



## Asset Class-Related Questions

### WHAT IS THE LIFE SETTLEMENT ASSET CLASS?

The life settlement market involves a longevity linked alternative asset class with both equity and fixed income-like characteristics. Institutional investors accumulate a portfolio of life insurance policies that they trade or hold until maturity. These policies are originally sourced from policyowners who have conducted a life settlement transaction.

### WHY WOULD AN INVESTOR ALLOCATE TO LIFE SETTLEMENTS?

The main benefit of allocating to life settlements for investors is that the asset class delivers returns that are only minimally correlated to traditional markets. Consequently, life settlements are considered as not only a source of 'true' alpha returns (given the lack of available beta exposure), but a clear diversifying portfolio allocation as well.

### WHAT IS THE SIZE OF THE LIFE SETTLEMENT MARKET?

Currently, the size of the secondary market – where a life settlement investor purchases a policy directly from a policy owner - is approximately \$4bn in face value per year, with approximately 3,000 policies sold in 2021 (according to the Life Settlements Report, part of The Deal). The life settlement market also has an "aftermarket", called the tertiary market, where investors trade either individual or blocks of policies, the size of which is difficult to calculate as the transactions tend to be privately arranged.

### WHAT IS THE POTENTIAL SIZE OF THE LIFE SETTLEMENT MARKET?

The size of the total primary life insurance market in the US was estimated to be \$21.2trn in 2021, according to the ACLI Life Insurers Fact Book, 2022 edition. Of this, approximately \$13.6trn was individual life insurance, the class of policy that is the subject of the life settlement market. In 2021, approximately 5.9% of individual life insurance policies in the United States were lapsed or surrendered without paying out a claim. It is these policies that could theoretically be sold on the secondary market, generating billions of dollars of value for the policy owners. However, it is difficult to estimate the potential size of the life settlement market as not all policies that lapse are appropriate for investors to purchase. Conning, a specialist research organization, estimated the net market potential in 2021 to be approximately \$160.5bn. This is almost six times Conning's estimate of the actual in-force life settlement market of \$26.7bn in 2021.

### DO ANY OTHER COUNTRIES HAVE A LIFE SETTLEMENT MARKET?

The US life settlement market is, by far, the largest secondary life insurance policy market in the world. Other markets exist in Germany and Canada, for example, but do not have the same structure as the market in the United States. The UK Traded Endowment Policy market was the first secondary market for life policies, but changes in how mortgage interest was taxed in the country means that the market is now largely defunct.

## WHAT ARE THE MAIN RISKS IN INVESTING IN LIFE SETTLEMENTS?

As with any other asset class, there are risks involved in life settlement investing. Some of the main risks include, but are not limited to:

1. Longevity risk: the risk that the individual insured person lives longer than anticipated, leading to lower financial returns for the investor due to payment of more premiums to sustain the policy.
2. Liquidity risk: life settlements are long term investments which may not be easily liquidated.
3. Cost of Insurance (CoI) risk: the originating carrier can, subject to certain rules, increase the cost of insurance component of a life insurance policy it has issued, which in turn results in an increase in premiums charged to maintain that policy. This results in decreased returns for the investor due to higher-than-expected premium payments.
4. Operational risk: the risk of loss resulting from inadequate or failed internal processes, such as missing a premium payment, which may cause the policy to lapse and render it null and void.
5. Legal risk: the risk that the death benefit due to the life settlement investor is subject to a claim by others which may result in the investor losing the death benefit.
6. Credit risk: the risk that the insurance company that wrote the insurance policy cannot pay the claim for the policy's death benefit when it matures.

## WHAT TYPE OF END INVESTORS ALLOCATE TO LIFE SETTLEMENTS INVESTMENT FUNDS?

Life settlements are long term investments, in which returns are realised over a period of many years. Consequently, end investors tend to include those that have long-term investment horizons; these include pension funds, endowments, foundations, insurance companies, and sovereign wealth funds. Family offices also allocate capital to third party investment managers, and some participate in the life settlement market directly. Most end investors that invest in life settlements do so by allocating capital to a third-party investment manager which specializes in transacting in the life settlement market.

## WHAT TYPES OF INVESTORS BUY LIFE SETTLEMENTS?

The buyers of life settlements are usually investment funds, which buy many policies – upwards of 100 or more – which are diversified by factors such as age of insured, life expectancy of insured, state of domicile, insurance company, and other variables. Other, 'accredited' investors, like family offices, buy life settlements as part of a diversified portfolio.

## DO RETAIL INVESTORS INVEST IN LIFE SETTLEMENTS?

Whilst it is possible for retail investors to invest in life settlements via some publicly offered funds, ELSA does not believe life settlements are an appropriate direct investment for retail investors.

Life settlements are complex, requiring substantial due diligence. In addition, they are long term investments, often with little or no interim liquidity available for those investors who may wish to unwind their investment. ELSA believes the asset class is appropriate for sophisticated institutional investors that have the resources to conduct appropriate research and due diligence, and the capacity to adopt to long dated investment horizons, committing capital for the long term.