting team that they think might feel very similar to where they are now. What we often hear from consultants is that they would only consider a move if it was to a provider.

GW: Are there any specific roles that are seeing higher demand than others?

TCJ: There are number of functions that can quite easily scale in this industry, with perhaps investment teams and operational teams having the most to gain here. However, it tends to be the pricing area as well as "deal champion" and business development that is hardest to scale. The demand is not equally spread across levels either. Whilst we typically specialise in more senior hires, we have seen a number of consulting houses repeat requests for individuals at the mid-level, with a few years of PRT deal experience under their belt. Such people are currently like gold dust, with packages rising rapidly, and arguably, unsustainably.

GW: Aside from financial compensation, what are some of the other benefits that hiring companies can offer to sweeten the deal? Is working from home seen to be a plus to job seekers, for example?

TCJ: The financial side is obviously important, but it's not the only factor. Even within the financial side, it's not all about pure salary. Bonus plays a significant role as does the willingness of firms to buy individuals out of any accrued bonus as well as offering any stock options or long-term incentive plan. Career development is also incredibly important with many people citing that they would only move for a "head of" position or significant step up in responsibility.

Soft benefits like working from home do make a difference, yes. Whilst much of the pension risk transfer business is in London, there are hubs elsewhere, both in the south and east of England, as well as into the midlands and the north. The ability for those individuals to move up the career ladder without having to relocate to London can be very appealing and smart teams are attracting people by offering this.

GW: Lastly, TC, what is the medium-term reality here for hiring companies? There are a lot of actuaries in this market, but it takes years for new actuaries to become qualified. It's not like tech where you can learn a programming language quickly.

TCJ: Great question. I think ultimately, the industry is not going be able to have sufficient human capital to deliver on its growing requirements simply by pinching people from each other's firms! Yes, it takes a long time to train an actuary, but I don't think that really is the issue. There are a number of actuaries within the insurance sector who are seeing technology disrupt out of date working practices, potentially freeing up their time to spend on higher value tasks. However, probably more significant is the inverse decline in traditional pension consulting that mirrors the boom of PRT deals. As such, employee benefit consultancies have ample pension actuaries in a shrinking part of the business that can be redeployed into pension risk transfer teams; almost every employee benefit consultancy is doing this. The challenge, however, is that it takes time to get up to speed in PRT and get the requisite deal experience so that consultants can fly solo on these deals.

The consulting community has, to date, provided a significant proportion of the insurers' pension risk transfer talent. We see no real reason why trend would not continue.

Term Life Insurance in the News but Universal Life Still the Dominant Policy Type in Life Settlement Market

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The essence of a life insurance policy's attractiveness to the life settlement industry lies in its pricing, which takes into account multiple factors, including the value of the policy, expected future premiums to keep the policy in force, the age and sex of the insured, and their life expectancy (driven largely by types and severity of health impairments).

That's partly why universal life insurance policies are the most common policy type purchased on the secondary market (and, therefore, on the tertiary market).

Universal life policies can accumulate a cash value, which earns credited interest, and policyholders can adjust their premiums to paying only the minimum cost of insurance charge, a key benefit in terms of cash flow for an asset manager. A universal life insurance policy 'prices' well for a life settlement investor.

> **"The vast majority of term life policies are not an attractive asset because these policies insure the life of the insured for a finite "term" which cannot be extended. Most managers are unable or unwilling to invest in the purchase and maintenance of a term policy due to the risk of losing the entire investment if an insured lives beyond the finite term"**
> **- Michael Freedman, Lighthouse Life**

Whilst universal life is the most common type seen in the market, others can price favourably as well. Whole life, where the premiums are fixed amounts, are not commonplace, however.

Whilst not yet robust in life settlement transactions, variable life insurance policies also make their way into the market on some level. These policies are considered to be securities because the investment risk of the amounts credited to be invested in the policy's account is borne by the policyholder.

For a life settlement asset manager to buy these, they must go through a broker dealer (life settlement brokers are licensed entities, but not usually also as securities brokers). Additionally, if a fund invests a significant amount (40% or more) in variable life insurance policies compared to the rest of its non-securities assets, then the fund will be an "investment company" regulated under the US Securities Exchange Act of 1934, which adds a layer of regulatory scrutiny (and cost), so variable life is seen less frequently.

Another type of life insurance that is seen in the life settlement market is term life. According to life insurance industry trade group the American Council of Life Insurers (ACLI), in 2022, 39.3% of all new life insurance policy sales were term life.

However, despite being almost 40% of the US life insurance industry overall, term life policies don't make up nearly as much of a corresponding percentage of the life settlement space.

There's a simple reason as to why.

"The vast majority of term life policies are not an attractive asset because these policies insure the life of the insured for a finite "term" which cannot be extended," says Michael Freedman, CEO of Lighthouse Life.

"Most managers are unable or unwilling to invest in the purchase and maintenance of a term policy due to the risk of losing the entire investment if an insured lives beyond the finite term," Freedman continued.

Term life policies that can be converted to a permanent life policy (typically a universal life policy) eliminate that risk and can become an asset that many funds will acquire. For a fund to accept a term policy, it must contain the conversion feature, which must be exercised by the policyowner before the conversion feature expires, and the permanent policy that it is converted into must be acceptable for a life settlement. Most commonly, eligible term policies are converted by the original owner prior to a life settlement.

It's these convertible term policies that can be interesting to the life settlement market. A recent court case filed by an insurance company, however, has brought renewed attention to whether a new owner can first purchase a convertible term policy and subsequently convert the policy after it was the subject of a life settlement.

Ameritas Life Insurance Company v. Wilmington Trust, N.A., filed on 25th March in California, has raised the topic of whether a secondary market policyholder must have an 'insurable interest' in the life of an insured when a term policy is converted. Essentially, the case is asking whether, by converting a life insurance policy owned by a third party, a situation of an illegal wager on human life will be created.

> **"Historically, and going forward, universal life insurance policies will remain the dominant type of policy for life settlement investors because universal life has the most attractive combination of cost, flexibility and benefit. We will continue to see the strongest demand from fund managers for this type of policy than term or whole life policies"**
> **- Michael Freedman, Lighthouse Life**

The life settlement industry will be watching this case with interest. But, regardless of the outcome, universal life will still remain the preferred type of life insurance for the market.

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