



The Life Settlements Market
An Actuarial Perspective on
Consumer Economic Value

ACORD LOMA Insurance Systems Forum
May 23, 2006

Jay Vadiveloo, PhD, FSA, MAAA, CFA
Professor & Director, Deloitte-UConn Actuarial Center
Senior Manager, Deloitte Consulting, LLP

Presentation Outline

- Background on Life Settlements industry
- Deloitte-UConn Actuarial Center study on Life Settlements industry
- Impact of study and next steps

What is a Secondary Market for Life Insurance?

- Allows for a life insurance contract to be freely traded in an open, competitive marketplace.
- Value of an insurance contract exceeds the cash surrender value when a policyholder's health deteriorates significantly compared to their health status at issue.
- Transforms a life insurance contract into a more efficient liquid financial asset.

Current Secondary Market for Life Insurance

- Created by the Life Settlements industry in the late 1990's as an extension of the Viatical industry.
- Targets:
 - Large face amount policies
 - Senior citizens over age 65; and
 - Policyholders with impaired mortality ranging from 2 to 12 years of life expectancy.
- Policyholder gives up ownership of the contract in return for a cash payment.
 - Payment varies by individual underwriting characteristics at time of settlement
 - Payment significantly higher than cash surrender value
 - Future premiums paid by Life Settlements company; and
 - Death benefit proceeds paid to Life Settlements company.

Key Statistics of Current Secondary Market

- One of the fastest growing segments of the insurance industry.
- Approximately 19% compound growth rate since 1998.
- Potential market of life insurance policies held by senior citizens with impaired mortality estimated to exceed \$100 billion.

Deloitte-UConn Actuarial Center Study

- Available on www.lifeselementeducation.com.
- First study of its kind to analyze the Life Settlements industry from an actuarial and consumer perspective.
- Study revealed several concerns about current structure of Life Settlements sales process:
 - High transaction costs;
 - Lack of disclosure on value of life insurance contract for an impaired life;
 - Inadequately trained agents;
 - Questionable sales practices; and
 - Limitation of current regulations.

Highlights of Study

New York Schedule 8 – New Life Settlements Sales
2000-2003
(\$ millions)

	<u>Total</u>	<u>Total as % of Face</u>
Face Amount	\$226	--
Intrinsic Economic Value	\$141	62%
Life Settlements Value	\$45	20%
Lost Economic Value	\$96	42%

Highlights of Study *(Continued)*

Asset Transactions Costs

<u>Asset Type</u>	<u>Transactions Cost (%)</u>
Stocks	0.01% - 1%
Bonds	1% - 2%
Mutual Funds	0% - 5%
Gold	3% - 5%
Residential Real Estate	4% - 8%
Art	10% - 15%
Life Settlements	50% - 67%

Conclusions of the Study

- The Life Settlements industry should be credited for making a relatively illiquid life insurance asset into a tradeable commodity when a policyholder is impaired.
- The Life Settlements industry is inefficient in its current form. The Life Settlements purchase price, while significantly higher than the policy cash value(CV), grossly understates the fair market value or IEV of the policy due to:
 - High expenses and commissions
 - The inefficient tax structure of a life settlements transaction
- An impaired policyholder who has estate needs is better off holding on to a life insurance policy which typically is the highest yielding asset in their portfolio.
- Complete disclosure of Life Settlements transaction costs and a policy's IEV for an impaired policyholder could shrink the target market of the Life Settlements industry in its current structure.



Next Steps:
Creating An Efficient Secondary
Market

Design of Efficient Secondary Market

- Liquidity to impaired policyholder provided through a loan with policy face amount as collateral.
- Loan amount is flexible and could range from the CV to the IEV of the contract.
- Future premiums to keep the policy in force paid by the lending body.
- Contract ownership retained by policyholder
 - Excess of policy face amount over accumulated loan and premiums paid to beneficiary/estate
 - Risk charge assessed when loan option exercised to cover the risk of accumulated loan and premiums exceeding policy face amount.

Efficient Secondary Market

- Modest transaction costs
- Tax efficient
- Flexible – Policyholder can trade portion of the policy
- Policyholder can satisfy both liquidity and estate needs
- Low risk and profitable
- Easily understood by policyholder
- Larger market potential and more players could participate e.g Life Settlements companies, banks, insurance companies, etc

Current Secondary Market

- High transactions costs
- Tax inefficient
- Inflexible – Policyholder trades entire policy
- Policy holder can only satisfy liquidity needs to the detriment of estate needs
- High risk to investors
- Lack of complete disclosure
- Target market likely to be smaller with more complete disclosure

Design Complexities

- Analysis of different loan financing and risk coverage designs.
 - Loan financing and risk coverage provided by insurance company.
 - Risk coverage provided by insurance company and loan financing provided by bank or other funding organization.
 - Both risk coverage and loan financing provided by non-insurance entity.
 - Reinsurance coverage for the collateral shortfall risk.
- Impact of tax and insurance regulations on different designs
- Assessment of the risk charge which varies by:
 - Underwriting characteristics of policyholder
 - Type of policy
 - Level of loan
 - Design of loan arrangement

Design Complexities *(continued)*

- Determination of the appropriate provision for adverse deviation in assessing the longevity risk.
- Administrative, systems, and process issues:
 - Loan management system;
 - Policyholder disclosures;
 - Policy illustrations;
 - Product filings;
 - Agent training materials.
- Securitization of the loan assets by impaired life expectancy tranches.

Potential Benefits Of Restructured Secondary Market

- Satisfies a critical consumer need
- Draws more players and serves more consumers
- Potential increase in life insurance sales
 - Increase in the value of a life insurance contract
 - Allows complete divisibility of an otherwise illiquid asset.
- Financial Planning flexibility
 - Help meet changing financial needs when health is impaired
 - Life insurance asset can be modified to meet current financial needs as well as for estate planning.

Potential Benefits Of Restructured Secondary Market *(continued)*

- Increase in policyholder persistency because of the valuable option to obtain liquidity from life insurance asset in the future.
- Eminence in the marketplace
 - Favorably viewed by regulators and consumers
 - Solves the major concerns surrounding the current secondary market in life insurance
- Liquidity benefit coverage
 - Has low risk
 - Can be naturally hedged
 - Is profitable.

Conclusion

- The secondary market in life insurance is here to stay and its existence enhances the value of the life insurance asset owned by consumers.
- In its current form, the secondary market is inefficient and may not be suitable for many policyholders to engage in.
- The proposed restructured secondary market is efficient, more flexible, can serve a broader group of policyholders, and would draw more players to participate in this market including Life Settlements companies, life insurance companies, banks, financing institutions, etc.