

Life Settlements ▼

## Mortality estimates and the impact on life settlements brokers



by Lori Booker

*Lori Booker is Associate General Counsel for Maple Life Financial, a mortality-based products provider and servicer based in Bethesda, MD. She can be reached at 240-333-7384 or [booker@maplelf.com](mailto:booker@maplelf.com).*

Recent changes to mortality tables by life expectancy

(LE) providers pose new challenges for the secondary life insurance market. This environmental shift has resulted in investors revising risk assessments and return rates and some life settlement providers rescinding offers to brokers based on old LE assumptions. How are these changes, along with others, impacting brokers? What strategies can savvy brokers use to compete in these new market conditions? Let's take a closer look.

### BACKGROUND

LEs are generated by underwriters who review insured's medical records and project the length of time an insured is anticipated to live. They play a major role in the calculation of the economic value of a life settlement policy and are used to project how long investors have to pay premiums before the death benefit is collected. Short LEs translate into higher offers for sellers, while long LEs typically result in lower offers.

### *Differences in Underwriting Life Settlements vs. Life Insurance*

Underwriting can be characterized as combining the evaluation of risk with the selection of an applicable mortality table. The application of the risk evaluation to the mortality table results in an underwriting class (or rating) for life insurance, or a LE in the case of life settlements. The underwriting of life insurance is constantly changing. People are living longer due to advancements in early diagnosis and treatment of disease. These advancements are gradually reflected in life insurance underwriting. At one time, individuals who had coronary artery bypass surgery were uninsurable. Now, those same individuals are charged a relatively small extra premium. Life insurance is much cheaper than it was 10 or 20 years ago.

The underwriting of life settlements is also evolving. The recent changes, resulting in longer LEs, seem more dramatic, but there are a number of reasons for this. First, the life settlement industry is relatively new and is still ascending the steep part of the learning curve. Second, the underwriting of life settlements is more complicated than underwriting life insurance. Life insurance companies target younger, healthier insureds (over 90 percent are issued standard or preferred).

An insured looking to sell his policy is older and generally in poorer health. Some life insurance companies won't issue policies to people who are "too old." This group of people presents the most challenging underwriting. The life settlement industry does not have its own underwriting manual, nor does it have its own mortality table. Insurance company manuals can be used, but subjective reasoning is applied to adapt the ratings to the senior life market.

Additionally, a number of impairments are not even covered. For example, Alzheimer's disease and ALS, usually

have a simple notation: “Decline.” Most life settlement companies use the 2008 Valuation Basic Table, released by the Society of Actuaries, as the basis for their mortality projections. However, it is modified in some way, based on the companies’ experience, outside consultants or other factors. No two mortality projections are the same, and the differences can be significant.

### **TRENDS**

Several trends have emerged since the recent changes in mortality estimates.

- **Push for standardization:** Due to increased pressure from investors and industry leaders to help reduce risks, LE providers will move to increased standardization, transparency, and auditing/access of data.
- **Lengthening of LEs:** As the life settlement market continues to mature and as statistically significant comparisons of actual to expected data become available there will be a lengthening of LEs. The recent change in LEs has resulted in narrowing the range between LE providers.
- **Lawsuits:** Some industry participants believe that recent changes could lead investors to file suit in order to recoup losses in portfolio values. An investor would have to show that faulty LEs were a direct cause of the loss sustained by the portfolio. It is unclear whether or not such a suit would be successful.
- **Technology:** LE providers will continue to offer new services to increase transparency and market efficiency. Some services will also be focused on providing specific data on impairments, allowing investors to perform analyzes matched to the characteristics of their portfolios.
- **Regulation:** The state of Florida began regulating LE providers in 2006. The Ohio Insurance Commissioner attempted to have LE providers licensed in 2008, but was unsuccessful. Industry participants believe that regulatory schemes with a focus on protecting consumers is misguided as LEs are produced for investors and the adequacy of the methodology should be determined by the investor market.

### **IMPACT TO BROKERS**

The recent changes in LE assumptions have impacted brokers in several areas including: longer LE assumptions, misconception of homogeneity, and increased fees.

- **Longer LE assumptions:** The changes have resulted, on average, in longer LE assumptions. Given the fact that mortality is a major component of the present value calculations used to derive prices, the results are predictable, lower prices to sellers. Life settlement brokers are struggling to adapt to this new paradigm. More policies are now marginally attractive to both sellers and buyers (a price high enough above the cash surrender value to make it economically prudent for the seller to act vs. a yield

acceptable to the buyer). Preconceived expectations regarding multiples of cash surrender value are ingrained in the market from years of relatively modest changes in underwriting. They are now being met with the reality that the recent changes in LEs leave much less to work with for the broker.

- **Misconception of Homogeneity:** An additional complication is the misconception that homogeneity had arrived in the area of life settlement underwriting. Various third party underwriters staunchly defending their methodologies continue to derive statistically meaningful differences in LEs confusing not only sellers, but investors as well.
- **Increased Fees:** Brokers are facing pressure to reduce transaction fees due to many providers no longer absorbing the costs for LE reports.

### **HOW TO COMPETE IN NEW MARKET CONDITIONS**

With all of these changes, savvy brokers will recognize the paradigm shift and look for ways to overcome these challenges. One of the easiest ways is to partner with an established life settlement provider.

Questions to consider when choosing a life settlement provider:

1. Does the provider strive to protect the interests of all parties involved in the transaction?
2. Are investment strategies and risks, along with purchasing parameters, thoroughly reviewed with customers?
3. Are combinations of external LE providers used for LEs?
4. Does the provider employ an internal team of experienced underwriters to review policies prior to offer?
5. Does the provider have an internal team of legal experts monitoring the changing regulatory requirements?
6. Are background checks and anti-fraud measures conducted?
7. Are committed offers honored?
8. Is E&O coverage provided to brokers?
9. Are broker/agent relationships respected?
10. Are consumer privacy and personal data safeguarded? ♦