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Just How Much Influence Do Interest Rates Have on the Life Settlement Market?

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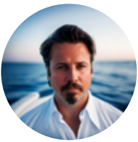

Chris Wells
Managing Editor
Life Risk News

The US Federal Reserve cut the country's interest rate by 50 basis points in mid-September, the first reduction since the spring of 2020. The impact will be felt across many private asset classes, but what of the impact to the life settlement market? *Greg Winterton* spoke to **Jonas Martenson**, Founder and Sales Director at **Ress Capital**, **Rob Haynie**, Managing Director at **Life Insurance Settlements** and **Phil Hall**, Director of Policy Trading at **Longevity Holdings** to learn more in *Just How Much Influence Do Interest Rates Have on the Life Settlement Market?*

Pension superfunds were seen as the saviour of under-funded defined benefit plans in the UK, but progress has been slow and stymied by both a lack of investment and delayed legislation. *Samantha Downes* spoke to **Will Griffiths**, Director at **WTW, Iain Pearce**, Partner and Head of Alternative Risk Transfer at **Hymans Robertson** and **Simon True**, CEO at **Clara-Pensions**, to get the lowdown on the space in *Pension Superfund Outlook Unclear Amidst Trustee To-Do List, Legislative Delays*.

With liabilities being lower than assets, Irish defined benefit pension funds looked set to accelerate their journey towards a bulk purchase annuity solution, but regulation has given them pause. *Aaron Woolner* spoke to **John Lynch**, Partner at **Lane, Clark & Peacock**, to find out what's going on in *Regulation Putting the Brakes on Ireland Pension Risk Transfer Market Activity – for Now*.

US life expectancy at birth is 77.6 years, one of the lowest among 38 member states of the Organisation of Economically Developed Nations. A new paper from The Research and Action Institute at the Association of American Medical Colleges suggests that eliminating firearms, drugs and alcohol-related deaths could improve the data and so *Aaron Woolner* covered the main points from the piece in *New Paper Suggests Vices, Firearms Knock 1.6 Years Off US Life Expectancy*.

New technological advances to meet key healthcare needs are a crucial element driving the performance profile of the healthcare sector. Most recently, obesity drugs have dominated the headlines, but this is an opportunity that has been on many investors' radar for some time. **Chris Eccles**, Portfolio Manager at **AXA Investment Managers**, explains more in *The Five Key Developments Set To Drive Healthcare Returns*, a guest article.

New analysis by consulting firm Lane, Clark & Peacock (LCP) of the new Projections Life Table AG2024, produced by the **Royal Dutch Actuarial Association**, finds that life expectancy assumptions are significantly higher than plausible alternative projections. **Stuart McDonald**, Partner & Head of Longevity and Demographic Insights at **LCP** explains in more detail in *How Wrong Is Your Mortality Projection Model?*, our second guest article this month.

The influx of private equity money delivers considerable benefits to the Asian life sector, which is experiencing an unprecedented wave of regulatory change. **Matthew Rose**, Managing Director, Practice Leader Life & Health, Asia Pacific and **Victor Hai**, Senior Vice President, Life & Health, Asia Pacific at **Guy Carpenter** dig into the trend in *Private Equity's Reshaping of the Asian Life Sector Has Further To Run*, October 2024's final guest article.

This year has, thus far, delivered another year of frenzied activity in the UK's bulk purchase annuity market. So, *Greg Winterton* spoke to **Swapnil Katkar**, Partner at **EY**, to get his thoughts on the current state of the space, and his views on the outlook for the next 12-18 months, in this month's *Q&A*.

The US Department of Housing and Urban Development's (HUD) financial year runs from 1st October to 30th September, so another 12 months is now in the books for the primary US reverse mortgage market. And, for many, it is yet another one to forget. *Greg Winterton* spoke to **Michael McCully**, Partner at **New View Advisors**, to get his views on what might get the market moving again in *A Tough Year for US Reverse Mortgage Origination but Recent Rate Cut Provides Optimism*.

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

Just How Much Influence Do Interest Rates Have on the Life Settlement Market?

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Life Risk News

The prevailing interest rate environment significantly impacts private asset classes in terms of both fundraising and deal activity levels. Higher rates tend to impact fundraising negatively, because they tend to provide institutional investors with what they see as a better yield versus liquidity payoff via investing in liquid fixed income products.

And in terms of deal activity, it is generally the same story. Higher rates mean less issuance in the private debt market, for example, as businesses are less willing to take on debt at a higher cost of capital and less willing to refinance existing debt. In private equity, leveraged loans are more expensive, impacting the price buyout shops are able to pay for investments, reducing the number of transactions.

So, it must be a similar situation in the life settlement market then?

In fundraising, yes.

"The fundraising environment in the past few years has definitely been slower than before rates began to rise," said Jonas Martenson, Founder and Sales Director at Ress Capital. "I'm not surprised, and from the conversations I've had with other market participants and at conferences, it's something that's impacted many, if not all asset managers in the space."

> **"While there won't be a sudden deluge of money coming into the market, there will be some investors that will either accelerate their plans to allocate to private asset classes that can provide an acceptable spread over risk-free, or re-look at their previous plans to continue to allocate to high yielding liquid investments like life settlements"**
> **- Jonas Martenson, Ress Capital**

So, when the US Federal Reserve lowered the target range for the Federal Funds Rate to 4.75% - 5% - a 50-basis point cut – in mid-September, life settlement types, just like all sub-categories of the private markets, would likely have felt encouraged.

"Certainly, it should help with fundraising. While there won't be a sudden deluge of money coming into the market, there will be some investors that will either accelerate their plans to allocate to private asset classes that can provide an acceptable spread over risk-free, or re-look at their previous plans to continue to allocate to high yielding liquid investments like life settlements," said Martenson.

In the deals market, however, the answer is not nearly that cut and dried.

In the tertiary market, it could be argued that rates will have had some impact. Any asset managers using a mark to model valuation method – which will likely have lower interest rates baked into it for policies purchased before rates began rising – will have higher valuations than a mark-to-market method, so they might be loathe to sell in the tertiary market at the moment, as they would likely realise a loss on the NAV of any policies sold in this situation.

But the reality is still that the price an asset manager is willing to pay for a life insurance policy is still heavily influenced by the life expectancy of the insured.

"You still have to consider longevity risk, which is the main investment risk in our market. When you're buying in the tertiary market, the insured's medical records might have changed, which would impact the anticipated policy maturity date. Now, they may change for the worse, but for those insured whose medical situation changes for the better, that would have a big impact on pricing," said Phil Hall, Director of Policy Trading at Longevity Holdings.

And, similar to the secondary market in private equity or venture capital, for example, there are always other reasons for activity.

"You get funds that are at the end of life that would be willing to take a haircut on the remaining policies that have not matured yet, and open-ended funds might need to sell policies if they have investor redemptions. While the latter might be influenced by interest rates, the former largely isn't," Hall added.

In the secondary market, interest rates carry so little influence, they barely come up.

That is because the drivers of activity in the space are consumer-based, and are as much

personal as they are economic; the need to pay for healthcare costs, or a divorce, or simply because the seller does not think they need the coverage anymore - perhaps their mortgage is paid off, or their children are now adults who are providing for themselves (or both). Often, these drivers of supply are uncorrelated to financial markets.

And the data bears that out. The Life Settlement Report, part of The Deal, publishes annual league tables that analyses secondary market activity in late spring/early summer each year; the data is for the prior calendar year.

This year, the data showed growth in the number of transactions for the third consecutive year; 3,181 transactions took place in 2023, compared to 3,051 in 2022 and 2,933 in 2021. The correlation between activity and interest rates has indeed been positive, not negative, and according to Rob Haynie, Managing Director at Life Insurance Settlements, that is a feature of the market that is permanent.

> **"Activity in the secondary market for life settlements has very little to do with the financial markets...The main reasons for selling a life insurance policy are to fund healthcare costs, because the premiums themselves are too high, or because an insured just doesn't need or want the policy anymore"**
> **- Rob Haynie, Life Insurance Settlements**

"Activity in the secondary market for life settlements has very little to do with the financial markets," he said.

"You may have a situation where a sudden rise in interest rates has made a mortgage unaffordable, and so an insured decides to sell their life insurance policy to pay off or significantly pay down the mortgage. But these situations are rare. The main reasons for selling a life insurance policy – more than 95% of the time – are to fund healthcare costs, because the premiums themselves are too high, or because an insured just doesn't need or want the policy anymore."

Observers have suggested that another rate cut could be on the cards in November or December (or both). Should that happen, then those in the private markets who are out raising money will likely raise a glass or two to the US Federal Reserve Open Market Committee.

But when they are talking to potential investors, interest rates are rarely mentioned.

"What we try and reinforce in conversations with investors is the low correlation between the return profile of a life settlement portfolio and the broader capital markets. Yes, interest rates impact investor demand. But they barely impact the portfolio performance," said Martenson.

"Life settlements provide a solid return above the risk-free rate, with low correlation to equities and bonds and lower volatility. Interest rates simply do not affect life settlement performance or activity like they do in other asset classes."

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Pension Superfund Outlook Unclear Amidst Trustee To-Do List, Legislative Delays

Author:
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Pension superfunds - consolidators backed by investors that help struggling defined benefit (DB) pension schemes in the UK to improve their funding status and achieve eventual buy-out - were seen as the saviour of under-funded plans, but progress has been slow and stymied by both a lack of investment and delayed legislation.

Superfunds are not an alternative to a fully funded insurer-led buyout; rather, they provide a bridge to one by acting as both a consolidator and intermediary, bringing in external investor capital and expertise to increase the scheme's funding. When the scheme becomes fully funded, it can then seek the assumed protection of an insurer buy-out.

> **"Our view is that the market can only go in one of two ways. It will either be unsuccessful, and in that scenario, Clara may exit the market. Alternatively, it will become successful and that will lead to new entrants coming into that market"**
> **- Iain Pearce, Hymans Robertson**

"There are three gateway principles for a scheme to enter a deal with superfund: That the scheme cannot access buy-out, then that it cannot be bought out in the foreseeable future, and third that trustees believe by transferring the scheme into a superfund the likelihood that members will receive their full benefits is increased," said Will Griffiths, Director in WTW's transactions team.

But in the intervening five years since the first superfund guidance first came out, the only provider to complete UK regulator The Pensions Regulator's assessment process has been Clara-Pensions, which did so in 2021. Since then, Clara has completed two deals, taking on Sears in November 2023 and Debenhams - which it took out of the Pension Protection Fund (PPF) - in March this year.

Having one player in the market is not the only stumbling block the superfund concept faces. Griffiths said the slow process of implementing legislation around the issue of profit-taking had been keeping investors away; superfunds rely on cash from external investors, which, once the benefits of members have been secured, take their cut through making successful investment decisions, so the ability to extract profits earlier in the process, rather than simply after buy-out, might help increase the number of deals.

Iain Pearce, Partner and Head of Alternative Risk Transfer at Hymans Robertson, added that uncertainty around profit extraction was not helpful and that legislation appears to still be some way off.

"Our view is that the market can only go in one of two ways. It will either be unsuccessful, and in that scenario, Clara may exit the market. Alternatively, it will become successful and that will lead to new entrants coming into that market," he said.

"Legislation will be a very helpful step, albeit one that's not going to be imminent."

Clara itself remains positive, and whilst legislation may not be imminent, it is being proactive to support the end goal of a legislative framework.

"Clara is supportive of further market innovation which provides more options for trustees to improve the security of members' benefits. The success of Clara's two transactions, with the Sears and Debenhams schemes, and our strong pipeline of further transactions, demonstrates the benefits of consolidation in improving member outcomes," said Simon True, CEO at Clara.

"We are working closely with government on the permanent legislation for superfunds, to enable the consolidation model to deliver tangible benefits to pensions scheme members," True added.

Meanwhile, Pearce added that the Mansion House proposal of having the PPF run a separate superfund may also be a disincentive.

"There will be a thought process, with these providers [potential entrants] wondering if this would undercut them on price. And also, will it be presumed to have an implicit state backing, so would the government actually allow it to fail?"

Market forces may be at work too. Griffiths said that in summer 2022, many DB schemes were around 80% to 90% funded (on a buy-out measure), enough to consider the superfund exit route, but a potential chunk of superfund business was impacted by the mini-budget-induced gilts crisis of

September/October of that year.

"But when interest rates shot up, the buy-out funding levels went up. So, they went from being in that sort of target zone for the super funds of 80% to 90% on buyouts to being over 90% funded on buyouts, just because of how interest rates moved," said Griffiths.

"So that pipeline of potential superfund business was removed in one fell swoop, because then those schemes were so close to buy-out, they no longer qualified for a super fund based on the gateway principles."

Other market forces could work in the favour of superfunds. Griffiths said something such as a "swing in longevity expectations" might encourage more partially funded schemes to consider the superfund route.

"If you have a scheme that has a non-distressed sponsor and decides to enter into a super fund, such a scenario would be a sponsor with a profitable, successful business, but a swing in longevity expectations means the liabilities go up," he said.

"So even though they've not got a sponsor that's imminently going to go under, it's easier to make the argument in that situation that the superfund is more likely to provide full member benefits than

"There's also such a lot going on in the pensions world at the moment. You've got the new general code, you've got your GMP equalisation, you've got more focus on data and benefits being clean and you've got pension dashboards to get ready for"
- Will Griffiths, WTW

relying on the sponsor covenant."

Both Pearce and Griffiths believe that the superfund market needs to have more than one player, and that while other entrants will be waiting in the wings, they will have a limited time frame in which to make their move.

"Over the next 10 to 15 years, a lot of schemes that will settle the liabilities will have done so in this market. The sooner you get in, the better," said Griffiths.

There is also the huge to-do list trustees currently have, which may make even considering a superfund exit a luxury.

"There's also such a lot going on in the pensions world at the moment. You've got the new general code, you've got your GMP equalisation, you've got more focus on data and benefits being clean and you've got pension dashboards to get ready for," said Griffiths.

"So, as a trustee, if you've not got a distressed sponsor, and you've got all this other stuff you need to do, you're going to be concentrating on that rather than worrying about a superfund transaction."

Regulation Putting the Brakes on Ireland Pension Risk Transfer Market Activity – for Now

Author:
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Contributing Editor
Life Risk News

The pension sector in Ireland is broadly similar in structure to the UK, according to a 2023 report from consultants Milliman, which said the main difference is one of scale. Data from the Irish Pensions Authority shows that in March 2022 the country's 525 defined benefit (DB) pension schemes had total assets of €73.7bn ($80bn).

With liabilities at the same date standing at €65bn, the stage was set for an uptick in pension risk transfer (PRT) deals amid the global rise in interest rates. This hasn't yet happened and John Lynch, Partner at actuarial consultants, Lane, Clark and Peacock in Ireland, says trustees have instead been focussing on two new sets of European Union regulation.

The European Insurance and Occupational Pensions Authority (EIOPA) steered the revised Institutions for occupational retirement provisions (IORP II) onto the statute book on 1st January 2024.

The directive is aimed at rebalancing pensions regulation to reflect the reality of the switch from DB to defined contribution (DC) pension structures and Lynch says it has also distracted trustees' attention away from the PRT sector.

> **"IORP II has raised the standard in terms of governance in pension schemes in Ireland and before it was introduced PRT activity was starting to increase. But while there are opportunities in the current market for pension schemes to derisk or buy annuities we don't see trustees engaging like they should"**
> **- John Lynch, Lane, Clark & Peacock**

"IORP II has raised the standard in terms of governance in pension schemes in Ireland and before it was introduced PRT activity was starting to increase. But while there are opportunities in the current market for pension schemes to derisk or buy annuities we don't see trustees engaging like they should," he said.

IORP II includes the requirement for schemes to produce an own risk assessment (ORA), as well as an annual Pension Benefit Statement, and also beefs-up the regulator's powers.

"Trustees have been actioning the directive and associated requirements over the last couple of years and in theory pension schemes should now have the bandwidth to look at PRTs. Maybe next year things will have quietened down in terms of regulatory requirements and pension funds will be able to look more closely at PRTs," Lynch added.

The problem is that at the start of next year all financial entities operating in the EU must implement comprehensive information and communications (ICT) risk management processes as part of the trading bloc's impending Digital Operational Resilience Act (DORA).

"Now DORA is being introduced by the EU. And that will again add time, cost and effort for trustees. So, actual market activity has been very low in 2024, much quieter than expected. It will probably get busier in the fourth quarter but nothing like the market needs, wants, or expects," says Lynch.

According to Lynch, the market needs activity to happen because, in common with pension schemes globally, funding levels that were depressed by the extended period of low interest rates in the post-Global Financial crisis era have now rebounded, leaving schemes in a position to buyout.

"There was very little buyout activity when bond yields were so low as schemes couldn't afford to transact. In line with the UK market schemes are now generally a lot better funded than they have been in the past," he said.

Buyout activity may be muted but Lynch says that Irish pension funds are derisking by investing into German government bonds, which have seen an uplift in yield in line with tighter global monetary policy. On 3 October, 20-year German government bonds were yielding 2.48%, versus -0.3% in July 2019.

Despite this marked rise, Lynch said that buy-outs could be a better option for some schemes.

"Schemes can actually get a higher return through taking a buy-out contract than they can by investing in German bonds, for example. I also think that schemes could generate a surplus if they opt for a buy-out meaning that a lot of pension schemes could actually improve their financial position with a PRT," Lynch says.

"When funding levels were in deficit it meant that if a scheme bought annuities for pensioners, it was prioritising this group over other members. Whereas schemes now actually are quite well funded and are generally holding assets to ensure all members are seen to be treated fairly. They could easily sell those bonds and buy annuities and actually improve the position that the scheme is in doing so, both in terms of funding, but also risk," he added.

"We were expecting a lot more action this year, but it just hasn't happened...But I think it will at some point. The Pensions Regulator has come out and said all trustees should be considering buy-out as a method of de-risking"
- John Lynch, Lane, Clark & Peacock

The start of September saw the US Federal Reserve opt for a bumper 50 basis points rate cut, an approach taken by five of the nine central banks overseeing the 10 most heavily traded currencies globally.

This raises the possibility that Irish funds could miss the window of opportunity if they don't transact soon. Lynch says, however, that the derisking by Irish pension funds means that the majority will have immunised their portfolios against interest rate decreases by ramping up their government bond holdings.

If pension schemes move to buy-out once the two EU directives have been fully digested, Lynch says that the market could be worth in the region of €1bn annually, via a series of relatively – by international standards – smaller deals.

"A €50m buyout will be considered large in Ireland and a very large deal would be around €150m. Ones over €200m are even rarer," he says.

The PRT market in Ireland had previously been a duopoly of Irish Life and New Ireland Assurance, until the recent exit of the latter from the market.

However, Aviva has now entered the sector, and Lynch says there is sufficient capacity - and appetite - from insurers for when pension funds start focussing on buy-outs, which he is hopeful will happen soon.

"We were expecting a lot more action this year, but it just hasn't happened," said Lynch. "But I think it will at some point. The Pensions Regulator has come out and said all trustees should be considering buy-out as a method of de-risking. Trustees will consider buy-out - it's just been slow to sort of take-off and for transactions to actually happen."

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New Paper Suggests Vices, Firearms Knock 1.6 Years Off US Life Expectancy

Author:
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Contributing Editor
Life Risk News

Despite spending $4.5trn a year - or $13,400 a person on healthcare - US life expectancy at birth is 77.6 years, one of the lowest among 38 member states of the Organisation of Economically Developed Nations, according to Narrowing the Gap: The Burden of Alcohol, Drugs, and Firearms on U.S. Life Expectancy, a new paper from The Research and Action Institute at the AAMC (Association of American Medical Colleges).

The OECD average life expectancy in 2022 is 80.6, and the US figures are over six years below Japan (84.1). In all, more than 27 OECD member states have a life expectancy at birth greater than 80 years and the handful of countries behind the US include Hungary, the Slovak Republic, and Latvia.

Kendal Ogera was lead researcher on the paper, which reported that not only was the US performing worse than its peer group of advanced economy states, but the gap has also widened over the last two years.

> **"If these deaths were eliminated (and other causes of death remained the same), life expectancy at birth would increase by 1.6 years"**
> **- AAMC Paper**

The paper said that in 2022, there were more than 48,000 firearm-related deaths (more than half were recorded as suicides, according to a soon to be published analysis by the AAMC), close to 108,000 drug-related deaths; and more than 51,000 alcohol-induced deaths.

"While these numbers made up a small fraction of the nearly 3.3 million deaths in 2022 in the United States, they disproportionately affected children and younger adults — and, as a result, lowered the U.S. life expectancy at birth. If these deaths were eliminated (and other causes of death remained the same), life expectancy at birth would increase by 1.6 years," the paper said.

The AAMC paper said that alcohol, drugs, and firearms deaths in the US were far higher than other countries, and it consistently led the world for the highest level of gun-related deaths in children and teenagers, which were over 9.5 times the rate of Canada in 2021.

The paper says that the issue of firearm related deaths in the US appears to be worsening and is now the leading cause of mortality among people aged one to 19 - previously it was unintentional injuries, a category which includes incidents such as car accidents.

The US has also had a long term issue with prescription drug use - in 2017 the opioid crisis was classified as a public health emergency by the US government, a status that remains in place.

The AAMC research said drug use - including opioids - was the leading cause of death for Americans aged one to 44 years old. According to the latest data from the World Health Authority drug deaths stood at 31.8 per 100,000 in the US.

This figure was significantly higher than neighbouring Canada (19.2) and over 15 times higher than Spain which recorded just 2.1 deaths per 100,000. Despite Scotland recording the highest level of drug deaths in Europe in 2023, the figure for the UK as a whole was 8.4 per 100,000.

According to the paper, drug-related deaths were the single biggest factor in reducing US life expectancy at birth figures. The think tank said that if no drug deaths had occurred the average American could expect to live nearly a year longer.

"The United States would add an average of 0.4 years and 0.3 years of life expectancy if firearm-related and alcohol-induced deaths, respectively, were eliminated. Younger Americans would see the greatest opportunity for gaining potential years of life if these causes of death were eliminated, though each age group would be impacted to some degree if deaths due to alcohol, drugs, or firearms were eliminated or reduced," the paper said.

There is a wide disparity in drug deaths across the US with the AAMC research indicating that an elimination of substance-linked mortality could spark an even bigger increase in life expectancy in certain jurisdictions.

West Virginia, Delaware and Washington DC would each see a 1.4 year jump in life expectancy if drug deaths were eliminated whereas in New Mexico, Alaska, and South Dakota, eliminating alcohol deaths would result in the greatest increase in life expectancy.

"In Louisiana, Mississippi, and New Mexico, residents would see the largest gains in life expectancy by eliminating deaths due to firearms," said the paper. "Overall, 10 states and the District of

Columbia would see a jump of at least two years in life expectancy if deaths due to alcohol, drugs, and firearms did not occur, ranging from 2.0 years in South Carolina to 3.0 years in New Mexico."

> **"Overall, 10 states and the District of Columbia would see a jump of at least two years in life expectancy if deaths due to alcohol, drugs, and firearms did not occur, ranging from 2.0 years in South Carolina to 3.0 years in New Mexico"**
> **- AAMC Paper**

There was also a significant disparity between ethnic groups. Taking the US as a whole, American Indian, Alaska Native, Black, White, and Hispanic populations would see the largest increases in life expectancy if alcohol, drug, and firearm-related deaths were eliminated.

It would only have a minimal impact on Asian populations and there would be no difference to the life expectancy of Native Hawaiian and other Pacific Islander populations would not see any impact on life expectancy.

The study did not look at socioeconomic causes for the differences in life expectancy.

The AARC report said that while it was impossible to eliminate deaths linked to drugs, alcohol, and firearms, relatively limited progress would have a material impact on increasing the US life expectancy at birth figures.

"Federal and state policies can help decrease these deaths and improve life expectancy for all. Reducing causes of death that disproportionately impact children, and young people is particularly important, since youth death rates have the greatest impact on the nation's average life expectancy. Even a slight reduction in deaths due to the three causes listed above would bring the United States' life expectancy at birth closer to the OECD average."

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LONDON, UK

The Five Key Developments Set To Drive Healthcare Returns

Author:
Chris Eccles
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AXA Investment Managers

> "Radiopharmaceuticals are a new technique for treating cancer... As these treatments become more logistically accessible, we could see rapid growth and gains for companies at the forefront"

New technological advances to meet key healthcare needs are a crucial element driving the performance profile of the healthcare sector. Most recently, obesity drugs have dominated the headlines, but this is an opportunity that has been on many investors' radar for some time.

For investors, it's also vital to look ahead at developments that could come to fruition further down the line. Here, driven by rapid technological development and powerful sectoral trends, the healthcare sector presents a promising landscape for potential growth and investment.

There are numerous opportunities for investors seeking to navigate this dynamic market, but five key developments show the potential for long-term investment returns.

There are new technologies set to soar

Breakthroughs are not always well-signalled, and diversification is important, as in any sector. But there are some emerging technologies we are watching carefully.

Radiopharmaceuticals are a new technique for treating cancer. These therapies use radioactive isotopes to target and eliminate cancer cells and could significantly improve cancer treatment. As these treatments become more logistically accessible, we could see rapid growth and gains for companies at the forefront.

Immunology research is focused on finding proteins or genes that have strong genetic association with diseases and on understanding how they interact, leading to the development of combination therapies. As more mature data emerges on cell therapies for autoimmune diseases, this will help us understand whether this niche approach is viable for treating some chronic diseases.

Neuroscience is another exciting field. Innovations therapeutics, including biomarker-driven precision approaches for psychiatric and neurological conditions, are occupying companies' development pipeline, and we could see some novel approaches emerging.

Biotech valuations are attractive

The biotech sector has displayed signs of recovery, with the Nasdaq Biotech Index (NBI) rebounding from its lows, although remaining about 15 below its previous peak.

Small and mid-cap biotech companies, in particular, offer an attractive investment proposition, with their enterprise value/cash ratio near all-time lows. Furthermore, the upsized follow-on offerings and record financing activities underline the robust investor appetite for quality biotech companies and clinical data, paving the way for a healthy outlook in the sector.

Heightened M&A activity in the biopharma industry, coupled with a supportive regulatory environment and a surge in novel drug approvals, underscores the attractiveness of biotech as an investment opportunity. With sentiment improving and major clinical and regulatory catalysts on the horizon, the biotech sector holds substantial potential for investment professionals seeking to capitalize on this burgeoning market.

Obesity treatment is undergoing a revolution

We are in the early stages of launch for what will likely become one of the largest therapeutics classes in biopharma history, treatments for obesity. Obesity has long been misunderstood and stigmatised as a simple lifestyle or willpower issue, but the narrative is rapidly changing. It is getting recognised as a real medical condition, associated with over 200 health complications.

The new generation of obesity treatments, led by Novo Nordisk's Wegovy and Eli Lilly's Zepbound, have shown impressive weight loss effects with tolerable side effects. Furthermore, Wegovy has shown a 20% risk reduction in major adverse cardiovascular events.

Both benefits are well-embraced by physicians and patients, leading to strong launches, while globally reimbursement coverage and supply constraint issues are being gradually ironed out. Due to the long-term attractiveness of the market, a number of potential competitors have emerged, and we are watching developments as to how this may impact the incumbents.

There is a bounce back after Covid

Outside of treatments, we have seen exceptional strength in healthcare utilisation, including general hospital volumes as well as medical procedures. It remains an open question as to whether this is just the beginning of the baby boomer generation entering into the higher acuity phase of their lives, but we see to two main drivers of the current trend.

Firstly, there is a small set of patients and needs in specific areas that are still catching up from Covid delays. More significantly, however, has been the easing of labour and cost conditions. As a result, hospital and facilities stocks, as well as large portions of the medical device and supplies sectors will benefit from this trend.

The life science tools and services segment, which experienced challenges in the aftermath of the pandemic, is now showing signs of recovery. Over-ordering during the pandemic led to lower levels of demand in the period since, and consumers drawing down previous stocks led to disruptions in the predictive power of the 'new orders' metric reported quarterly by these companies.

With these supply disruptions resolving, and with a growing demand for innovative therapies and cost-efficient drug discovery, companies in this space are poised for long-term growth, making them attractive investment targets.

The result of the US election could have an impact on drug prices

The big trends driving healthcare – longevity, demographics, and the impact of AI on medical research – are largely impervious to short-term political moves. Nonetheless, the US political landscape plays a pivotal role in shaping healthcare regulations, particularly in terms of patient access and drug pricing. With the implementation of the Inflation Reduction Act (IRA) and ongoing discussion of healthcare reform, we are monitoring the potential for impact of regulatory changes on the prioritisation of R&D spending and acquisitions within biopharma.

"The big trends driving healthcare – longevity, demographics, and the impact of AI on medical research – are largely impervious to short-term political moves. Nonetheless, the US political landscape plays a pivotal role in shaping healthcare regulations, particularly in terms of patient access and drug pricing"

Despite muted discussion of healthcare regulations in the current election cycle, the implications of the IRA and potential adjustments under a new administration remain critical factors. We expect that Republicans would see a large-scale repeal of the IRA as neither feasible nor politically attractive. The implications of the IRA on the prioritisation of R&D dollars as well as acquisitions within biopharma remains a key topic. It also remains to be seen how direct price negotiation with the US government will affect volume and private payor positioning for the first 10 drugs being affected by IRA reforms.

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How Wrong Is Your Mortality Projection Model?

Author:
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Lane, Clark & Peacock

> "So different are the projections that the value of the €20-30bn of Dutch pension fund liabilities expected to be bought out by insurers by 2027 could differ by at least €500 million depending on the model used"

This was the question that I asked delegates when I presented at the nineteenth International Longevity Risk and Capital Markets Solutions Conference (Longevity 19) in Amsterdam in September.

I illustrated the significance of model risk by showing that the Projections Life Table (AG2024) produced by the Royal Dutch Actuarial Association produces forecasts which are materially different from the forecasts which result from applying a widely used alternative model to Dutch data.

In fact, so different are the projections that the value of the €20-30bn of Dutch pension fund liabilities expected to be bought out by insurers by 2027 could differ by at least €500 million depending on the model used.

The alternative model I used was the CMI Mortality Projections Model (CMI model) produced by the Continuous Mortality Investigation and which has widespread usage in the UK. Specifically, LCP took the latest version of the CMI model, "CMI_2023", and calibrated it to Dutch data from 1983 to 2023. We compared the range of resulting projections with those obtained from the newly released AG2024 and also its predecessor "AG2022".

The explanation for the large difference between the projections is relatively simple.

The AG2024 (and AG2022) projection assumes that excess mortality seen since the Covid-19 pandemic will run off very quickly, with annual improvements in mortality quickly reaching a long-term rate. This rate is based on the trends seen in selected European countries over the last five decades and is much higher than the rate of improvements seen in the Netherlands since 2010.

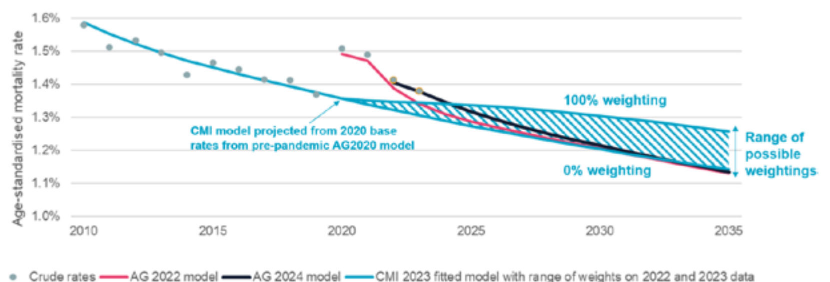
Meanwhile, LCP's calibration of the CMI_2023 model assumes that the lacklustre improvements in mortality seen in the Netherlands since 2010 will continue in the near term, trending only slowly up to a higher long-term rate of improvement.

The impact of the different projections on life expectancies varies by age and sex, and also depending on how much weight is placed on post-pandemic data when using the CMI model.

The difference between the models is particularly pronounced for females, as illustrated in the chart and table below.

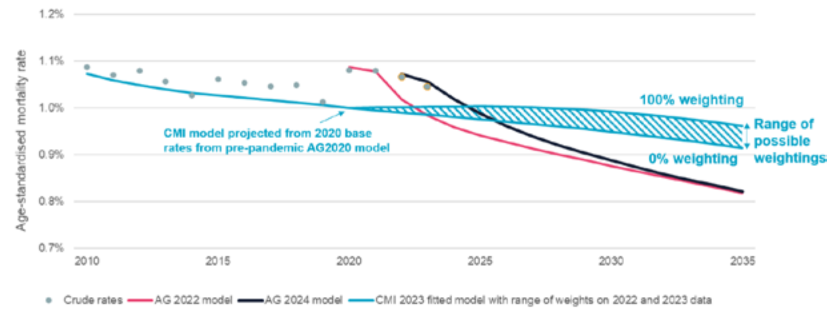
Projections of mortality rates

Figure 1: Comparison of projected mortality rates - Males



Source: LCP analysis, age-standardised over ages 20 to 100. Pre-2022 crude rates from the Human Mortality Database. 2022 and 2023 crude rates are estimated from provisional data from STMF database.

Figure 2: Comparison of projected mortality rates - Females



Source: LCP analysis, age-standardised over ages 20 to 100. Pre-2022 crude rates from the Human Mortality Database. 2022 and 2023 crude rates are estimated from provisional data from STMF database.

Table 1: Cohort Life expectancy in 2024

Cohort life expectancy (years) in 2024	AG2024 model	CMI_2023 (no weight on 2022/23 data)	CMI_2023 (full weight on 2022/23 data)
Male; Age 65	20.5	-1.4%	-4.9%
Male; Age 80	8.7	+1.7%	-2.1%
Female; Age 65	23.3	-5.3%	-6.7%
Female; Age 80	10.2	-2.8%	-4.9%

> "These life expectancy differences are a great illustration of model risk. The differences between the two models are far larger than the differences recently seen between successive versions of either the AG model or the CMI model"

These life expectancy differences are a great illustration of model risk. The differences between the two models are far larger than the differences recently seen between successive versions of either the AG model (cohort life expectancies fell by 0.1% for males and 0.2% for females between AG2022 and AG2024) or the CMI model (cohort life expectancies at age 65 fell by 0.4% for males and 0.2% for females between CMI_2022 and CMI_2023).

With models from two well-respected actuarial bodies producing such different mortality projections, how should Dutch pension funds, and the insurers and reinsurers active in the growing pension risk transfer market, set mortality assumptions?

Solely relying on traditional actuarial methods to predict future mortality trends no longer works. Instead, LCP's approach draws from our multi-disciplinary team of actuaries, health professionals, epidemiologists and public health experts to provide insights on what is driving changes to mortality and provide informed forward-looking scenarios.

We recently ran a structured Delphi process to obtain insights into how mortality rates in the UK are likely to progress over the next decade. We are currently running a similar exercise for the Netherlands with a panel of experts including several Dutch experts and will have results available later in 2024.

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Private Equity's Reshaping of the Asian Life Sector Has Further To Run

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> **"New regulatory regimes are being introduced across the region to make them more focused on risk-based capital frameworks, with changes already in place in Australia, Mainland China, South Korea, Hong Kong and Singapore, and due to come into effect in Japan and Taiwan"**

Private equity-backed reinsurers' appetite for Asian life insurance assets is unlikely to be sated any time soon, as there is $2 trillion of assets/liabilities under management that are currently providing sub-par capital returns. Shareholder pressure and new capital standards are likely to drive companies in Japan to move first.

As of December 31, 2023, private equity-backed reinsurance transactions representing $25 billion of assets had occurred in Asia, only 2 percent of the addressable total. However, the value of deals rose tenfold between 2019 and 2023, led by recent transactions between insurers such as AXA HK, Manulife, FWD, T&D, Daiichi and Japan Post and reinsurers such as KKR-backed Global Atlantic, Apollo-backed Athene, Blackstone-backed Resolution, Carlyle-backed Fortitude and Reinsurance Group of America (RGA).

The influx of private equity money delivers considerable benefits to the Asian life sector, which is experiencing an unprecedented wave of regulatory change, as well as grappling with the introduction of International Financial Reporting Standard 17 (IFRS-17). New regulatory regimes are being introduced across the region to make them more focused on risk-based capital frameworks, with changes already in place in Australia, Mainland China, South Korea, Hong Kong and Singapore, and due to come into effect in Japan and Taiwan.

These reforms are leading life insurers to de-risk their balance sheets and seek to exit longer-term, or more capital-intensive, liabilities. Through entering these transactions, insurers are able to free up capital they can then use either to improve their solvency ratio or reinvest in areas such as digitisation or new, more-profitable products.

Concurrently, just as private equity firms are becoming more bullish on the life insurance sector, Asian insurers have become increasingly bullish on investing in private equity and private credit, with the Asian trend toward investing in these areas outpacing the change in EMEA and the US.[1]

For private equity-backed reinsurers, the transactions deliver access to in-force books of business that provide permanent capital, which can be re-invested. In addition, through buying up insurance assets in different markets, private equity-backed reinsurers benefit from greater diversification.

While private equity investment in reinsurance may be relatively new to Asia, it is well established in such regions as the US, where private equity interest in life insurance began with Berkshire Hathaway's acquisition of National Indemnity in 1967. This interest accelerated after the 2008 financial crisis. At the end of 2022, private equity firms owned 137 US insurance companies with USD 533.7 billion in assets, representing 6.5% of total US insurance assets, according to data from the National Association of Insurance Commissioners.[2]

The involvement of private equity firms globally has been met with increased scrutiny from some regulators, with a US Treasury Department Panel and the International Monetary Fund both raising concerns about systemic risks to the economy. This has been caused at least in part by issues raised by some smaller deals in Europe that failed, putting policyholders' funds at risk.

However, these unsuccessful transactions represent a small fraction of the overall trend. The majority of insurers continue to see private equity-backed reinsurance as a vital source of capital, with their funds collateralised and quarantined from other assets within substantial, well-funded reinsurers financed by credible global firms.

In the vast majority of cases, customers experience no change, which is vital for a sector renowned for longevity and stability.

In the vast majority of cases, customers experience no change, which is vital for a sector renowned for longevity and stability. The carrier retains servicing and administration of the policies. Ultimately, consumers stand to benefit, as the insurers—with newly bolstered balance sheets—redeploy the proceeds into new initiatives and products that enhance the customer experience. This also gives the carrier greater stability to pay any benefits that are non-guaranteed, such as dividends and bonuses, which provides additional certainty that customers receive the product that they have purchased.

In addition, these private equity-backed reinsurers are carefully monitored both by Asian regulators and at home. Almost all of these acquiring groups are domiciled in Bermuda, which received Solvency II equivalence from the European Commission in 2016, putting the regulatory regime on a par with those in countries such as the US and Canada,[3] and where the Bermuda Monetary Authority has continued to make changes to tighten its already conservative and effective supervisory regime.

> "Private equity interest in Asia's life insurance sector is likely to remain strong over the next decade, which will be welcomed by the region's carriers as they look to satisfy the dual demands of increased capital requirements and enhanced profitability"

The private equity-backed reinsurers provide access to asset classes and investment expertise that often don't exist within the traditional carriers themselves.

As with traditional reinsurers, all elements of the reinsurance structure are negotiated, analysed, tested and transparent. In line with an insurer's appetite for volatility and risk, the reinsurer will find the appropriate balance of asset classes to invest in, and the private equity-backed reinsurers provide access to asset classes and investment expertise that often don't exist within the traditional carriers themselves.

Private equity interest in Asia's life insurance sector is likely to remain strong over the next decade, which will be welcomed by the region's carriers as they look to satisfy the dual demands of increased capital requirements and enhanced profitability.

While the recent uptick in transactions has managed to grab the headlines, this may just be the tip of the iceberg. Ultimately, this new injection of funds can only be beneficial for the long-term health of the sector overall.

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[1] 2024 Global Insurance Survey by Goldman Sachs Asset Management, quoted in Asia Investor. https://asianinvestor.net/article/asian-insurers-plan-to-add-duration-credit-risk/495380

[2] Insurance Newsnet article, January 9, 2024. https://insurancenewsnet.com/innarticle/private-equity-stake-in-life-insurers-draws-new-round-of-critical-reports

[3] KPMG report into Life/Long-Term Structures in Bermuda. https://assets.kpmg.com/content/dam/kpmg/bm/pdf/2021/04/kpmg-life-industry-bermuda-web.pdf

This Guy Carpenter article originally appeared on guycarp.com

Q&A

Swapnil Katkar
Partner, EY

Author:
Greg Winterton
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Life Risk News

EY recently appointed Swapnil Katkar as a new Partner in the firm's London office where he will lead the bulk purchase annuity (BPA) and capital markets solutions business at the firm. Greg Winterton caught up with Katkar to get his take on the current state of the BPA market and his views on the outlook for the coming 12-18 months.

GW: Swapnil, the growth in the UK BPA market is not only made manifest in the number of deals being completed, but also evidenced by the recent and planned entries of new insurers into the market. What is your view of the reality of just how large this market can grow to on an annual basis?

SK: The BPA market experienced substantial growth during 2023. This was largely driven by higher interest rates and credit spreads making BPA transactions a lot more affordable compared to 2022, and attractive in terms of value for money that these transactions offered to pension schemes. We estimate that around 225-250 BPA transactions were executed across nine BPA providers in 2023, covering a total deal volume of c.£45-50bn (compared to c.£25-30bn in 2022).

The growth in the BPA market during 2023 attracted new entrants, and we expect around 11 BPA providers to be ready to conduct business by H1 2025. New entrants will likely focus on smaller deals initially, giving pension schemes under £200m in size additional options and potentially better pricing.

Despite this, we are seeing more subdued growth in the BPA market in 2024 so far and anticipate lower annual growth in total deal volume this year. This is largely a result of weaker affordability due to tighter pricing (driven by low credit spreads) and due to fewer deals over £1bn in size – which were key in driving deal volume in 2023.

GW: Let's talk interest rates. The Bank of England reduced rates recently, and there are doves on the Monetary Policy Committee that want further cuts. What is the hedging status of most of the plans you work with? Are they sufficiently protected from further cuts? Indeed, are the days of schemes' funding status whipsawing gone now?

SK: Interest rates are forecast to continue to fall over the coming years, although the level and timing of future rate cuts remains to be seen. However, for pension scheme hedging, the most important aspect is long dated interest rates.

Looking back, a ten-year gilt yield – which could be seen as proxy interest rate for hedging purposes – has jumped from less than 1% pa to around 4% since 2022, substantially improving the pension scheme funding levels.

Many pension schemes have hedged their interest rate and inflation exposure embedded in pension liabilities on the scheme's funding basis. However, the majority of pension schemes likely remain under-hedged on a buyout basis, representing a higher liability compared to an average funding basis.

Overall, we anticipate that the days of schemes' funding status "whipsawing" – when pension liabilities go up and down materially more than pension scheme assets due to interest rate fluctuations – are largely gone, as the vast majority of schemes have largely hedged this exposure. However, that's not to say that other factors won't contribute to future fluctuations in funding levels.

Continued on next page...

GW: What's your view on concentration risk? There is an awful lot of pension liabilities hitting the balance sheets of life insurers and consequently, reinsurers.

SK: Concentration risk is currently an issue for the life insurance industry and its regulator, the Prudential Regulation Authority (PRA). It is mainly driven by funded reinsurance transactions whereby, for instance, a UK BPA insurer reinsures a proportion of its pension liabilities with an offshore reinsurer. Given its limited oversight and control over offshore reinsurers, the PRA has been looking at this area closely and has recently published the final policy statement on the use of funded reinsurance. This statement focuses on the need for BPA providers to consider diversification between funded reinsurance counterparties, and how they will set internal limits for any recapture of collateral from a single reinsurance counterparty.

This is likely to create significant operational change for BPA insurers as they put new processes in place to demonstrate compliance and how they are mitigating the concentration risk.

From a pension scheme standpoint, typically, an entire pension scheme liability is insured with a single BPA insurer under the BPA contract. This is the concentration risk the pension scheme is directly exposed to, in addition to indirect exposure to sources like concentration risk within the BPA insurer's investment strategy or its funded reinsurance strategy. This means pension schemes need to carefully consider all aspects of concentration risk when looking into executing a BPA transaction and the potential measures to mitigate this risk.

GW: What's on your radar in terms of longevity/ mortality trends? What are insurance companies and pension fund trustees currently discussing here that is impacting pricing, if at all?

SK: From a risk standpoint, post the Covid-19 pandemic, we are seeing less excitement among pension schemes to hedge longevity risk. In fact, the growth in the BPA market means that several schemes with legacy longevity hedges in place continue to assess opportunities to convert these into funded BPA contracts, especially as a number of these legacy longevity hedges are running at a loss.

We also see that the mortality assumptions used by pension schemes are now more aligned with the assumptions used by BPA providers, creating less impact in terms of any deficit on BPA basis.

Separately, there are continued developments in the reinsurance market which means the reinsurers now have substantial ability and appetite to provide longevity protection against longer duration liabilities (i.e.: on younger lives). This means pension schemes now have more choice in terms of hedging longevity attractively, either via BPA transaction or a longevity swap directly in the reinsurance market.

GW: Lastly, Swapnil, if you're a pension trustee reading this who has not yet begun the journey towards an insurance solution, what's your recommendation in terms of where to start?

SK: A pension trustee looking for an insurance solution could start by reviewing their strategic objectives as a key part of their journey planning. This could either be done upfront before executing any strategy or on a regular basis, for example, when the trustee board meets quarterly. Given the financial environment tends to change at pace, a more regular review would be recommended to ensure previously agreed objectives remain relevant and suitable.

In addition, given the range of strategic options available to pension trustees today – from run-on to buyout, from captive insurance to DB superfunds, from longevity hedging to self-insurance – it is recommended that these options are carefully considered before deciding on a chosen strategy. This could make a substantial difference to the long-term outcome for scheme members in terms of benefits received and the security of those benefits. This will also ensure that the pension trustees and corporate sponsors are reasonably aligned on the chosen strategy.

A Tough Year for US Reverse Mortgage Origination but Recent Rate Cut Provides Optimism

Author:
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Life Risk News

The US Department of Housing and Urban Development's (HUD) financial year runs from 1st October to 30th September, so another 12 months is now in the books for the primary US reverse mortgage market.

And, for many, it is yet another one to forget. HUD publishes a list of Home Equity Conversion Mortgage (HECM) endorsements on its website, and the data for FY 2023-24 makes for grim reading, with only 26,521 endorsements, the lowest observed since 2003, according to data on industry group the National Reverse Mortgage Lenders Association's website.

The main driver of the pull back in activity in the past few years should come as little surprise; higher interest rates have led to a dampening of demand in the space.

"Like all mortgage origination, forward and reverse, higher interest rates adversely impact volume," said Michael McCully, Partner at New View Advisors.

"In the US market, agency volume is highly correlated to the 10-year CMT index because that is what is used to calculate the Expected Rate – the interest rate used to determine borrower proceeds" - Michael McCully, New View Advisors

"In the US market, agency volume is highly correlated to the 10-year CMT [Constant Maturity Treasury] index because that is what is used to calculate the Expected Rate – the interest rate used to determine borrower proceeds," McCully added.

Higher interest rates may be the main driver of slower activity in the reverse mortgage market, but they are not the only one.

"Baby boomer homeowners have more debt than their previous, depression-era homeowner counterparts. That has meant that the number of transactions 'short to close' in the reverse mortgage space has been rising in recent years," said McCully.

Additionally, American seniors have other options if they want to access cash from their home. The HELOC (Home Equity Line of Credit) loan is one of these and activity in this area has an impact – albeit, in the younger cohort as opposed to the older one.

"There are many more HELOCs originated than HECMs so yes, HELOCs take away volume from reverse. They're easier to close, and with much smaller upfront closing costs. However, HELOCs have a monthly payment, the LOC can be withdrawn should home values fall, and older borrowers often do not qualify for HELOCs, based on age and income," said McCully.

Another demand dampener is the fee structure in the reverse mortgage market. American seniors taking out a government guaranteed HECM reverse mortgage are charged 2% of the home value at closing for the initial Mortgage Insurance Premium – and then 0.5% annually thereafter. The Federal Housing Administration raises the Maximum Claim Amount each year, so the average upfront MIP payment has been increasing. Add to that rising rates and falling proceeds, upfront MIP as a percentage of available proceeds has never been higher.

It is something that the reverse mortgage industry would like to see changed, and is trying to change, but no progress has been made - yet.

"The industry has submitted proposals to FHA recommending changing the HECM to make it more of a "pay as you go" product, i.e.: less upfront MIP, and more ongoing MIP. While FHA has made several meaningful program changes to improve liquidity and ease of assignment since the RMF bankruptcy, their resources are limited and there is no timeline for a lower upfront MIP product," said McCully.

It is not all bad, of course. Two recent, albeit very different, examples of support for the primary market came when Premier Plus Lending announced recently that it is expanding into the senior-focused home equity market with a new division, Retirement Mortgage Solutions, which will include reverse mortgages and other home equity-based lending instruments. And in the District of Columbia, DC Housing Finance Agency has resurrected its Reverse Mortgage Insurance & Tax Payment Program, which is designed to help

reverse mortgage owners who have received a legal notice that they are in default due to failure to pay property taxes or insurance premiums, or are facing difficulty in paying past due balances.

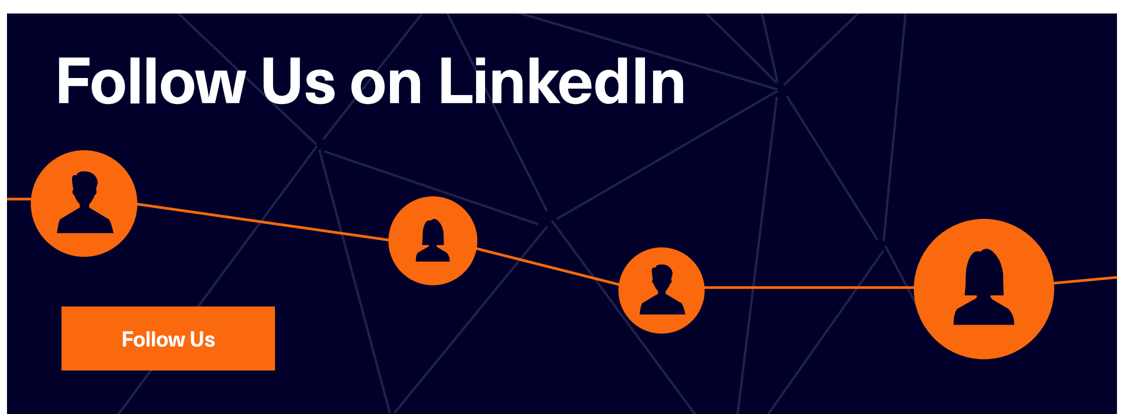
But undoubtedly, the greatest impact on the market comes in the form of the prevailing interest rate regime. Something that might appear counter-intuitive in the financial markets occurred recently, as the 50 basis points reduction in the US federal funds rate was accompanied by a corresponding rise in the 10-year yield. While market commentators suggest that this was little more than make-up for markets pricing in too much easing before the Fed meeting, it still means that American seniors that are waiting for rates to fall before entering into a reverse mortgage transaction will need to wait a little longer for financial normalcy to resume and yields on the 10-year to fall.

The good news is that they might not have to wait too long. According to the CME FedWatch, 100% of interest rates traders are pricing in another reduction at the Fed's next meeting, scheduled for 7th November, and almost 20% of interest rates traders are pricing in a 100 basis points reduction from current levels at the Fed's 18th December meeting.

In order for the US reverse mortgage market to 'reverse' its recent run of slowing issuance, more rate decreases can't come soon enough.

> **"The industry does need other changes – for example, changing the up-front formula for the MIP charge – but those changes will not have the same kind of immediate impact on origination that a significant fall in the 10-year treasury rate will have"**
> **- Michael McCully, New View Advisors**

"Again, volume is mostly about the 10-year treasury rate," said McCully. "In order for reverse mortgages to increase their attractiveness to American seniors, the rate will need to come down. The industry does need other changes – for example, changing the up-front formula for the MIP charge – but those changes will not have the same kind of immediate impact on origination that a significant fall in the 10-year treasury rate will have."



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