



On August 9, 2011, SCOR SE, a global reinsurer with offices in more than 31 countries, acquired substantially all of the life reinsurance business, operations and staff of Transamerica Reinsurance, the life reinsurance division of the AEGON companies. The business of Transamerica Reinsurance will now be conducted through the SCOR Global Life companies, and Transamerica Reinsurance is no longer affiliated with the AEGON companies.

While articles, treaties and some historic materials may continue to bear the name Transamerica, AEGON is no longer producing new reinsurance business

# The Forecaster

## Life Settlement Market: Emerging Trends and Experience



**By Michelle Moloney,**  
FSA, CFA

Executive Managing Director,  
AEGON Group Cessions

*The secondary market in life insurance policies has been a topic of high interest with life insurers for some time, and Transamerica Reinsurance has reported on the life settlement market from different perspectives. In this issue we look at the secondary market from the view of a life expectancy underwriter. Recent data now suggest that the life expectancies assumed when pricing life settlement policies may have been too short.*

*Michelle Moloney, Executive Managing Director of AEGON Group Cessions and formerly the Vice President of Strategic Development for Transamerica Reinsurance, discussed this emerging experience and other changes in the life settlement market with Philip Loy, President and founder of AVS Underwriting, LLC, which recently conducted a mortality study of life settlement policies. Loy has a background in biophysics and is a graduate of Mount St. Mary's College and the University of Houston. He has served on the Board of Directors of the Life Insurance Settlements Association and the National Viatical Association.*

**Michelle Moloney:** *The evolution of AVS reflects the development of the life settlement industry. Can you give us a quick background on your company?*

**Phil Loy:** We began evaluating viatical settlements in 1994 on individuals who had AIDS and generally had small policies. We developed our core modeling concepts at this time and continued to improve them over the years. Next, we expanded into other terminal illnesses such as Lou Gehrig's disease and pancreatic cancer – conditions that insurers would flag as “risk not acceptable.” This experience gave us insight into modeling mortality for specific impairments, a key element of our evaluation process today. Then, as the secondary market evolved we developed experience data involving policies of older age individuals.



**By Philip Loy,**  
President  
AVS Underwriting, LLC

---

### Market Conditions

---

**MM:** *How would you describe the state of the life settlement market today?*

**PL:** Probably the biggest changes are a decrease in premium financing, an increase in synthetic products and an increase in smaller face amount policies being submitted for life settlements. The market for larger face amount policies – \$2 million and up – has pretty much stayed the same.

In the last two years AVS averaged 35 to 40 percent growth, and our 2008 volume is up 60 percent over the first half of 2007. The overall market is experiencing substantial growth; sales numbers were about \$13 billion in 2005, and I think we could see \$60 billion in sales within five years.

**MM:** *What is driving the reduced interest in premium-financed policies?*

**PL:** Most of the large investors who purchased premium-financed policies in the past have been scared off by the life insurance companies. These policies, sold by agents with a non-recourse premium financing mechanism, are the cause of great concern to life insurers to the point that some have challenged paying claims to investors on the grounds of insurable interest.

Many life insurers now include questions in their applications about the funding of

premiums. Some have modified their product designs to include features such as policy loans based on face amount rather than cash surrender value to make them less attractive for life settlement. Also, life insurers through the ACLI are urging the NAIC to lengthen the contestability period for settling a policy.

Given the current environment, some investors have made blanket statements that they are not interested in taking policies that came out of the premium finance market. There may be some interest out there, but people who market these policies are telling me that they can't find buyers for them at all.

*MM: How competitive is the market?*

**PL:** We've definitely seen an increase in the number of players in the marketplace. More competition is good, but some of the newer players are not very knowledgeable about the industry. They are underestimating the impact of the life expectancy assumption on their internal rates of return (IRR) and in turn are competing against themselves in places they shouldn't. Still, some of the other newer investors bring a lot of knowledge with them. They come with actuaries in tow and are making much better investment decisions.

*MM: Why are there so many more players entering this market?*

**PL:** It has to do with market fundamentals. To grow this business, it takes a balance of enough policies and enough money to buy the policies. Over the years there have been times when the industry has had more policies than money to buy them and vice-versa. Today's market has balance.

On the policy side there is more awareness among agents, brokers and other distributors. They recognize the value of life settlements as an alternative to policy lapse or surrender. On the money side, more capital is available because of failures in other markets and investors are looking for alternatives. Still, across the board they're all competing with each other for the best policies.

*MM: How is this affecting margins?*

**PL:** Margins are coming down for a variety of reasons. For agents and brokers, sales are up and commission income is up, but commission rates are down because of increased competition for the business. For

investors, particularly the big investment banks, income is up, but rates of return are down because of increased competition for quality assets and higher funding costs. Also, experience is showing that policyholders who entered into life settlements are living longer than we as an industry originally expected, affecting realized IRR. Nevertheless, an increase in investment capital has fueled the development of tertiary and synthetic markets. Previously, the only way investors could make money was when the insured died, but now they have other options.

*MM: Can you tell us more about tertiary and synthetic markets?*

**PL:** The tertiary market involves the resale of life settlement policies from one investor to another. Historically, resales were rare because the assets were difficult to value and transfer. However, the increase in large investor capital in the past few years has added liquidity and facilitated the trading of life settlements.

By comparison, synthetic markets offer mortality exposure without investors having to take actual possession of the life insurance policies. In other words, they are life-linked but not policy-linked. These derivatives are based on the experience of large pools of anonymous policies. Most of the major investment banks either have or plan to offer synthetic products. Both the tertiary and synthetic markets have high growth potential.

And both markets are certainly becoming more active. We have a number of clients in this market who call weekly asking about our mortality table, so I know there is a great deal of interest in evaluations for these markets.

*MM: What about growth in the volume of lower face amount settlements?*

**PL:** The smaller-face amount policy business is starting to grow dramatically, which may be a result of the current tough economic times. People still need extra money for a variety of reasons, and their life insurance policy is the one asset that has retained its value. Real estate, stocks and bonds have dropped pretty significantly. You may even see further increase in this type of business near term and certainly more marketing focused in that area.

---

---

## **Mortality Experience**

---

---

*MM: How did the Actual-to-Expected (A/E) numbers work out in your study?*

PL: For the first time we had comprehensive data to work with, and it was a bit sobering that it was less than 100 percent. Our life expectancy valuations are consistently the most accurate in the business, but we have room for improvement. I think it will work out in the 80-85 percent A/E range once we are finished with the analysis.

Another finding from our A/E studies is that we performed much better with some specific impairments than with others. For example, statistically people with mild coronary artery disease will probably have one of the biggest changes for us because of their higher-than-expected survival rate. They may even look like preferred insureds with mild coronary disease, likely because of treatment with newer statins and blood pressure medications.

*MM: Can you tell us more about the data you used and your thoughts on the study's results overall?*

PL: From 1999 – 2007 we collected 200,000 evaluations on 60,000 individuals with a peak age between 72-85. Unlike life insurers, we see some cases several times because an insured may try to sell the same policy repeatedly or have multiple policies to sell. Such cases are included once for each year in which they were evaluated, giving us 80,000 data points. Since the medical history and underwriting methodology change over time, how past data is incorporated into the current evaluation can have a significant impact on the A/E result.

Back in 2004, we lacked the data to break results out into specific impairments. Today we have enough data to really start developing particular table considerations. Overall, I think that the study validates what we have been doing all along. We respond to the actual data and make appropriate changes to our processes. The most accurate results possible given available information benefits our clients going forward.

*MM: I've seen A/E results fluctuate as much as 25 percent to 30 percent due to different definitions of life observations.*

*Would a standardized A/E format help to improve transparency?*

PL: I've proposed for some time that the industry needs a mechanism for a standardized A/E, at least using one specific table and one analytical format. This would be hard to do, just as it would be hard to get insurers to use the same format.

However, A/E analysis is more than the life expectancy assumption and the mortality table that's being used; a host of other factors come into play. That is why we actually give the data to our clients so they can calculate the A/E themselves. The investors are very sophisticated today. Many of them understand the mechanics of the business well enough to analyze past experience on their own.

*MM: Given your findings that life expectancy evaluations are 15 to 20 percent too short, how do you expect the industry will respond to this emerging experience?*

PL: For the most part, the actual life expectancy will be about four to six months longer than the AVS evaluation. However, there is significant variation depending on the specific impairment, so some will be a year or more too short. We aim for accuracy and are just getting enough data to get there. Shifting life expectancy assumptions upward will reduce IRR. However, I don't see companies making any major changes in how they conduct and analyze their business.

Our experience study is based on cases presented to AVS for evaluation, not what the provider used for the transaction. The provider may well have used a life expectancy purchased from a different underwriter or developed their own. Our assumptions tend to be more conservative, so if the provider did use a different assumption from ours, their actual experience probably had an even greater effect on their IRR.

*MM: How do you anticipate that the mortality experience adjustment will play out, and is it analogous to the current credit crisis underway?*

PL: I expect to see some churning in the tertiary market, but most participants in today's market possess sufficient wherewithal to support their business and adjust their

expectations. It's not a scenario where the portfolio becomes valueless. It just shifts the performance. In that respect, it's an IRR-type of problem and not analogous to the credit default troubles elsewhere in the financial arena.

**MM:** *Do you have any closing thoughts on the industry in general?*

**PL:** The genesis of this business was viatical settlements, where we were that last source of money that was desperately needed by people who were terminally ill. These people may have had health insurance but no longer had jobs for income, and life settlements provided that critical social need. The industry's use of life settlements has broadened significantly since the early days and there have been abuses. I am concerned that negative perceptions of our industry obscure the legitimate value that life settlements offer to policyholders.

In these current tough economic times we again are seeing life settlements provide people with an alternative source of money when other assets have failed to retain their value. Yesterday we filled a social need for the ill; today it's the elderly. I believe that this market in its more simplified form has a great opportunity to thrive.

*The AVS mortality study reflects experience of all policies underwritten regardless of whether they ultimately were sold. Given the competitive bidding environment a policy with the shortest life expectancy generally will be the one that's sold. Additionally, AVS life expectancy assumptions tend to be more conservative. In fact, another medical underwriter recently announced a 25 percent increase in life expectancies. As a result the market overall may be short by more than the 15– 20 percent adjustment indicated by the AVS data.*

*One of the reasons life settlements have been attractive to investors is their higher rates of return as well as their being non-correlated with the capital markets. Realized IRR may test the longer term investor appetite. For example, to give an indication of the impact on returns, a 25 percent increase in life expectancy reduces the IRR from a base of 10 percent to about 7 percent or 300 basis points (bp) while a 35 percent increase halves the IRR, from 10 percent to about 5 percent or 500 bp. While the final adjustment to the emerging actual experience may not be known for some time, truing-up of life expectancy assumptions by life settlement providers and investors is now underway. This will have material consequences for participants in this emerging market.*

*Transamerica Reinsurance is committed to keeping our clients up to date on these and other important market issues. For more information on life settlements, please visit the hot topics page of our web site at [www.TransamericaReinsurance.com](http://www.TransamericaReinsurance.com).*



Visit our web site at [www.TransamericaReinsurance.com](http://www.TransamericaReinsurance.com)

Main Marketing Office  
Transamerica Square  
401 North Tryon Street  
Charlotte, North Carolina 28202  
704.344.2700

Asia Pacific Head Office  
27 F China Resources Bldg.  
26 Harbour Road  
Wanchai, Hong Kong  
852.2877.6222

Latin America Head Office  
2200 North Commerce Parkway  
Suite 208  
Weston, Florida 33326-3258  
954.349.1660

Europe Head Office  
7 Place de la Defense  
92974 Paris La Defense Cedex  
France  
33.1.49.67.81.60

*The information conveyed and the views expressed in this newsletter are provided for informational purposes only and are based on opinions and interpretations made by Transamerica Reinsurance. The opinions and interpretations expressed by Transamerica Reinsurance may not be the only interpretation available. This publication should not be copied or shared with any other company, reinsurer or consultant without obtaining prior approval from Transamerica Reinsurance.*

*Transamerica Reinsurance, a division of Transamerica Life Insurance Company.*

an  company