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BVZL
International Secondary
Markets for Life Insurance

Issue 1 | March 2017

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BVZL
International Secondary Markets for Life Insurance

2017: Pointing the way forward for the international secondary and tertiary life insurance markets

2016 was an eventful year both economically and geopolitically; it was above all marked by Great Britain's "Brexit" decision, a resulting increase in scepticism towards the European project, the election of Donald Trump as the 45th US president, local and regional conflicts with tangible social and political impacts as well as the influence of political and monetary decisions, all of which have resulted in a sustained feeling of uncertainty among consumers and investors and unchanged volatility on the international financial markets.

In this atmosphere of insecurity and anticipation, it was above all the international secondary and tertiary life insurance markets that delivered positive growth signals after a stage of market shakeout and consolidation. Thanks to the work of the BVZL and other international trade associations (among other players), consumers are increasingly regarding life insurance as a "tradeable asset" and as part of their

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Inside the BVZL

Christian Seidl

Ingo Wichelhaus

financial planning strategy. And more and more institutional investors are recognizing the potential of life insurance as an attractive investment alternative (“off the mainstream”) and as a supplement to their existing portfolio mix.

Membership of the BVZL: a quality seal

Thanks to the ongoing efforts of all heads of section, the BVZL is in Germany now seen as the “general representative” of the various secondary markets, not only by the public but also opinion makers and the media. This puts us in a good position to represent our members' economic, legal and political interest even better in the future.

The industry standards created by the BVZL, especially with regard to transparency and comparability of the various international asset class segments, are regarded as “benchmark” and BVZL membership as a “quality seal” for companies.

2017 is pointing the way ahead

It is not yet clear how the global political landscape, international trade relations and the global financial markets will develop in the course of this year. What can however be said is that Europe will in many cases be at the center of future changes and that the European project will certainly have to brace for more stress testing. It remains to be seen whether this change process will further strengthen or weaken the EU and its member states.

Especially in times of economic and geopolitical uncertainty it is of uttermost importance for associations to take a clear public and political standing and to be clear on the interest of its members. The BVZL is prepared to do whatever it can to win back investors' trust in the asset class of life settlements and to convince the public, consumers and investors of the possible add value generated by the life settlement markets.

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Inside the BVZL

Save the Date: BVZL / ELSA: International Life Settlement Investor Conference 2017

On September 12, 2017 the "who is who" of international secondary life insurance markets will once again get together for a one-day expert symposium at Ernst & Young, London.

This largest European life settlement conference will be hosted and organized for the fourth time in a row by the BVZL and its British counterpart ELSA (European Life Settlement Association).

Numerous expert speeches are going to shed light on current trends and developments, challenges and market opportunities on the various secondary markets for life insurance. Problems of the past will be openly discussed and solutions and new investment opportunities will be highlighted.

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Be a part of it

Take advantage of excellent networking opportunities in a relaxed atmosphere! Exchange ideas with international experts, consultants, press representatives and investors at this most renowned European trade forum! This may help you to open up new perspectives for your company and new investment opportunities for your customers.

Details on sponsoring opportunities, registration fees, special early bird discounts as well as further information on the agenda and supporting program will be available soon at the BVZL's website at www.bvzl.de.

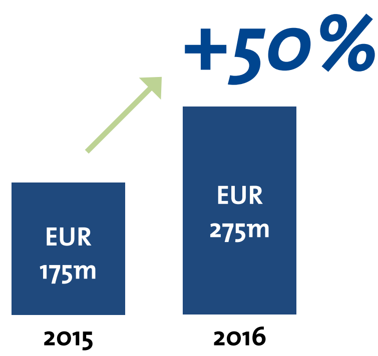
News from our member companies

2016: German policy purchasers organized in the BVZL able to raise volume of purchased policies by 50%!

This is a clear sign of recovery for the German secondary market. With a volume of purchased policies amounting to EUR 275m, German policy purchasers were able to increase the 2015 volume (EUR 175m) by approx. 50%. According to board member Ingo Wichelhaus, responsible for the German segment, this is a clear indicator of a renewed general positive environment for the German secondary market.

Encouraged by the debates revolving around the primary life insurance market, Mr Wichelhaus emphasizes the significance of expanding the generally positive public perception of the secondary market and to highlight the numerous advantages for all market participants. In his view it will be important to inform consumers, brokers, intermediaries and potential investors of the opportunities provided by the secondary market and to optimize processes as soon as possible, e.g. with regard to education and information of interested policy holders on the simplicity of the purchase process and the sustained mortality coverage in case of a policy sale.

Volume of purchased policies



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Mr Wichelhaus sees another clear sign of a renewed positive market environment in the so-called "policy purchase barometer" (available at the BVZL's webpage), which is currently in the clear "high" ranges. According to the barometer, the probability of a policy purchase by a BVZL member has been over 60 percent since the beginning of 2017. Average purchase prices have been rising too, so policy owners are profiting from even greater price advantages on the secondary market compared to the cash surrender value available from the insurer. And what's more: the remaining mortality coverage is sustained!

On our own account

Mr Lothar Trummer, until December 2016 head of section Communication & Politics, is no longer responsible for the public relations work at BVZL. Details on an alternative solution will be given shortly. We would like to extend our thanks to Mr Trummer for the long and trusting cooperation and wish him all the best for the future!

Since the BVZL's foundation in 2004, Lothar Trummer, who is also the director of ConsulTancy GmbH, Munich, has played an important role in the association's internal and external communication processes. He was a strong contributor to building up a trusting and open dialog with the media, politicians, trade and consumer protection associations and the wider public.

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Stress testing: EIOPA results

Markets – Germany

In December 2016 EIOPA, the European Insurance and Occupational Pensions Authority, published its final report on the Europe-wide stress test for insurance undertakings. The test involved major insurance companies that operate in Germany and across Europe and that are particularly exposed to the extended period of low interest rates. Dr Frank Grund, Chief Executive Director of Insurance Supervision at BaFin said: "The results confirm BaFin's assessments regarding the vulnerability of German life insurance undertakings to the risks in question. We are well prepared in this regard".

20 German life insurance undertakings participated in the stress test which – measured based on their gross technical provisions excluding index-linked and unit-linked business – account for approximately 75 percent of the market. In accordance with EIOPA requirements, the selection of German participants included small, medium-sized and large life insurance undertakings.

Please take a look at BaFin's full press release **here**

You can access a detailed summary / presentation of the major findings / results here **1** **2** **3** **4** **5**

The published results and the approach taken by EIOPA also triggered harsh criticism by some prominent figures. Dr Wilhelm Schneemeier, chairman of the German Association of Actuaries (DAV) said: "Under the given circumstances the state of vulnerability of German life insurers that was found in the report is hardly surprising. There was actually no need for actuarial calculations".

EIOPA had defined two scenarios for the stress test which served as the basis for analyzing the resilience of life insurers. The scenarios simulated a drastic worsening of the capital markets and future development of interest rates. These assumptions go significantly beyond the safety level already required by Solvency II rules. These rules require insurance undertakings to hold economic capital to ensure that ruin occurs no more often than once in every 200 cases.

Please click **here** for the full statement from the DAV (German version only!)

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According to the GDV, the German Insurance Association, the stress test scenarios are based on very restrictive assumptions that are in part economically unjustified. It is assumed that companies do not respond to the stress scenarios if they actually occurred - neither with regard to their product offering nor their investment policy. In the GDV's view the results of the stress testing do not allow any conclusions for the stability of insurance undertakings.

The full GDV statement can be accessed **here**
(German version only!)

An industry being pilloried

Life insurers are having a truly hard time. Not only are they struggling with low interest rates - the regulation catalog of supervisory authorities and the general public debate on pension provision is making regular headlines - and not in a positive sense for insurers.

The demographic changes and an increase in longevity risks are making it increasingly difficult for insurers to uphold guaranteed interest rates. The subjects of "digitalization" and "Insurtech" are also tying lots of resources. The additional provisions required in the context of the low interest environment and their uses are getting insurance companies into more and more trouble, not only politically, but also with regard to consumer protection agencies and the public. Apart from long-term debates about lacking transparency and little insight of policy holders into their life insurance product, this is aggravated by "skirmishes" of individual primary insurers with consumer protection agencies concerning the issues of "termination of lucrative old contracts" and "final costs". Little wonder that Germans' trust in their former favorite pension provision product is suffering strongly.

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The industry is putting obstacles in its own way!

It is unfortunate that insurers are regularly complicating matters. Acting according to the motto "The more danger, the more honor" not only ruins the "goodwill" of politicians and supervisory authorities, but also the relations with a large number of institutions and trade associations that have been active promoters of "life insurance" for years - also out of self-interest, of course. In this regard, we would like to refer to the current debate on the implementation of the EU Insurance Distribution Directive – IDD – in Germany and the outcry of a large number of associations of brokers and intermediaries.

Even more surprising was the rather high level of confidence shown by the primary insurance industry when presenting its annual figures.

You can access the GDV's press release **here** (German version only!)

Please find an overview of the development of life insurance **here** (German version only!)

The experts of Assekurata (the most important rating agency for the German insurance sector) were somehow much less euphoric when presenting their current study ... **here** (German version only!)

The political scene has mixed feelings, too. Please find further information **here** (German version only!)

End of the road for secondary annuities

Markets – Great Britain

End of the road for secondary annuities It seemed to be a big chance for some new business and a good thing for the consumers in Great Britain – but what a bad surprise, not only for the BVZL members. HM Treasury announced in November 2016 it will not take forward plans to introduce a secondary annuities market, which was due to open in April 2017. After consultations took place with industry, financial regulators and consumer groups, the Treasury claims that the consumer protections required could undermine the development of the market. The government also believes that there would be insufficient purchasers to create a competitive market – it could not guarantee that consumers would get good value for money. The government had predicted that only around 5% of current annuity holders would take advantage of the option to sell, but scrapping the reforms is likely to leave an estimated £485m shortfall in the Treasury's expected revenue next year.

You will find a summary of the discussion and consultations **here**

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New focus, new market, new chances for the industry: Insurance Linked Securities (ILS) – Proposed Handbook changes to reflect the new regulatory framework for ILS

The Financial Conduct Authority (FCA) has published a consultation setting out the changes which the FCA will propose to make to the FCA Handbook to reflect the new regulatory framework for Insurance Linked Securities (ILS). This includes changes to the application provisions of parts of the Handbook to incorporate ILS, some additional rules to create for ILS business, proposals for fees for the registration of Protected Cell Companies (PCC), and a number of consequential changes. The consultation closes 14 March 2017. This follows on from the joint Consultation Paper with the Prudential Regulation Authority (PRA) in November 2016 on the approach to authorisation and supervision of Insurance Special Purpose Vehicles (ISPVs), which carry out ILS business.

More details about the Consultation Paper (PRA CP42/16 | FCA CP16-34) "Authorisation and supervision of insurance special purpose vehicles" here

Background

As part of the March 2015 Budget, HM Treasury signalled an intention to work with the London insurance market to design a new framework which would attract Insurance Linked Securities (ILS) business to the United Kingdom. The regulators also committed to work with HM Treasury to examine what steps might be taken, within the constraints of the Solvency II regime, to address any obstacles within the regulatory framework for ILS business.

Subsequently, in March 2016, HM Treasury released a consultation document in which it sought views on the regulatory, tax and corporate structure framework for ILS business in the United Kingdom. As part of that consultation, comment was also invited on the authorisation and supervision of ISPVs. HM Treasury released a second consultation document on Wednesday 23 November 2016 setting out further details of its proposed approach.

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Markets – USA

Multiple Impairments – The Whole Can Be Less Than The Sum of The Parts

By Prof. Dr. Jochen Ruß

Estimations of life expectancy (LE) are typically based on a "base mortality table" that gives annual mortality probabilities, and thus also gives the LE for an "average" person. An LE-provider then performs a medical assessment to answer the question of whether and by how much the mortality of a certain individual is above or below average. In this process, typically debits and credits are being used. For example, "75 debits" means that the annual mortality probability of a certain individual is increased by 75% and therefore amounts to 1.75 times the mortality probability of an average person. These individualized mortality probabilities are then used to calculate the individual LE.

If an individual has more than just one impairment, an LE-provider would typically assess each impairment separately, come up with a respective number of debits for each impairment, and finally aggregate these debits. The important question is: How should these debits be aggregated?

For illustration, let's consider the example of a male insured aged 85 who has a severe impairment (A). If the insured had only impairment A, this would result in 200 debits. Now assume that the insured additionally has three minor health issues (B, C, and D). If the insured had only impairment B, this would result in 50 debits. Only impairment C would also result in 50 debits. Only impairment D would result in 25 debits.

There are many possible ways to aggregate these debits, e.g.:

The naïve approach simply adds up the debits, i.e. the person from the above example would receive 325 debits.

The primary impairment only approach assumes that the insured will most likely die from the most severe impairment and the other impairments can therefore be ignored. The person from the above example would receive 200 debits.

The balanced approach assumes that the most severe impairment is indeed dominating, but the other impairments are still assumed to have some kind of influence. The person from the above

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example would receive a number of debits that lies somewhere between 200 and 325.

Finally, Murphy's approach assumes that some of the impairments interact in a way that things get much worse. The person from the above example would therefore receive a number of debits that even exceeds 325.

Common sense suggests that the naïve approach is usually not the best solution; that the primary impairment only approach is only suitable if the primary impairment is very severe; that Murphy's approach should be applied in those rare cases where there is clear indication from medical research that the combination of two impairments is worse than the sum of the parts; and that most of the time the balanced approach would yield the best results. Unfortunately, it is not intuitively clear, which weighting should be given to non-primary impairments in the balanced approach.

To help answer this question, we have performed analyses based on selected cases (age > 85, total number of debits > 100, at least two impairments, originally underwritten after January 1, 2008) from Fasano Associates' database. For the purpose of this analysis, these cases were re-underwritten based on Fasano Associates' current mortality tables and underwriting guidelines.

The following table (where the cases are segmented by type of primary impairment) shows "Actual to Expected Ratios" (A/E-Ratios) that would have resulted as of today, assuming that the "naïve approach" and the "primary impairment only approach" had been followed in the underwriting process. The last column gives the "optimal weighting" for the "balanced approach". This is the weighting that should originally have been applied to the non-primary impairments in order to end up with an A/E ratio of 100% today.

For example, the second line of the table contains the results for insureds where the primary impairment is cardiovascular. Had the underwriter used the naïve approach, then today's A/E ratio would be 94%. Had the underwriter used the primary impairment only approach, then today's A/E ratio would be 140%. Under the balanced approach the debits for non-primary impairments should have been weighted with a factor of 80% to result in today's A/E-ratio of 100%.

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	Sample Size	Naïve (%)	PI Only (%)	Weighting that results in A/E = 100%
A/E ratio (all cases)	209	96	127	80 %
A/E ratio (Cardiovascular cases)	61	94	140	80 %
A/E ratio (Dementia cases)	75	101	131	100 %
A/E ratio (Other cases)	73	92	116	55 %

We can see from these results that the naïve approach appears slightly too aggressive on average, but seems to work rather well with dementia cases. The primary impairment only approach appears too conservative. Our analyses also indicate that non-primary impairments should be weighted at about 80% on average. But there are strong differences between the different segments. For example, weightings as low as 55% seem to be appropriate for some cases.

The following table gives similar results using segmentation by “dominance of the primary impairment”. In the line denoted by (1), there are only cases where the number of debits for the primary impairment (PI) is at least two times as large as the sum of the debits for all other impairments (AO). These are the cases where the primary impairment is highly dominant. Line (2) gives the results for cases where the number of debits for the primary impairment exceeds the sum of the debits for all other impairments (but not as heavily as in (1)). Finally, line (3) gives results for cases where the number of debits for the primary impairment is lower than the sum of the debits for all other impairments.

	Sample Size	Naïve (%)	PI Only (%)	Weighting that results in A/E = 100%
A/E ratio (all cases)	209	96	127	80 %
(1) PI > 2x AO	93	96	111	62 %
(2) PI > AO but < 2x AO	71	94	131	74 %
(3) PI < AO	45	100	173	100 %

Again, we observe strong differences between the segments. If the primary impairment is highly dominant, the debits for the other impairments should only be counted with a rather low weighting (of 62%). The more pronounced the non-primary impairments are (relative to the primary impairment), the more weight should be given to them.

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LE-estimates for insureds with multiple impairments are of high relevance for the secondary and tertiary market, because these insureds are often rather old and have a large total number of debits, so they have a rather short LE. This implies that investors can offer a price that significantly exceeds the surrender value. Therefore, these cases are likely to close. Unfortunately, the sensitivity of the investor's return with respect to the LE is particularly high, meaning that an incorrect LE-estimate has a particularly high impact. To illustrate this effect, we have priced a hypothetical policy based on both the naïve and correct approach (as per the weighting of secondary impairments resulting in a 100% A/E) and generated mean LEs of 63.1 and 68.8 months, respectively. If an investor should price the policy at an expected yield of 12%, but using the wrong LE, the expected return would in fact only be 9.02%. If an investor should price the policy at an expected yield of 8% using the wrong LE, the expected return would in fact only be 5.64%. So an investor would "loose" 2.5 to 3 percentage points in expected return if the original pricing is based on a wrong assessment of multiple impairments.

To summarize, our results strongly indicate that cases with multiple impairments need to be underwritten carefully. The impact of non-primary impairments appears to depend on the type of primary impairment and on the "intensity" of the primary impairment relative to the non-primary impairments. The effects seem to be very pronounced: The "optimal weighting" for non-primary impairments can be as low as 55%. But the effects are also very heterogeneous: The results differ heavily between different subpopulations.

We have to caution, however, that the results shown are preliminary and that the small sample size limits their statistical credibility. Also, the results of the different segmentations (by type of impairment and by "intensity" of the primary impairment) cannot simply be aggregated.

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Download the Article **here**

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Demography and longevity: Major future debates

Not only people in Germany are reaching an ever older age. This is suggested by international statistics and the latest figures of the Statistical Federal Office.

Experts are viewing the demographic change with ambivalence: One the one hand, it might mean opportunities for new products and services, but on the other a scarcity of skilled workers and increasing poverty in old age due to problems with social security systems.

Life expectancy forecasting is also prone to false assumptions. Studies suggest that Germans significantly underestimate their own life expectancy. A fatal trend: If you do not know how long you will live statistically, how can you know how much money to put aside?

The statistical lifespan is therefore a crucial factor for pension provision. It does not only indicate the period each of us must provide for financially. It also determines the right strategy: is private pension provision worthwhile? Are state pensions secure and sufficient?

The German Insurance Association GDV dealt with such questions in the context of its annual press conference and also invited two renowned experts in the field:

Please take a look at the speeches held at the GDV demography workshops by Prof Dr Jochen Ruß (Director at ifa, the Institute for Financial and Actuarial Sciences) **here** (German version only!)

and Dr Johannes Lörper, board member at the German Association of Actuaries **here** (German version only!)

European Review

Financial services: Agreement on the involvement of consumers in policymaking

On 14 February 2017, representatives of the Council and the European Parliament reached agreement on a programme to promote the involvement of consumers in policymaking in financial services. Grants will be provided to two NGOs – Finance Watch and Better Finance – to support activities that encourage the involvement of consumers and other end-users in policymaking. The programme will also contribute to the information of consumers about issues at stake in regulation of the financial sector. "As much as regulators, consumers are well placed to judge the suitability of a financial product or service and can contribute actively to policymaking", said Edward Scicluna, Maltese minister for finance and president of the Council. "This EU-wide support programme is meant to strengthen this consumer participation."

The new programme follows on from a 2011 pilot project that set out to restore consumer confidence in the financial sector following the 2007-08 financial crisis. It will be established for the period running from its entry into force until 31 December 2020 with a financial envelope of € 6 million. Financial services consumers cover a range of users including individual savers, retail investors, insurance holders, pension fund participants and borrowers.

The agreement will be submitted to EU ambassadors in the coming days for approval on behalf of the Council. The Parliament and the

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Council will then be called on to adopt the proposed regulation without further discussion.

EIOPA-News

The European Insurance and Occupational Pensions Authority (EIOPA) released a new Consultation Paper on the proposal for Guidelines under the Insurance Distribution Directive on insurance based investment products that incorporate a structure which makes it difficult for the customer to understand the risks involved.

The Insurance Distribution Directive (IDD) aims to strengthen the protection of customers and to harmonise national provisions concerning the distribution of insurance products. Insurance distributors will be required to comply with these new rules by 23 February 2018.

More details about the Consultation **here**

Insurance Europe: A Blueprint for Pensions – Saving enough, saving well, saving wisely.

Europe is ageing, adding to the huge challenge for its governments of making sure that people have an adequate retirement income. The Blueprint of the European insurance and reinsurance federation sets out the extent of this challenge and proposes ways to help ensure that European citizens can save enough, save well and save wisely for their retirement.

Effective, affordable and sustainable pension systems are a cornerstone of a successful modern society and economy. The fact that Europeans are living longer is putting increasing pressure on pension systems at a time when public finances are already under strain. The number of people aged 65 or above relative to those aged 15 to 64 is expected to double between 2013 and 2060. As a result, many European states have already started reforming their pension systems, but that is not enough. As the Organisation for Economic Co-operation and Development (OECD) reiterated in December 2016, citizens also need to take personal responsibility and contribute more and for longer periods if they are to have an adequate income in retirement.

Find out **more**

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Spotlight

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