Carlisle CEO Garcia on life settlements' growing role in the ILS market

By Susan Barreto - August 12, 2024

Insurance-linked security (ILS) products have been gaining in popularity in recent years among traditional hedge fund investors especially, but another sub sector outside of catastrophe bonds is growing in influence.

Life settlements are a unique niche at Carlisle Management, a Luxembourg-based fund management firm. At *Alternatives Watch*, we wondered what was driving interest in this market and what the future holds for this market as allocators look for risk protection amid geopolitical uncertainty.

We caught up with Carlisle Management CEO Jose Garcia following Abacus Life's July 18 acquisition on of the Luxembourg-based investment manager for approximately $200 million. The deal signalled the U.S. publicly traded Abacus' continued expansion as a global asset manager.

Garcia, who was at the helm when the firm was established, is currently working on new investment vehicles focused on life settlements as a distinct form of diversification from traditional investment markets. He has a 20-year track record in the capital markets working on everything from structured finance transactions to real estate.

In this Q&A, Garcia outlines the firm's innovation in this arena and how global allocators are putting these products to work in their portfolios today.

AW: How has Carlisle's business evolved over the years?

Garcia: Carlisle is a Luxembourg based investment firm that was founded by industry veterans in 2009. The objective was to offer a pure US investment opportunity through a unique set-up: a Luxembourg regulated investment product.

We offer a broad range of investment solutions catered to institutional investors, designed to provide investors with the opportunity to invest into mortality-related products — an asset class that is uncorrelated to traditional financial markets and that offers a valuable diversification benefit to traditionally managed portfolios.

Since inception, we have seen growing interest from investors. Our client base has developed across numerous regions as investors have an opportunity to further diversify their allocation without additional exposure to traditional financial markets.

Carlisle is now managing approximately $2 billion across life settlement strategies.

AW: Increasingly, investors are eyeing insurance-linked products. How do life settlements fit into that asset class?

Garcia: Innovation has always been at the core of the alternative investment philosophy. It led to the discovery of a multiplicity of new asset classes but only a few managed to capture the requirements of the institutional investors, most notably Insurance-Linked Securities (ILS).

ILS represent a broad specter of financial instruments, all based on the same principle: assessment of the insurance risk, covering for the specific event such as but not limited to catastrophe or person's death. Their performance is therefore contingent on the occurrence of the specific insurance event.

There are two main categories: Non-life insurance linked securities (i.e. catastrophe bonds) and life insurance linked securities (i.e. life settlements).

Both main types fall below the ESG-oriented investments (Environmental Social and Corporate Governance), particularly catastrophe bonds for what it concerns the E — Environmental — part (designed to provide additional sources of capital to help the broader societal goal of helping countries and communities recover from disastrous events) and life settlements for the S — Social — part (providing much needed liquidity to seniors in possession of unwanted or unneeded life insurance policy).

Unlike cat bonds, life settlement is not exposed to climate change. Some members of the investment community value that characteristic that may be a differentiation factor, while comparing investment opportunities.

Life settlements is the subcategory of ILS for which the underlying value is contingent on life expectancy or longevity risk. Next to IT and healthcare, this is one of the few asset classes positively impacted by the COVID-19 crisis, due to its underlying asset.

Several factors led to the inception of life settlements:

- Huge volume of active life insurance in U.S. (over $20 Trillion of active Life Insurance).
- Robust regulatory framework
- The aging population and skyrocketing policy lapsing rates, which caused many US seniors to look for a cash exit strategy for an unwanted or unneeded life insurance policy. Such liquidity may be used by seniors to cover more immediate healthcare or pension expenses. Further 2017 amendments to the federal estate tax exemption have made more policies obsolete.

Life settlement yields have already attracted largest private market investors to the industry, thus moving the demand curve up.

Interestingly, some affiliate our investment proposal to hedge fund or alternative fixed income strategies such as private debt as there is contractual repayment obligation at maturity.

AW: What drives returns in life settlements?

Garcia: It is first absolutely important that the investment process includes several steps whereby life settlements subject to acquisition are being challenged to a set of strict quantitative and qualitative selection criteria as well as rigorous stress testing in order to ensure that adequate risk premium has been incorporate into sourcing price.

That requires direct experience in every phase of the life settlement process allowing top tier managers to employ unparalleled risk and yield assessment.

Secondly, capacity to source policies at substantial discount to market prices which directly translates into necessity of sourcing reach, the breadth and depth of the relationship in the market. As Life Settlement is an OTC market which is highly intermediated therefore the level of expansion of one's sourcing network and reputation play a huge role.

With the above in mind, the main performance driver for life settlements in mortality, which is also uncorrelated from most economic indicators and financial markets.

AW: How should investors benchmark returns in insurance-linked securities?

Garcia: While catastrophe bonds (cat bonds) remain the dominant type of outstanding ILS, there is growing appetite for other strategies. Both life and property/casualty (P/C) sectors hold great appeal for investors.

Non-cat bond ILS and life settlements have similar features in terms of longevity risk and returns.

Though liquidity windows and returns are not quite similar, fund selectors tend to benchmark life settlement's returns to alternative fixed income strategies.

Indeed, the mechanics of cat bonds, life settlements, or annuities clearly reminds the one of the bond's: there is initial purchase price that is based on a discounted cash flow model, premiums to be paid during the course life of a contract and a set face value at the maturity.

However, the risk/return profile, market size and liquidity remain to be very different from traditional fixed-income instruments. The underlying variable is unique, which is exactly what turns those assets into a new hedging solution, sought after by pension funds, sovereign wealth funds and insurance companies.

From an institutional perspective, what truly differentiates life settlements from previously mentioned alternatives is the robustness of the valuation: despite the asset class being relatively young and innovative, the fundamentals have been built on over a century old life insurance industry, with valuation models in place that have been largely utilized by large pension funds and insurance carriers for hundreds of years.

That being said, due to the nature of the asset class there is no publicly available reporting mechanism or publicly available benchmark.

AW: What makes Carlisle's approach unique?

Garcia: Carlisle is the biggest specialty finance company in the life settlement space and the only one offering a range of diverse fund structures

Sourcing policies are one of the key areas for performance generation. Our managers have not only pioneered various aspects of the life settlement market, but have also invested significant time, money and resources in creating direct origination relationships. Our managers utilize long-standing partnerships and marketing facilities to provide investors with the most efficient and profitable policy acquisition strategies. As a result, our funds underwrite only the highest investment grade assets while realizing higher margins on transactions.

The breadth and depth of these relationships has been and will continue to be a highly effective competitive edge in the sourcing of well-priced portfolios of policies in addition to being able to find value in the undeserved market segments

Carlisle Management Company’s success comes from years of experience, strategy testing, monitoring and refining our approach to the life settlement industry. Our top-quality team, enabled with our market intelligence, can anticipate changes, identify new sources of policies, and participate as leaders in the market.

AW: Are there new offerings planned at the firm?

Garcia: The focus for 2024 is the execution of the upcoming closing of our fourth vintage, namely Absolute Return Fund IV. More to come as we should launch a new closed-ended strategy soon!