A.M. Best gives haircut to mortality ratings in draft life settlement securitization report
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Insurance rating firm **A.M. Best Co.** has issued a draft report outlining major revisions to its methodology for evaluating life settlement securitizations, including reducing values of mortality ratings issued by medical underwriters.

Mortality ratings indicate an insured's health status, with 100% being equivalent to standard health. Ratings of more than 100% reflect impaired health and ratings below 100% reflect better health.

A.M. Best is proposing to reduce the ratings assigned by medical underwriters when it considers its own valuations of life settlements, because insureds have generally been living longer than the underwriters project.

"We're scaling down the probabilities of death for nearly all insureds in pools simply because the mortalities we see aren't keeping up with projections," said Emmanuel Modu, managing director and global head of insurance-linked securities for A.M. Best in Oldwick, N.J.

He also said that non-recourse, premium-financed policies are one of the worst-performing segments in life settlement securitization pools.

"This is a major revision," Modu said. "It's a more comprehensive revision than we've done in the last couple of years."

The 28-page proposal, issued Sept. 30, describes the rating agency's method for evaluating securities backed by life settlements. Comments on the proposal by industry participants are due by Oct. 30.

Modu said that A.M. Best takes into account five general considerations in its quantitative analysis when it reviews a portfolio: age of the insured, gender, death benefit, mortality rating and whether the policy was premium-financed.

He said the rating agency's previous methodology never explicitly explained that these five factors were used.

The report is intended to give better guidance to people who are contemplating seeking a rated securitization, he added.

The proposed revisions to A.M. Best's methodology are based on its observations of the general performance of portfolios, studies of portfolio results by actuarial groups and early indications about the differences between the 2008 and 2014 Valuation Basic Table.

The VBT, published by the Society of Actuaries, summarizes insurance industry mortality experience. The table is then modified by life expectancy underwriters for use in the life settlement business.

A.M. Best also said it expects the industry to start using the 2014 VBT and may revise its criteria again to reflect more recent data.

The firm said it has no public ratings associated with life settlement securitizations.

Modu declined to say whether he is currently reviewing any portfolios for possible securitizations.

Few rated securitizations have been completed in the life settlement market and they are not expected to happen frequently, the draft report said.

"The prospects for life settlement securitizations have generated great interest in the capital markets," the report said. "However, rated life settlement securitizations will continue to be rare."

A.M. Best attributed the lack of securitizations to the difficulty in acquiring a critical mass of life settlements needed for statistically reliable cash flows, significant issues with insurable interest in life policies that have been used in settlements, high transaction costs in acquiring life settlements that make securitizations economically infeasible, the wide range of opinions on life expectancies in old portfolios and the divergence of actual results to expected results in such portfolios.

Growth in securitizations also will depend on increased clarity and standardization of methods of predicting life expectancies, including public release of data on the performance of medical underwriters, the rating agency said. Such growth also will require transparency in the pricing of life settlements and intermediary fees and industry safeguards of identities, health conditions and financial status of insureds.

Other factors influencing growth in this market include the development of more effective industry regulatory oversight and self-policing, continued refinement of rating agency standards to assess credit risks of such transactions and the emergence of new initiatives supported by the life insurance industry to compete with the secondary market, the report said.

The first publicly rated securitization in the market occurred in 2004 on a $70.3 million **Legacy Benefits Corp.** portfolio rated by **Moody's Investors Service**. In 2009, **American International Group Inc.** received a rating from A.M. Best on a portfolio of 3,400 policies with $8.4 billion in death benefits, although it was an internal transaction between two AIG companies. Another securitization fell apart in 2011 when **Standard & Poor**'s backed out of rating an AIG portfolio with $4.5 billion in death benefits.