THE ENVIRONMENT FOR INVESTMENT IN LIFE SETTLEMENT IN EUROPE IS IMPROVING

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OUTLINE

• Part 1: Historical Landscape
• Part 2: Future Opportunities
PART 1: HISTORICAL LANDSCAPE

- Aggregate Worldwide Investment Volumes
- Aggregate European Structure Types (by Face Value)
- Aggregate European Structure Types (by Number of Products)
- Aggregate European Investor Types
- Aggregate European Countries
- European Investment Volumes by Year
- European Structure Types by Year
- European Investor Types by Year
- Investor Experience

Source: ELSA estimates based on information relating to more than 150 investment products and privately-owned portfolios established between 2001 and 2012. The database includes both secondary and tertiary market purchases and may double-count individual policies as a result. Investment volumes are based on face value at the time of purchase and do not take into account subsequent policy maturities. Much of the information is not publically available and no representation is being made as to its accuracy or completeness.
The Americas, and specifically the U.S., has been the largest market for life settlement investment to date, with approx. $55 billion of face value purchased since 2001.

Approx. $35 billion of face value has been purchased by European investors, and approx. $5 billion from investors in the rest of the world.
• The majority of European investment by face value has been through open-ended funds.
• The category ‘Unspecified’ represents products for which the investment structure is not publicly available, but a significant portion of these are closed-ended structures.
European investors usually use a regulated structure for investments.

- The most common investment vehicles are closed-ended funds, open-ended funds and notes.
• The majority of European investment has come from institutions.
• Common jurisdictions for retail funds have included Luxembourg, Germany and Guernsey.
• A number of products have accepted both retail and institutional capital, and are classified as “Retail, HNW, Institutional” in the chart above.
• Countries reflect the domicile of the products and generally do not reflect the jurisdiction of the investors.
• One exception to this in the chart above is Germany, which was a significant source of investor capital between 2003 and 2006.
• Some products have changed domicile since establishment for tax or regulatory reasons.

Note: Netherlands includes Netherlands Antilles.
European investment in the asset class peaked in 2006 to 2008.

Since the global financial crisis and LE extensions in the fall of 2008, investment volumes have declined.

However, the last two years has seen the market stabilise at levels seen a decade ago.
• This chart shows the dominance of open-ended fund investments between 2005 and 2008.
• A small number of large privately owned portfolios were established in 2007 and 2008.
**EUROPEAN INVESTOR TYPES**

- The mixed investor type “Retail, HNWI, Institutional” has been less prominent since 2008.
- Other types have been largely in proportion with one another over time.
INVESTOR EXPERIENCE

• Characterised By
  – Poor financial performance relative to original expectations.
  – Life expectancy estimates that have proven to be much too short.
  – Poor product structuring, including inadequate liquidity provisions.
  – Inconsistent or absent regulation.
  – Conflicts of interest.
  – Cases of fraud.
  – Bad press/headlines.
PART 2: FUTURE OPPORTUNITIES

- Investor Sophistication/Conservatism
- Due Diligence/Appetite for Research
- Structural Developments
- Transparency Initiatives
- AAP’s Data Collection Process
- Comparison of Projected Yields
- Standardisation Initiatives
- Positioning Initiatives
- Conclusions
INVESTOR SOPHISTICATION/CONSERVATISM

• **The Challenge**
  – To convince past investors in underperforming products to invest again.
  – To convince new investors to enter the asset class for the first time.

• **The Path to the Future**
  – Transparency regarding the A/E results from medical underwriters.
  – Transparency regarding the A/E results from asset managers.
  – Mark-to-market valuation instead of mark-to-model valuation.
  – More transparency regarding essential portfolio information (valuation methodology, source of LE information, face value distribution, average current LE, discount factors used, etc.).
  – More conservative assumptions in every respect.
  – Focus on institutional investors, not on retail clients with relatively low sophistication.
  – Employment of fee structures which are tied to realised performance instead of ‘phantom gains’.
  – Eventually, more ‘skin-in-the-game’. 
DUE DILIGENCE/APPETITE FOR RESEARCH

• Due Diligence
  – Fund managers are becoming better educated on how and what to purchase, and in checking cases for resale-ability.
  – Due diligence is no longer a matter of ticking boxes and moving on – the documents have value and add value to the asset.
  – The enhancement of the due diligence process has highlighted the importance of picking the right groups with which to work.

• Appetite for Research
  – More and more academics are taking an interest in the asset class and producing groundbreaking research studies/analysis, which not only helps the industry as a whole but benefits investors seeking to gain more knowledge.
  – There have been several academic research papers and hundreds of articles written about the industry – the industry should be proactive and participate in this research.
STRUCTURAL DEVELOPMENTS

• Third-Party Exchanges
  – Although electronic exchanges did not take off as well in the secondary market, there has been increasing interest in tertiary market trading over the last year.
  – LifeBondXchange and Bridge Exchange have been the more prominent groups working in the space – currently no trading volumes have been published by either.
  – Funds trading with funds is not a new concept, but the revival of electronic trading may increase standards.

• Consolidation and Vertical Integration
  – More funds are moving towards vertical integration.
  – Providers are consolidating and are amending business models.
TRANSPARENCY INITIATIVES

• Index Development
  – AAP has calculated and published the ‘AAP Life Settlement Index’ since Dec 2007.
  – AAP is working on releasing a second index, also based on open-end funds, which will be investable for investors.
  – AAP also calculates the ‘AAP Life Settlement Reference Rate – Main Market’ from actual trades.
  – The development of a further index, based not on the performance of open-end structures but on actually closed transactions, is being evaluated.

• Transparent Providers
  – There have been efforts made by providers to participate in AAP’s transparent provider project.
  – As U.S. regulation helps drive the maturity of the market, it is hoped that the project will gain further support.
AAP’S DATA COLLECTION PROCESS

Data collection

- Data collection from multiple sources via PricewaterhouseCoopers.
- Providers are protected, we don’t know which provider had how many or which transactions.
- Providers get a platform via our publications, our homepage and so forth.
COMPARISON OF PROJECTED YIELDS

Yield & Duration
Corporate Indebts vs. AAP Life Settlement - Main Market

Projected Yield in % (YaR)

0%  5%  10%  15%  20%  25%

0.00  2.00  4.00  6.00  8.00  10.00
Duration in Years

Data for 'AAP LS - Main Market' is collected from providers. The transparent providers are:

- Abacus Settlements
- Berkshire Settlements
- Institutional Life Services
- Life Equity
- The Lifeline Program
- LifeTrust, LLC
- Magna LS/Mida Capital
- Q Capital Strategies
- Settlement Group, Inc.
STANDARDISATION INITIATIVES

• **ELSA’s Code of Practice Edition 3.0**
  - July 2010 – Edition 1.0 introduced to establish common standards of best practice within the European life settlement industry and protect the interest of investors in the asset class.
  - September 2012 – Edition 2.0 built upon that work and its themes of transparency, suitability and education, and reflected the industry and regulatory developments that had taken place since then.
  - June 2013 – Edition 3.0 separates the standards into requirements and guidance and introduces disclosure of non-compliance to mirror the approach taken by regulators. It also establishes additional standards to reflect “Big 4” auditing practice.

• **BVZL’s Best Practices Version 1.0**
  - January 2013 – Best Practices working group established.
  - Goal is to combine (i) guidelines for investors, (ii) best practices for asset managers, product designers/initiators, providers and medical underwriters, and (iii) detailed enforcement procedures.
  - September 2013 – Targeted release date.

• **Closing Package/Policy Documentation Standardisation**
  - See handout.
  - Especially in the tertiary market, it is important to define a standard list of documents that an investor should receive or expect to have when purchasing or selling policies.
  - On a case-by-case basis funding entities may have, or may request, more than this.
POSITIONING INITIATIVES

• Opportunities for Pension Fund Investors
  – There are numerous qualitative arguments supporting the hypothesis that the correlation between a typical European pension fund’s longevity risk and the longevity risk associated with a typical life settlement investment is only weakly positive.
  – A leading provider is currently working on quantifying this correlation, and proving this hypothesis.

• Opportunities for Insurance Company Investors
  – Life settlement investments may be attractive to European insurance companies with long mortality risk positions or looking to increase investment diversification.
  – Fund managers able to provide detailed policy data, pricing model support and a robust track record may allow an insurance company investor to meet Solvency II’s “look through” requirements and avoid the 49% capital charge on typical hedge fund and other third-party managed investments.
  – An experienced fund manager is currently working with a “Big 4” accountancy firm to develop these arguments and to quantify the benefits of such an investment.

• Socially-Responsible Investment
  – Yesterday, Professor Naik highlighted the role that life settlements play in improving the welfare of policyowners and providing social benefit.
  – In the coming months, these arguments will be presented to a number of European bodies specialising in the review and certification of companies from an ESG perspective, with the goal of having life settlements certified as a socially-responsible investment.
CONCLUSIONS

• There is real value in the market today, particularly for thoughtful institutional investors.

• The investment story has never been more compelling, supported by:
  – Mortality experience approaching critical mass, and mortality assumptions starting to converge.
  – More transparency and openness, and a greater willingness of market participants to share data.
  – Codes of practice and other standardisation efforts.
  – Initiatives targeting specific investor groups (e.g., pension funds, insurance companies).

• This is a socially-responsible, welfare-improving industry that deserves to thrive.