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Viatical Companies

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What follows was written for a research paper on low interest rates. It did not make it through my final edits for that project but I wanted to publish it somewhere.

Companies that buy existing life insurance policies directly from the owner generally do so because there is a mispricing either at issue or several years later, often due to a change in health status. Because life insurance policies offer the same cash surrender value whether a policy owner is currently healthy or not, a viatical firm can perform underwriting and possibly make a more generous offer to the policy owner. There is a risk of moral hazard in these instances, so the buyer of the policy can't be allowed to influence the outcome. There are many instances where the owner of a policy would be better off to sell it to this type of company than to accept the cash surrender value. Since these policies are generally only bought if a claim is expected to be short-term in nature, with little volatility from mortality (for example), interest rates are important from a discounting standpoint only if the excess mortality does not occur. Viatical firms may also become active in variable products if rates are low and guarantees subsidized in the fixed account option or if guaranteed benefits are in-the-money. These policies are also call life settlements.

Reversion to the Mean

How much of risk management is simply being independent enough from peers to recognize and communicate that most of what happens daily is noise? Very little time elapses between momentum shifts and pronouncement that there is a new trend. The herd is almost always wrong, but there is job security in following them.

Does this mean that a good risk manager is predicting the future? I would say yes. We should start with historical data, but must be aware of new information that changes trends that will be reflected in future results. Graphing the data can be very useful, looking at it in different ways to find trends and then testing those trends to make sure they are real and causative.

Systemic Risk

The risk that the financial system will collapse is called systemic risk (some regulators call it macroprudential risk, although they seem to think of it as good practices that become bad when everyone does the same thing). Regulators have been looking at large companies at risk of these actions, but that is wrong. The focus should be on practices undertaken regardless of company size. If the practice is poor the company should be scrutinized. The problem is that for insurance, the regulators are understaffed and short of the top practitioners. They are very susceptible to lobbyists that build up the larger consulting firms as experts. Many insurance regulators are elected positions, so they can't afford to be seen with mavericks, even if they are the experts who can help anticipate questionable practices.

Drought

Many parts of the United States are in drought conditions, and with a slower moving jet stream it could mean that when rain does come the soil can't hold it. As populations grow and aquifers and snow melt reduces, the job of the farmer will become much harder. New forms of farming may need to be developed to keep soil from giving up its ability to remain fertile.

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