THE FINANCIAL CONDITION OF BABY BOOMERS

Baby boomers are finding themselves ill-prepared for retirement and are turning towards alternative financial solutions.

At first glance, we can see that this is partially driven by an increase in health costs in tangent with an increase in life expectancy. According to a report by The Stanford Center for Longevity - In 2013, average out-of-pocket health care spending by Medicare beneficiaries was 41% of average per capita Social Security income. Life expectancy in the U.S. has also increased, from 69.7 years in 1960 to 78.7 years in 2015. However, the standard retirement age hasn't changed accordingly, which means that, absent other means, funds have to be stretched across a longer lifespan.

However, in addition to rising health costs, baby boomers are also faced with circumstances that have resulted in a generational decline in household wealth compared to their predecessors. An analysis was conducted using Health and Retirement Study data collected between 1992 and 2014, assessing the financial well-being of older households, starting with heads of households in their 50s and tracking them well into their last years of life.[1]

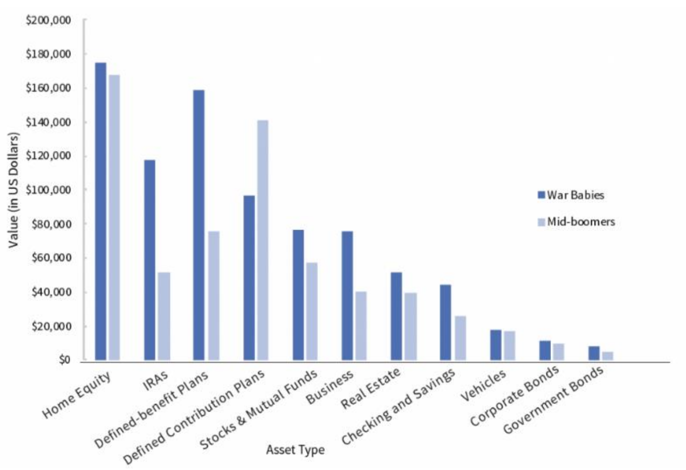
Overall, baby boomers are in a financially weaker position than earlier generations of retirees, in terms of home equity accumulation, financial wealth and total wealth.

In 2014, baby boomers had less home-equity, financial wealth, and total household wealth than retirees who were 10 years older. One-third of baby boomers had no money saved in retirement plans in 2014, when they were age 58, on average, leaving them with little time to start saving for retirement. Even for those with positive balances, the median was only about $200,000.

To make consistent comparisons, the study compared different birth cohorts when they were in their 50s. Mid-boomers had the least amount of net worth, home equity and the lowest level of retirement funds. Baby boomers overall had accumulated the most debt, both in absolute terms and as a share of their wealth, compared to prior generations. Such heavy debt burden renders baby boomers more financially vulnerable and prone to economic downturns than prior generation.

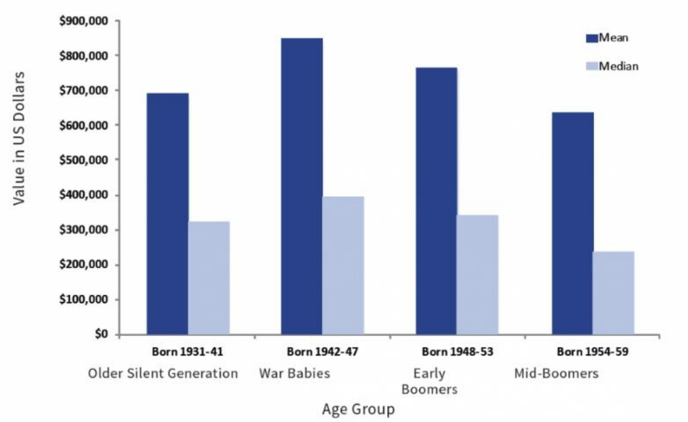
Additionally, the 2008 financial crisis worsened baby boomers' retirement resources. Baby boomers, who were highly leveraged in debt and already inadequately prepared for retirement, were hit especially hard by the crisis and suffered a slower recovery post-recession. Many baby boomers who had also just begun their retirement, were also deprived of home equity growth opportunities when the housing market crashed.[1]

HOUSEHOLD WEALTH ACROSS ASSET TYPES



Mid-boomers' wealth accumulation lags behind war babies across almost all categories, despite the fact that the war babies in this analysis are more than 10 years older and have been drawing from their retirement accounts already.

HOUSEHOLD WEALTH ACROSS GENERATIONS



Compared to the prior generation, baby boomers had less household wealth in 2014[1]

Baby boomers engaged in more borrowing than previous generations

As one would expect, the unresolved accumulation of debt had worsened post-crisis despite over a decade of economic growth.

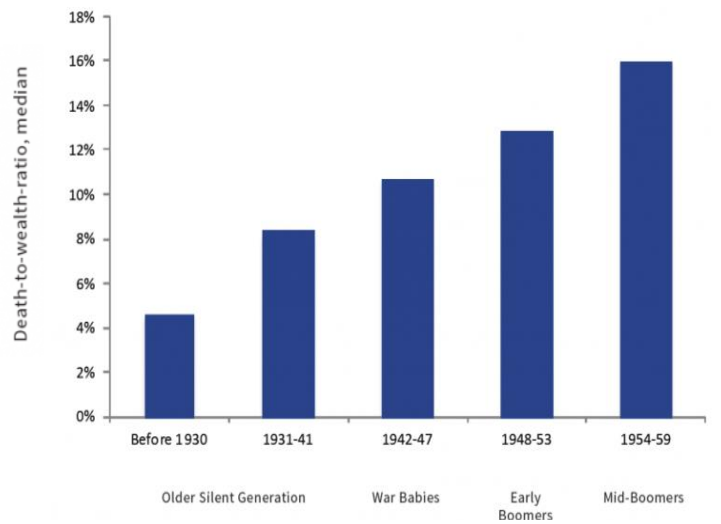
A growing number of older Americans are suffering under the weight of mortgage loans, student loans and credit card loans, jeopardizing their retirement security. For example, the proportion of homeowners over age 65 who haven't paid off their housing debt rose to 35% in 2012 from 23.9% in 1998, and the median amount they owed doubled from $44,000 to $82,000. The number of people age 60+ with student loans quadrupled from about 700,000 to 2.8 million between 2005 and 2015. Between 1989 and 2010, the percentage of families with credit card debt decreased for those under age 55 but showed a sharp increase for those age 55 and older.[1]

The HRS analysis also examined the relative debt burden as a percentage of household income or wealth. The results show that mid-boomers had a median debt-to-wealth ratio of 16%, the highest across the board. The proportion of households with extremely high debt-to-wealth ratios were also analyzed. In particular, 15% of mid-boomers had debt exceeding 50% of their wealth, 11% had debt exceeding 80% of their wealth, and 8% had debt exceeding 100% of their wealth.

It is also worthy to note, that baby boomers as a generation engage in significantly more borrowing and debt-financing compared to the generation before them. And when they do, they carry a higher debt balance. About 70% of mid-boomers had some debt in 2014, compared to only 20% of those born before 1930 and 40% of those born in the 1930s. Among households with debt, baby boomers had an average debt level over $110,000, which was more than 50% higher than that of people born in the 1930s.

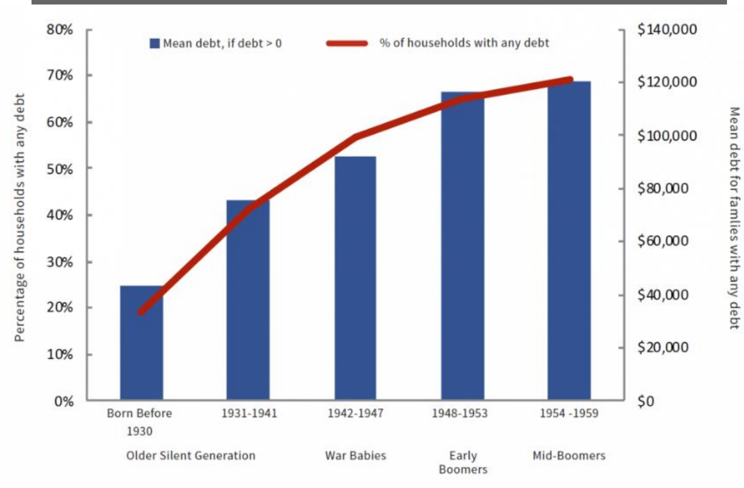
This is likely a result of a cultural shift in spending behaviors, and not at the fault of a single generation. That said, there is no argument that high amounts of leverage have made baby boomers significantly more vulnerable to economic headwinds and consequently contributed to a ripple effect in household wealth over time.

RELATIVE DEBT BY GENERATION



Baby boomers have the highest debt-to-wealth ratio compared to earlier generations

HOUSEHOLD DEBT BY GENERATION



One-third of baby boomers had saved nothing in retirement accounts (workplace plans or IRAs) in 2014

Even more concerning is that nearly 30% of baby boomers have a zero balance in their retirement accounts (workplace retirement plans and IRAs together). Even among those with positive balances, the median was only $209,000 for mid-boomers, less than the balances for war babies ($280,000) and early boomers ($290,000). On average, mid-boomers were 58 years old in 2014, leaving them with another 20 to 30 years or more to live. Given these low balances, it will be challenging for them to retire full time at age 65 and try to maintain their pre-retirement standard of living.[1]

		Workplace Retirement Plans + IRAs	
Birth Year	**Average Age in 2014**	**Percent with Positive Balance**	**Median Balance, if Balance is Positive**
1931-41	77	67.9%	$178,266
1942--47 (War Babies)	69	74.5%	$280,053
1948-53 (Early Boomers)	63	70.6%	$290,000
1954-1959 (Mid-Boomers)	58	71.7%	$209,246

This analysis conducted by Stanford goes into further detail, but we can draw some key points regardless. First, given the current level of assets and debt among baby boomers, it's highly likely that they will either need to reduce their spending in retirement, work into their late 60s and 70s, or do some combination of the two. Second, recent and incoming retirees will also need to get creative with their financial security solutions in the next two or three decades: delaying Social Security retirement income, optimal strategies for drawing down retirement assets, and additional strategies that can help retirees manage existing housing and non-housing assets.

This is a good place to transition into life settlements and their increasing popularity as a financial solution.

THE EMERGENCE OF THE LIFE-SETTLEMENTS MARKET

LIFE INSURANCE MARKET OVERVIEW

Life insurance is a contract between a life insurance company and the insurance policy holder. It is a form of financial protection for the beneficiary of the insured person in case of death. The policy holder pays periodic amounts called premiums for the duration of the policy and upon death, the insurance company pays a specific sum of money to a designated beneficiary in the form of income. The insurance policy can also cover other expenses related to burial and funeral. Payment from the policy can be a lump sum or an annuity, which is paid in regular installments for either a specified time or for the lifetime of the beneficiary.[2]

In 2018, existing life insurance policies in the U.S. amounted to roughly $20 trillion[3], with approximately 59% of adults having owned life insurance. In the same year, the U.S. was the leading life insurance premium writing country, with a total value of life direct premiums written amounting to roughly $600 billion.

We will not go into depth about millennials in this paper. However, it is worth mentioning that millennials have overtaken baby boomers as the largest living adult generation in 2019, swelling to 72.1 million. Meanwhile, baby boomers, nearly half of whom are at retirement age or older, have shrunk to 71.6 million.[4]

To some surprise, millennials are also purchasing life insurance at higher rates than expected. LIMRA's 2016 life insurance ownership study, which encompasses data from 1960 to 2016, found 70% of millennial households owned some form of life insurance—the largest percentage of any age group. In addition, LIMRA's Facts About Life 2018 report found more adults under 45 owned life insurance in 2016 than in 2010, while ownership by those over age 45 dropped during the same time period. There are many opinions on how millennials should be described, though some would say that most have worked hard towards achieving their own financial stability, which strengthens the motivation to protect what they have built – and thus fueling continual growth in the life insurance market.

WHAT IS A LIFE SETTLEMENT?

A life settlement is a transaction in which a life insurance policyowner sells a policy to a third party for more than the cash surrender value offered by the life insurance company. The buyer pays all subsequent premiums to the life insurance company and receives the net death benefit of the policy at its maturity. For the buyer/investor, a life settlement is a negative coupon bond with uncertain duration. It offers an opportunity to gain exposure to an alternative asset class through the purchase of securities whose performance is contingent on late-stage mortality, and thereby largely uncorrelated with other financial markets.

By selling the policy, the seller not only eliminates the burden of having to fund future and often increasing premium payments, but also receives an up-front cash lump sum. That cash can assist the policymaker in various ways: need for liquidity, such as an income shock, a health shock, an increase in medical costs, a need for long-term care funding, a loss of bequest motive, or a change in estate tax law.

While the concept of a life settlement may not be familiar, it is not new. The Supreme Court in 1911 declared that a life insurance policy was an asset; therefore, the insured could sell, trade, pledge or barter the asset like any other asset. In the early 1990's the life settlement industry had its origins as an organized business model. Before the origin of the selling of life settlements was earnestly pursued, the options for those who needed and wanted to sell their life insurance policies were very limited. Their choices were to surrender the policy for a limited cash value, or continue to meet premium payments or let the policy lapse. In fact, according to research conducted by Milliman and Robertson, an international actuarial firm, 89.5% of all universal life policies never result in a death claim. Since the birth of the life settlement industry in 1991, policy holders can realize significantly more value for their asset. Life settlements are now considered a valuable financial planning tool recognized by the AARP, The American Institute of Certified Public Accountants, Wharton School of Business, the Wall Street Journal, USA Today and the American Cancer Society, to name a few.

The emergence of life settlement transactions has created a growing secondary market for life insurance policies, enabling more and more policyowners to realize the market value of their policies as opposed to only the cash surrender value. According to research from The London Business School, policyowners collectively received more than four times the amount they would have received had they surrendered their policies to their respective life insurance companies.

There is also an increasing number of policies retaining a share in the net death benefit when selling their policies, otherwise known as a retained death benefit. A retained death benefit is a life settlement where a policy owner shares the insurance cost and death benefit with another investor or sells the entire policy (and forgoes the premiums) but retains a contractual right to some portion of the death benefit. This arrangement allows the policyholder to retain a portion of value in their original policy while relieving some or all of the burden of monthly payment. Retained death benefit life settlement transactions provide a win-win scenario and offers an additional solution to address income or liquidity issues without sacrificing the entire death benefit.

As one can see, the presence of the life settlement market has helped significantly in enhancing the welfare of policyowners who wish to terminate their policies. More importantly, the life settlement has provided a valuable and relatively unexplored alternative to lapsing or surrendering the policy.

WHY LIFE SETTLEMENTS?

1. Life Settlements Are Non-Correlated Assets

The investment has "no-market risk." In other words, the value of your investment is not affected by: war, the stock market, unemployment rates, oil prices, political changes, the housing market, interest rates, terrorism or human emotion. The only factor which affects payout is "mortality" and mortality in 80+ year olds with impaired health is extremely predictable.

2. Life Settlements Are Highly Regulated

Life Settlements are regulated by the Security and Exchange Commission (SEC), Texas Department of Banking (Escrow Agent oversight) and by The Texas Department of Insurance.

3. Life Settlements Use Legal Reserves Life Insurance Companies

Policies that are purchased for Life Settlement purposes are only purchased from "A" rated or better companies which include John Hancock, American General, Met Life, Pacific Life, New York Life, Mass Mutual, Transamerica and others.

4. Life Settlements Have Known Payouts

Each Life Settlement has a predetermined gross profit with an absolute known return, ultimate safety with potentially high upsides and exceptional ROI's. All policies are priced to return low double digits annual compounded ROI's even when maturing at maximum life expectancy.

5. Life Settlements Are Passive Investments

Which means you don't have to manage this investment. You always realize the highest possible value every time.

6. Life Settlements Accept Qualified Funds

Life Settlements accept monies from IRA's, 401K's, Roths, SEP, Trust Funds and Pensions.

7. Life Settlements Monies Are Escrowed

No one touches an investor's money. Investors know where their monies are at all times. The entirety of the transaction is managed by an established escrow agent.

THE IMPACT OF COVID-19

Given the recent unexpected circumstances driven by the COVID-19 pandemic, there are additional motivations for existing policyowners, particularly retirees, to sell their policies:[5]

- **The pandemic's impact on jobs and retirement accounts:** The recent COVID-19 pandemic has hit retirement accounts hard and caused millions to lose their jobs. Many of these workers are seniors who have had to continue working due to the senior retirement gap. Life settlements can be a source of urgently needed funds.
- **The new, higher estate tax exemption:** In 2017, the estate tax exemption increased to $5.5 million. In 2018, it skyrocketed to $11.18 million for singles and $22.4 million for married couples. This means policyowners who bought life insurance to pay estate taxes might no longer need the policies because they no longer have an estate tax issue.
- **COI increases by carriers:** Because interest rates remain at historic lows, carriers are unable to make money the way they used to from investments. To make up for it, many carriers have increased their cost of insurance (COI) charges to customers. An option for policyowners to avoid increased COI charges in their premiums is to sell their policies.
- **Comfortable regulatory environment:** 43 states and Puerto Rico have life settlement laws that provide substantial consumer protections in the sale of a life insurance policy. Nine states require carriers to disclose that there are alternatives to the lapse or surrender of a life insurance policy when a policy is in jeopardy of lapsing, which includes the life settlement option. Additionally, in 2019, the National Conference of Insurance Legislators reaffirmed its commitment to making sure policyholders were informed of life settlement as an option. Even the National Association of Insurance Commissioners, the watchdog of the life insurance industry, has endorsed life settlements as a way for seniors to finance their long-term care costs and other expenses.
- **Baby boomers holding large amounts of life insurance:** About 60% of Americans were covered by some type of life insurance in 2018. The value of total life insurance coverage in the U.S. was roughly $19.6 trillion at the end of 2018.

A CRUTCH FOR CRISIS

From 2006 – 2009, consumers netted $5.62 billion more cash from life settlements than the comparable amount being offered by the life insurance company, according to the 2010 Life Settlement Study conducted by the U.S. Government Accountability Office – an average of 800% more value.

THE SECONDARY MARKET HAS SIGNIFICANT ROOM TO GROW

As beneficial as a life settlement can be for an existing policyowner, in reality many people appear to be unaware of the option. Instead, policyowners who wish to terminate their policies have typically resorted to one of two options, both of which forego substantial value:

1) **Surrender the policy:** Redeem the policy for its cash value. Policyholders would get a sum of money and be relieved of paying further premiums.

2) **Allow the policy to lapse:** Stop paying premiums and allow the policy to lapse. All the years of making monthly payments are rendered worthless and the value of the policy is forfeited. Unfortunately, the majority of policyholders will simply stop paying their premiums, outright losing a valuable asset in a life insurance policy that could've generated a significant cash payment.

According to a 2018 study by investment management firm Conning, $200 billion worth of life insurance will lapse or be surrendered each year through 2027 — all of which could qualify for a life settlement and be pocketed by the policyowner. And according to research conducted by Olin Business School, Washington University in St. Louis and Wharton School, University of Pennsylvania, nearly 88% of universal life policies ultimately do not terminate with a death benefit claim. In fact, 74% of term policies and 76% of universal life policies sold to seniors at age 65 never pay a claim.

More than 38% of individuals who sold their life insurance policies in life settlement transactions last year said they were planning to lapse, cancel or surrender their policies until they learned of the life settlement alternative.

- **Welcome Funds Survey, April 2020**

With so many policyowners apparently unaware of the life settlement transaction, there is a clear dislocation between the perceived value of life settlements and the proportion of Americans considering them. Additionally, life insurance providers who would naturally be incentivized to conceal the life settlement option are facing more regulatory pressure to properly educate consumers on all possible opportunities. For example, new provisions for life settlements in the 2017 Tax Cuts and Jobs Act (TCJA) has brought more attention to a policyholder, through a tax professional or estate planner, that they can sell their policy.

WHY MIGHT PEOPLE LET THEIR LIFE INSURANCE POLICIES LAPSE?

- Large negative income shocks, especially for those with higher debt
- Households are twice more likely to surrender their policy after spouse becomes unemployed
- Liquidity shocks for smaller policies typically purchased by lower-income households
- In a period of low interest rates, the cost of insurance premiums become relatively more burdensome
- Insurance providers are discouraged from mentioning alternative solutions
- Financial advisors lack the incentive to mention life settlements as a solution

A NOTE ON FRONT-LOADING

The value that the policyowner loses from lapsing or surrender is even greater when considering the fact that most life-insurance policies are ***front-loaded****, meaning that premiums start off higher than fair value to account for policy expenses and sales commissions. Front-loaded policies take on many forms, including level premiums, single premiums, limited-pay whole life, and decreasing term insurance policies*

Most importantly, front-loaded pricing allows insurers to capture more of the premiums earlier in the policy to account for longevity risk.

Effectively, policyholders over-pay relative to their mortality risk early into the life of the policy in exchange for receiving a discount later on. When a policy is dropped (lapse or surrender), the amount paid in excess of the actuarially fair price is not fully repaid to consumers. Hence, ***insurers make money when policies are dropped.***

Most term policies, which offer coverage for a fixed number of years, lapse prior to the end of the term, as about one in every 14 customers stop paying premiums each year. Similarly, most permanent policies are surrendered (i.e., lapsed and a cash value is paid) before death or their expiration at age 100 or older.

"In 2017 and through the first half of 2018, the life settlement market has exhibited growing strength," said Scott Hawkins, a Director, Insurance Research at Conning. "The volume of new settlements continues to increase, a positive indicator for growth in the number of in force life settlements. Geographic expansion, capital raises, and the sales of policy portfolios are recurring themes among market participants."

As baby boomers continue to experience financial stress into their retirement years, coupled with the severe economic impact caused by COVID-19, we expect the secondary market for life insurance (the life settlement market) to expand significantly in the next several years. As the evidence suggests, the life settlement market is still clearly underserved.

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[1] http://longevity.stanford.edu/sightlines-financial-security-special-report-mobile/#retirement-preparedness-report
[2] https://www.statista.com/topics/1411/life-insurance/
[3] https://www.acli.com/-/media/ACLI/Files/Fact-Books-Public/2019FLifeInsurersFactBook.ashx?la=en
[4] https://www.pewresearch.org/fact-tank/2020/04/28/millennials-overtake-baby-boomers-as-americas-largest-generation/
[5] https://www.forbes.com/sites/forbesfinancecouncil/2020/05/07/why-life-settlements-are-becoming-a-mainstream-financial-option/#787411c747fd