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Die Zeitschrift des Verbands Schweizerischer Vermögensverwalter (VSV)
La revue de l'Association Suisse des Gérants de Fortune (ASG)
La rivista dell'Associazione Svizzera di Gestori di Patrimoni (ASG)

US Life Settlements: no-correlation, low volatility, absolute returns

Pooled life policies: A perfect bond substitute

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Holder of a life insurance can sell their policy to a third party for cash. Not only the rights, but also the duties are thereby transferred to the buyer. The market for Life Settlements is prospering. The main risk is up to the life expectancy of the policy holder.

The secondary market for life policies emerged some 17 years ago with the advent of «viatical» settlements, the buying and selling of policies owned by the terminally ill. A payment is made to the policy owner/insured in exchange for the right to recoup the face value at maturity. The premise for Viaticals gives terminally ill people an option to convert an otherwise illiquid asset into cash when money is needed to help them through their last difficult months.

While the market emerged originally because of the need to finance medical treatments of seriously ill people, the segment of «Seniors», people over 65 years of age, has now replaced them. The motivation to sell their policies is completely different: being alone in life, not willing or affording to pay the high premiums – between 2.5 to 4 percent of face value –, being well secured by other assets, being over insured or changing into better terms at the primary market are frequent rea-

sons. Up until recently, in such a situation, policyholders had two choices:

- 1) Allowing the policy to lapse, in which case they would receive nothing in return or
- 2) Surrender the policy to the insurer and receiving a small amount in return – the surrender value

Surrender values are usually so low that the secondary market is paying substantially more, yet still achieve absolute returns above LIBOR plus 400 basis points for the investor. The inefficiency in insurer-paid cash surrender values provides policy sellers with an alternative source of liquidity and buyers with the opportunity for above market returns.

Pivotal point life expectancy

The main investment risk is up to the life expectancy of the policy holder. As of being researched by several industries (pharmaceutical, financial, insur-

ance), life expectancy of an elderly person is estimated in number of months done by medical underwriters. Most of them are very conservatively, nevertheless, it is worth obtaining two individual statements before acquiring a policy. The insolvency of the insurance company, another potential risk, is limited by its quality. Most of the industry players are A-rated or better. Further more, a national insurance pool is in place for losses which might occur. Both risks are dramatically reduced by pooling policies into a portfolio and avoiding cluster risks neither to insurance companies nor to diseases. Portfolios over 40 policies have an estimated volatility of less than 1.5 percent.

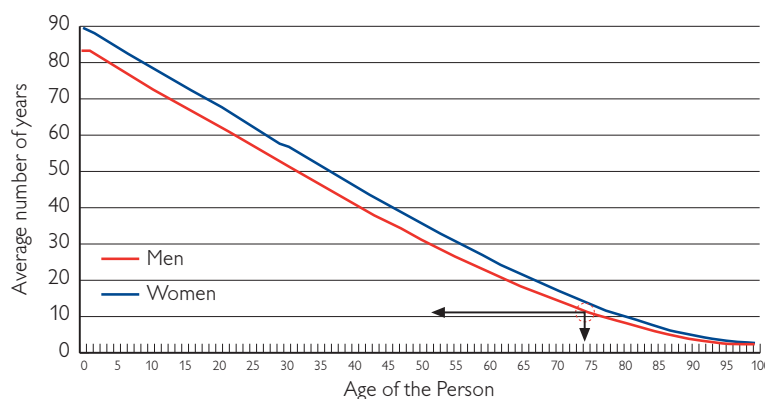
A multiple win-win-situation

Life Settlements offer unique opportunities to all stakeholders of the deal. As circumstances change, the ability to obtain cash from the sale of a life insurance policy can be particularly valuable. The majority of Life Settlements transactions are entered into for the purpose of purchasing other valuable insurance and financial products.

Every transaction requires that the price negotiated between the Life Set-

Life Settlement: A Life Settlement is an insurance policy sold by the owner to a third party for cash at a discount of the face value of the policy including the transfer of its rights and its duties. It creates a multiple win-win-situation. On the one hand, the policy owner receives liquidity over the surrender value indicated by the insurance company. On the other hand the investors are achieving accurate absolute returns by measurable low risk.

Average life expectancy in years

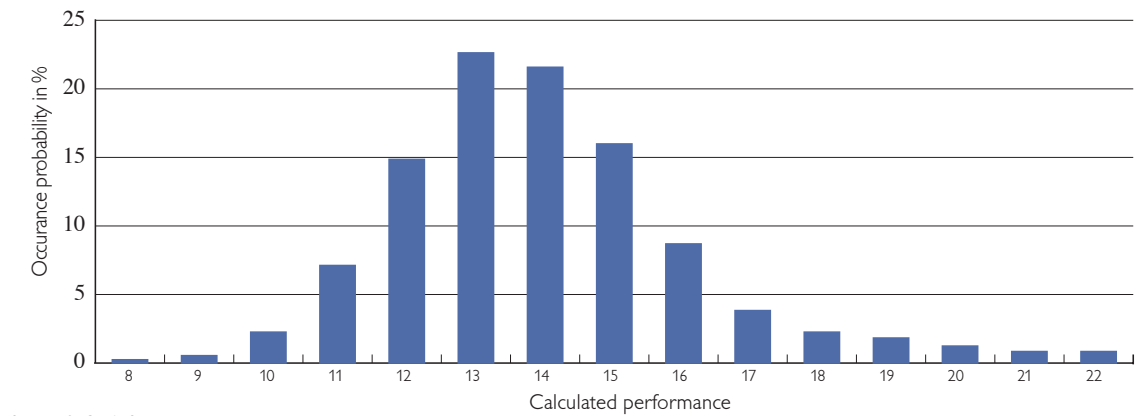


Sources: <http://www.ssa.gov/OACT/STATS/table4c6.html#fn2> on August 23, 2007

The life expectancy represents the average number of years of remaining life, e.g. a 75 year old male has an average life expectancy of 10 years. Most life insurances pay the face amount upon completion of the 100th anniversary. Out of 100 000 people, 0.5 percent of male and 1.8 percent female attain this age.

The figure shows the performance probability within a specified portfolio of life insurance policies: e.g. 50 policies, average life expectancy of 8 years, average age of policy holders 78 years). About 80 percent of the calculated performance returns are within a scope of 12 to 15 percent annually.

Performance allocation within a portfolio of life insurance policies



tlement provider and the policy holder, is paid in a trust account, such called *escrow agent*. With successful completion by reassigning the policy of the insurance company, the account will be released.

A positive addition to a balanced portfolio is offered to the investor. The absolute returns of investing in US Life Settlements are made more attractive due to the fact that they are mostly uncorrelated to traditional asset classes.

From unknown and in-transparent to prosperous

According to *On Wall Street* magazine (September 2004), the market for senior settlement securitisations was just 50 million US dollar in 1990 with the current market estimated in excess of 134 billion US dollar. It is reasonable to conclude that the outstanding face value of policies on insured over age 65 and with a life expectancy of two to 12 years is in the region of several hundred billion dollars. Considering the subset of those policies where there is a willing seller, Fundabilis Group, estimates the market over 20 billion US dollar yearly turnover within the next three to

four years. The growth potential is evident and will be fuelled by the aging population in the United States.

The market and its reputation might probably develop similarly to the Hedge Fund industry. Unknown and in-transparent at the beginning, controlled and covered as mystic secret by the market insiders, but prosperous, helpful as investment tool and rapidly growing year by year.

At the moment, a significant offer volume growth is expected due to the need of covering cash needs based on over indebtedness from mortgages.

Ethical or not? – A Church among the investors

At the beginning, Viaticals, by definition terminally ill with a life expectancy of less than 36 months, could not afford a wait-and-see tactic for best prices. Pains and fears of diseases put them under a certain time pressure. Nevertheless, they were selling the policy among their friends and families at a first priority. Uncertain who had more stress, family related «purchaser» which were as well not uninhibited and had to «accept» an eventually over-valued special relation price or the Viatical himself.

The suppliers in the senior Life Settlement market are free of such time and family relation pressures. Being differently motivated, they are selling personal property as a part of their assets, which they are able to dispose thank to the secondary market. They are somehow the winners out of such deals because they get cash on hand for an illiquid party of their wealth.

The market has well developed over the last 12 years. The growth process should continue even more rapidly. By market maturing, the returns will slowly decrease to a fairer value of Libor plus risk spread of 150-200 basis points.

By the way, one important investor to this market is the German Association of the Evangelist Church. If there is any investor who has to behave their ethical und sustainable investment process, it is probably them.

Summing up the present market conditions, an investment into US Senior Life Settlement is *not unethical* and rather becomes a fair sustainable asset class in the near future.

Product opportunities

The US Life Settlement Market typically produces closed-end collective investment products.

Due to increased demand for product structures, for instance currency hedges, synthetic note-wrappers, capital guarantees and/or leverage effects, an underlying fund with monthly liquidity is a must. This hurdle has to be organised in detail, supported by several credit or lending tools. A boomerang effect in case of unexpected resale of policies should then be preventable.

Platform for US Life Settlement products by Fundabilis

The B2B/B2C Life Settlement platform has a unique structure and is the first of its kind in this market. Its main focus is product diversity, offering tailor-made portfolios and to present investment and market transparency. In combination with an open-end fund, it allows an

easy entry to that niche market. Investors are able to get experiences and profit of a long term expertise of the portfolio management. The monthly liquidity offers to realise own investment ideas in mandates or white label products over the platform.