

Observations on the Current State of the Life Settlement Market

September 2014

The regulatory environment has matured

- Life settlements are now regulated in 42 of the 50 US states.¹
- Of the two Model Acts upon which regulation is generally based, NCOIL reviewed theirs in March 2014 and chose not to amend it, and the NIAC are due to review theirs in 2015.
- There have been no significant new pronouncements from investor-side regulators, including the SEC, FCA, CBI, ISE and CSSF, since November 2011.

And recent legislation has been largely favourable

- There have been no new STOLI actions brought by carriers in almost three years. These actions largely involved policies issued between 2006 and 2009.
- Legislation allowing individuals to use life settlement proceeds to fund Medicaid expenses has been passed into law in Texas and Kentucky, and proposed in a further nine US states.²
- Six US states now require disclosure of the life settlement option.³ Lincoln National is currently defending a class-action lawsuit in California which may result in more widespread adoption of disclosure standards.⁴

Which has helped to improve the industry's reputation

- The industry's focus has returned to "plain vanilla" policies, issued with clear insurable interest many years prior to settlement and with a smaller average face amount.
- According to the US GAO, between 2006 and 2009, policyowners received \$5.62 billion more from life settlements than they would have received had they surrendered their policies.⁵
- According to London Business School, between 2001 and 2011, policyowners selling their policies collectively received more than four times the amount they would have received had they surrendered their policies.⁶
- According to the NAIC, there have been over 20,000 consumer complaints related to life and annuity insurance since 2011, and only 3 of these relate to life settlements.⁷

This, along with a better understanding of longevity risk

- Significantly more relevant mortality experience data is available now than when the industry began in the early 2000's, and medical underwriters and investment managers are making more use of that data.

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- There is evidence to suggest that the life expectancy estimates provided by the leading third-party medical underwriters are starting to converge.
 - The US Society of Actuaries released their draft 2014 VBT mortality tables on 14 August. If adopted by the market as expected, pricing and valuation assumptions will converge further.

And an appreciation for the fundamental benefits of the asset class

- Attractive returns.
- Largely uncorrelated to those of traditional asset classes.
- And with relatively low return volatility, if held to maturity.

Has led to more capital and new investors entering the market

- Apollo Global Management LLC has received \$1.555 billion in commitments for investment in its second life settlement fund, Financial Credit Investment II. As of June 30, Apollo had invested \$653 million of that amount.⁸
- Blackstone Group LP recently purchased a portfolio with more than \$800 million in face value.⁹

Which has contributed to a reduction in policy yields

- The “AAP Life Settlement Reference Rate - Main Market” averaged 16.1% between May and July 2014, compared to an average of 19.0% between January 2011 and April 2014.¹⁰

And encouraged more policy origination

- The face value of life insurance policies sold reached \$2.57 billion [in 2013], an increase from \$2.13 billion the year before.¹¹
- 2014 has seen an increase in TV, radio and internet marketing and advertising by brokers and providers, some using well-known actresses and actors as spokespeople.
- A number of providers are also working on “direct to consumer” initiatives and the promotion of irrevocable beneficiary (“IB”) transactions.

Bringing additional activity and growth to the industry

- ELSA and the other industry associations are attracting new members, with LISA reporting 13 new members in the past three months.
- Conference numbers are up by 30% or more. ELSA and BVZL are expecting a record attendance at their joint summit on 29 September.
- ELSA’s first half-day symposium in June was enthusiastically received, and it is planning a second event in December.
- Further collaboration between the industry associations is expected, as they work together to meet the increasing demands of their members and the market for unbiased information and expertise.

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- ¹ “Life Settlement Law”, LISA, October 2014. Delaware, Michigan and New Mexico regulate viaticals only. Alabama, Missouri, South Carolina, South Dakota and Wyoming are unregulated.
- ² “Medicaid Life Settlement Laws and Legislation”, LISA, April 2014. Legislation has been proposed in California, Louisiana, Maine, Maryland, Massachusetts, New Jersey, New York, Pennsylvania and Washington.
- ³ “Mandated Consumer Disclosure by Insurers”, LISA, April 2014. Kentucky, Maine, Oregon, Washington and Wisconsin require disclosure of life settlements. New Hampshire requires disclosure of alternatives (non-specific) to lapse or surrender.
- ⁴ Larry Grill et al v. Lincoln National Life Insurance Company, 5:2014cv00051, U.S. District Court, California Central District (Riverside).
- ⁵ “Report to the Special Committee on Aging, U.S. Senate”, July 2010 at <http://www.gao.gov/assets/310/306966.pdf>.
- ⁶ “Empirical Investigation of Life Settlements: The Secondary Market for Life Insurance Policies”, December 5, 2013 at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2278299.
- ⁷ “Closed Confirmed Consumer Complaints by Coverage Type, As of August 25, 2014” at https://eapps.naic.org/documents/cis_aggregate_complaints_by_coverage_types.pdf. 20,034 is the sum of the 2011 to 2014 “Life & Annuity” entries on page 1. “Reasons Why Closed Confirmed Consumer Complaints Were Reported, As of August 25, 2014” at https://eapps.naic.org/documents/cis_aggregate_complaints_by_reason_codes.pdf. 3 is the sum of the 2011 to 2014 “Viatical Settlement” entries on page 3. Note that the life settlement market is much smaller than the life and annuity insurance market. In “Life Settlements: A New Opportunity in Smaller Policies”, 2013, Conning, Inc. estimates that the cumulative face amount of in force life settlement policies was approximately \$34.8 billion at the end of 2012. In the ACLI’s “2013 Life Insurers Fact Book”, the sum of individual life insurance in force and individual annuity considerations at the end of 2012 is approximately \$11.4 trillion. Based on these figures, in proportion to the size of each market, the number of life settlement complaints is approximately one-twentieth of the number of life and annuity insurance market complaints.
- ⁸ The Life Settlements Report, Volume VIII, No. 14, August 21, 2014.
- ⁹ The Life Settlements Report, Volume VIII, No. 15, September 4, 2014.
- ¹⁰ AAP Life Settlement Market Update, Volume 3, Issue 7, August 2014 at <http://www.aa-partners.ch/life-settlement-market-update/> and prior monthly reports. AA-Partners attribute some of this reduction to factors other than demand, including a shift towards using more conservative medical underwriters in pricing.
- ¹¹ The Life Settlements Report, Volume VIII, No. 11, June 19, 2014.