MOODY'S
INVESTORS SERVICE

RATING METHODOLOGY

US Life Insurance Securitizations Surveillance Methodology

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This methodology replaces *Moody's Approach to Monitoring Life Insurance ABS* published in January 2015. The methodology's title and table of contents have been revised. We have also removed outdated information, and we have made limited editorial updates to improve readability. The updates do not change the substantive approach of the methodology.

Scope

This methodology describes our approach to monitoring US life insurance securitizations.

Rating Approach

Asset Overview

US life insurance asset-backed securities (ABS) are backed by three types of policies: life insurance policies that pay lump sums upon the death of the insured individuals, annuity policies on the lives of the insured individuals purchased at closing with bond proceeds, and, in some cases, supplemental policies to cover certain risks.

The payouts from life insurance policies, received upon the death of the insured individuals, provide cash flows to amortize the bonds; in these transactions, payments from annuity policies cover the policy premiums on the life insurance policies associated with the corresponding insured individuals. Additionally, any excess annuity payments that do not fund the life insurance premiums are used to pay interest on the bonds, and, in some cases, build reserve funds or amortize the bonds.

One of the key risks in life insurance ABS transactions is the potential lapsing of the underlying life insurance policies, as described below in the "Key Risks" section. To offset this risk, life insurance ABS contain mechanisms to keep the underlying life insurance policies active.

In some transactions, supplemental policies such as gap insurance and contestability insurance[1] on the underlying annuity and life insurance policies augment the annuity cash flows. In transactions that lack the protection of supplemental policies, annuity payments may keep the underlying policies active only until the insured reaches a certain age, or for a few years beyond the insured's original life expectancy.

Thus, taken in sum, the sources of cash flow to life insurance ABS are: (1) death benefits from an insurance policy, which are paid only if the policy has not lapsed, (2) annuity payments, which continue to pay until the insured passes away, even after a lapse of the corresponding life insurance policy, and (3) deal-specific reserve accounts.

Key Risks

The primary risks associated with life insurance ABS are the creditworthiness of the underlying life insurers and annuity providers; a contest to a life insurance or annuity policy, leading to an adverse adjustment to the cash flows to the deal; and potential lapse of a life insurance policy.

» **Creditworthiness of life insurance companies and annuity providers**. The key risks associated with the life insurance companies and annuity providers that back the transaction collateral are nonpayment or a delay in the payment of death benefits and annuity payments when due.

» **Contest to a life insurance or annuity policy**. Life gap and life contestability insurance policies cover any decrease in death benefit payments to the trust that may arise if the insurance company contests a policy because of misrepresentations of age, gender or any other material information. Annuity gap and annuity contestability insurance providers offer similar protection for annuity contracts.

» **Lapses in a life insurance policy.** A policy lapse occurs if not enough premium is paid into a life insurance policy to maintain its account value and the account value falls to zero, leaving the insurance policy with no death benefit to pay to the trust. The account accrues value through the crediting rate (the interest rate paid on an insurance policy, which typically correlates to the market interest rate) and premiums paid into it. The account loses value through the cost of insurance and any administrative fees (if applicable).

The risk of a policy lapse increases as the insured individual ages and/or the interest rates fall significantly. While increasing age leads to a higher cost of insurance (and a higher insurance premium), declining interest rates lead to a reduced crediting rate on the account value of the insurance policy, thus reducing the rate of accrual of the account value. If the annuity payment to the account and the accrual in account value through crediting rate are not able to keep up with the rise in the insurance premium charged to the account, the account value starts to decline.

Two strategies can mitigate the risk of a policy lapse: (1) life insurance premium payments funded by the annuities can be high enough to keep the corresponding life insurance policies in force for a required period of time, in which case the initial assumptions about mortality and interest rates will be key, or (2) the transaction can have supplemental policies in place that will pay premiums into a life insurance policy over and above the annuity payment, if required, to keep the life insurance policy active.

As with every rating, in determining final rating outcomes our rating committees will combine qualitative judgment with quantitative and modeling techniques. We do not run a model as part of this approach.

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the ratings tab on the issuer/entity page on www.moodys.com for the most updated credit rating action information and rating history.

[1] Life gap insurance and life contestability insurance may fully or partially offset certain downward adjustments in death benefits if the life insurance policy is contested or payment delayed. Annuity gap and annuity contestability insurance may fully or partially offset certain upward adjustments to annuity premiums if the annuity policy is contested.

Asset Analysis

Because supplemental policies can help mitigate the impact of lapses in life insurance policies, we generally rate life insurance ABS that have such policies in place to the lowest of the insurance financial strength ratings[2] of the (1) annuity provider, (2) life insurance provider, and (3) supplemental policy providers, while considering the extent of the protection that the supplemental policy providers offer.

For life insurance ABS deals that Moody's currently rates that have supplemental policies that fully mitigate the risk of lapse in life insurance policies, the certificates, in order to pay down, rely upon full eventual payment of all the death benefits on life insurance policies backing the deals, resulting in the lowest of policy provider ratings approach described in the preceding paragraph. These deals generally use any excess annuity payments remaining after paying the cost of insurance into the corresponding life insurance policy to pay interest to the certificate holders and to fund certain reserve accounts; hence, the contribution of annuity income to amortize the certificates is usually minimal to nil.

For life insurance ABS with no supplemental policies, or if the policies do not fully mitigate the risk of lapse in life insurance policies, we assess the risk of a policy lapse by comparing the potential future cost of insurance to available funds in the corresponding account, the crediting rate, and the scheduled annuity payment. We also assess the risk of default of the individual life insurance policy providers based on our insurance financial strength ratings[3] of the corresponding insurers.

Ongoing Information

We monitor life insurance ABS based on the information that we receive from the trustee. Monthly trustee reports contain high level information on the underlying portfolio as well as information on interest and principal distribution and reserve balance. If required for more in depth analyses, we may sometimes request additional information on the pool characteristics such as individual policies' account values, past and expected future cost of insurance, etc.

[2] If the insurance financial strength rating is not available, Moody's uses the senior unsecured debt rating.

[3] Ibid.

Moody's Related Publications

Credit ratings are primarily determined through the application of sector credit rating methodologies. Certain broad methodological considerations (described in one or more cross-sector rating methodologies) may also be relevant to the determination of credit ratings of issuers and instruments. A list of sector and cross-sector credit rating methodologies can be found here.

For data summarizing the historical robustness and predictive power of credit ratings, please click here.

For further information, please refer to *Rating Symbols and Definitions*, which is available here.

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