Investment Center
MARKETVIEW
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US Life Settlements – an attractive possibility to diversify your portfolio

The life settlement industry is about the secondary market for US life insurance policies. Life settlements are an alternative class of investments, which is gaining an increasing degree of popularity for investors due to the attractive returns and the comparatively low risk. More and more investors in the USA (especially institutional clients), Europe, Asia and the Middle East appreciate the new investment possibility. In Great Britain a market for such policies has been existing for years, the German market has a current volume of about 800 million Euros with an estimated potential of 6 billion Euros. Also in Switzerland there already are some investment options, which – rightly – are gaining growing interest.

On the offering side mainly the demographic development contributes to the rising volume. US policies with an insurance sum of about 1`600 billion USD are expiring annually because the premiums have not been paid. An estimated 150 billion USD are suitable for life settlements, but only a small part of it is offered on the secondary market so far. Life settlement companies are acting as agents between the policy sellers and the investors and are pooling prematurely cancelled policies into diligently examined, diversified portfolios.

Why are life insurance policies being sold?

A lot of elderly people possess a satisfactory retirement provision and are even over-insured. Often the original reason for the closing does not exist anymore, if for example the benefited partner has died or the security for residential property is not needed anymore.

The secondary market for life insurance policies in such cases offers the possibility to sell the life insurance policies. The buyer pays a percent aged share in the insurance sum, adopts the duty to pay the premiums and, in return, is entitled to the receipt of the insurance sum in case of the death of the insured person.

In life settlements it is distinguished between Viatical Settlements (Viaticals) and Senior Settlements. The former are policies of critically ill, often younger people. Those insured persons often run the risk of financial hardship due to loss of salary caused by illness, treatment costs and premium liability – added to their physical pain. The Viatical-share nowadays amounts to only about 4% of the market. Senior life settlements are policies of persons over the age of 65 – thus of that part of the US population, which in the next 25 years will grow an approximate 90%, three times as fast as the total population .

Process of a life settlement business

First of all the life settlement company verifies whether the offered policy is at all suitable for a life settlement. For this the previous duration – among other things – is crucial since after two years the possibility of contesting the insurance due to possible wrong information of the insured person or a specific cause of death does not apply anymore. Further the financial conditions of the policy (premiums, insurance sum and so on) as well as the state of health of the insured person are of significance.

The value of the policy depends on the moment of death of the insured person. The prognosis of the remaining life expectancy is therefore very significant. It is the basis of all calculations. The calculation is being made by an independent actuary institution based on the anamnesis and the disease pattern. After that independent specialists will be analysing the anamnesis as well as the current state of health of the insured person and then will furnish their own opinion about the life expectancy. Afterwards the policy will be verified with the insurance company (existence, validity, accordance with the insurance conditions, negotiation of the premiums for the remaining duration).

When the policy has been verified and the life expectancy has been estimated, the life settlements company will negotiate about the purchase price of the policy with the seller. The deduction on the insurance policy amounts to 40-80%. The purchase process is being handled by an escrow agent (fiduciary). With the sale of the policy rights and duties are passed on to the seller. He has to pay the premiums up to the death of the insured person (by a deposit bank) and is entitled to the insured capital.

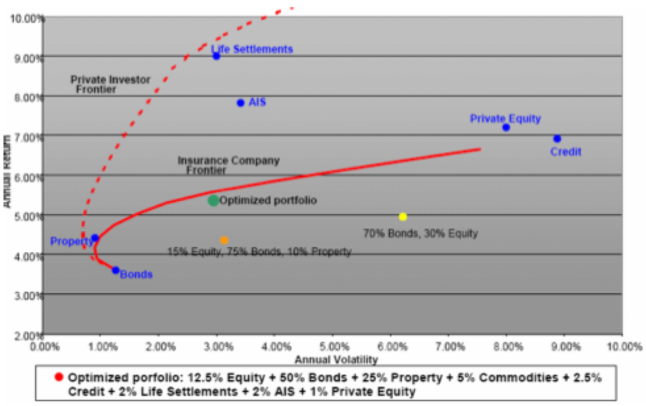
Moral Concerns

The investment success of life settlements depends on the occurrence of risk, meaning on the death of the insured person. This may arouse moral concerns. It has to be kept in mind, however, that life settlements transactions are win-win situations. The premium liability is dispensed with for the insured person and they get a compensation for the policy, which is well above the surrender value. The financial means enable the seller to continue their life style and to pay for their health expenses. Furthermore the heavy weight nowadays lies with older, well situated insured persons, who do not find themselves in emergency situations. In the US even the church and nursing homes are acting as agents between sellers and life settlements companies.

Why to invest in life settlements? Prospects and risks

"Second hand US life insurances promise high security and good returns" (Swiss consumer´s magazine "Saldo" from 22.11.2006). While the volatility of life settlements is relatively low (circa 2%), returns of over 8% p.a. may be generated. Due to the low correlation to other investment classes life settlements are an excellent instrument of diversification. This has to do with the fact that US policies are pure risk insurances without savings. Since life settlements do not correlate with other financial markets, they create an absolute return. A certain protection of capital is guaranteed by the minimum rating of the insurance companies as well as by the requirement of membership of the insurance company in the deposit protection fund.

A life settlement investment increases the portfolio efficiency



Quelle: Commerzbank

A life settlements fund is a self liquidating investment (closed end fund). Payouts to the investors are effected quarterly according to number and sum of the expired policies. According to experience circa 70% of the policies will have expired by the fifth year. The original capital investment will have flown back by the end of the fifth year approximately. Policies, which have not expired by the end of the duration of the fund, will be sold. Finally, the fund will be liquidated by a final distribution (Life Partners).

In the context of investments in life settlement funds it has to be considered that they are usually "closed end funds". The capital invested should not be needed for about 5 years. There is a small secondary market for fund shares. This means that the respective return of this new investment category can be attributed to the limited liquidity. Also, there is no guarantee for the accuracy of the life expectancy expertise. The medical progress may prolong the life expectancy and thus affect the return. The life expectancy mainly determines the price, which ought to be paid for the policy. Simultaneously it is also the biggest risk in this investment category.

Furthermore, the payment of the insurance sum is dependent on the solvency of the insurance company, which has issued the policy. To this effect a well diversified life settlements fund for private investors controlled by experienced fund managers offers more security than individual investments. The Swiss consumer´s magazine "Saldo" (edition from 22.11.2006) quotes the Swiss tax authorities as follows: "the capital investments in US second hand policies are calculated in a way that there is no loss risk for these investments and the payback of the capital investments is virtually guaranteed with more or less return."

Conclusion

The life settlements industry has developed a lot in the past ten years so that the tasks of the individual stakeholders are clearly determined today. This has led to bigger transparency. The growth potential of the life settlements market is considerable and the investment form coming from the USA is finding its way to Europe. In England and Germany numerous products are already on the market. For everyone, who wants to profit from this investment possibility with an extremely attractive return-risk-ratio, life settlements offer a great investment opportunity.

Our experiences in the field of life settlements investments

The HYPOSWISS Privatbank AG, the private bank of the St. Galler Kantonalbank group, has been investing in the life settlements industry for some years. Existing products register an annual return of up to 15%. We are working with experienced partners and profiting from their expertise in this field. (IB LIFE AG) At the moment we are considering the launch of an 8-year capital protected product (pay back of 90% on the expiry of the duration guaranteed) in CHF, EUR and USD, for which a qualitatively first class life settlements fund (open-end fund) serves as underlying investment. Also in these products very experienced stakeholders are involved (Commerzbank/IB LIFE AG). The annual interest warrant amounts to 5%. We expect an annual return between 9-11% at a very low risk – compared to CHF-, EUR- or USD-stocks with 10 year durations and a return between 4.3-4.8% extremely attractive. This product is suitable for clients with a buy-and-hold strategy, who set value on high income (interest warrant) as well as exchange profits at low risk budget. This strategy corresponds to the implemented capital protection modality since it is only valid upon the expiry date of the product.