DAS SCHWEIZER WIRTSCHAFTSMAGAZIN
BILANZ

Bilanz: 11.10.2006

A dead certain business

Nothing is as certain as death: the acquisition of prematurely sold US life insurance policies is an investment with guaranteed profit.

STEFAN O. WALDVOGEL

Due to the low interest classical life insurances are totally uninteresting. On average Swiss providers only guarantee 1,4 per cent interest for the savings part of the insurance. "The business with one-time deposits is dead", also the asset managers say.

However, there are still hundreds of thousands of long time ongoing contracts and the beneficiaries receive money in case of survival or at the latest upon the death of the insurance holder. In this case we speak of mixed insurances because they consist of a savings part (survival) and a risk part (death). If in Switzerland one wants to back out of an ongoing contract, one can only give back the policy directly to the company - generally, though, with a surrender loss.

In Anglo-Saxon countries the losses in case of buyback are even higher; therefore there has been a market for "used life insurances" for some time. These are policies, which are not needed anymore by the insured person. Be it because the benefited wife has passed away before her husband or because possible debts have already been paid off. It may also be that the annual premiums cannot be paid anymore.

In the USA the contracts generally are valid for a life time and are pure risk insurances – as opposed to in our country. The value of the individual insurance is therefore completely independent of any possible development of the stock exchange, the interests and so on. At the time of death of the insured person each beneficiary receives money; the only "unknown" is the exact time of death.

In reality, of course, the business is a bit more complex, but specialized so-called settlement companies are dealing with the legal and medicinal questions on location (see "that´s how it works" on this page). The Bank Leu is going to launch the first fund of funds by next year. But before getting the official authorization by the Federal Banking Commission they are not allowed to advertise or announce any details, they said on enquiry of BILANZ.

In the 80ties one spoke about Aids policies because terminally ill patients had to sell their policies to pay for their medication. Meanwhile the market has changed completely. The business referred to as "Viatical and Life Settlements" with policies of remaining policy periods of maximal two to four years account for only 4 per cent of the US secondary market. Instead this class of insurance business now concentrates on elderly people, on policies of over 65 year old persons with a remaining life expectancy of one to nine years. Instead of approximately 25 000 dollars per policy as in the past the insurance sum nowadays adds up to about one million dollars.

"Thus it becomes clear that the sellers are nowadays mostly persons, who are or have been living in well secured financial circumstances. This is agreeable for many buyers", says Ettore Scudella, manager and founder of IB Life AG in Hünenberg. "We ourselves only buy policies of over 65 year olds, only at a minimum of 350 000 dollars and the insured persons on their part have to show a statistically and medicinally shortened remaining life expectancy of a maximum of 7 years, be it due to illness or belonging to a risk group, like smokers or overweight people", E. Scudella is listing the strict conditions.

To find the right policies is this business` crux. The asset managers have concerned themselves for years with US second-hand policies, in search of investment alternatives. Due to the huge demand of such second-hand policies it has become even more challenging to buy the right policies. "However, meanwhile even the insurance agents in the USA are pointing out this sales opportunity to their clients", says E. Scudella. "The market it still almost virginal and only a very small part of the insurances reaches the secondary market", adds E. Scudella. According to the US insurance commissioner National Association of Insurance Commissioners (Naic) each year policies with an insurance sum of about 1600 billion are being given up; thereof about 100 to 150 billion would be suitable for the secondary market. At the moment only about 4 per cent of the insured persons are using the secondary market.

For the local investor this is of no big significance. He pays less for the policy than what he will receive later. Thus the profit is guaranteed, but it remains unclear when the money will flow back and how big the effective annual performance will be. The price for second-hand policies mainly depends on the estimated life expectancy of the insurance holder. If the policy becomes due earlier, the returns will be increased; if the insured person dies later, they will decrease. This may sound cynical, but somehow is part of life. "We understand US second-hand policies therefore as part of alternative investments for risk-conscious, well-off investors and not a product for the mass market", E. Scudella explains.

This is how it works

The insurance holder is offering the policy he does not need anymore to different settlement-companies. Depending on the age, state of health and kind of policy the company makes a bid. On the basis of medical expert opinions and statistic calculations the remaining life expectancy of the seller will be predicted. According to the remaining life expectancy the foreseeable premiums to be paid and all the administrative costs are being deducted from the insurance sum (sum insured in case of death). If the insurance holder does agree with the offered sum he will be paid this amount.

The insurance holder receives cash and in return his rights are being sold to one or several investors. Upon maturity of the policy the investment capital along with the earnings will be paid out. There is a risk that the predicted life expectancy may not be accurate. Also, for Swiss investors there is the risk of a fall of the dollar rate.

The difference between the purchase price of the policy and the determined maturity payment represents the added value for the investor (buyer of the policy).

Investment vehicles with publicly distributable proof of performance historically show a return of between eight to twelve per cent a year.

The biggest advantage: with an investment in American policies there is no correlation whatsoever to other asset classes (money market instruments, stocks, shares, CAT-bonds, hedge funds and so on). The reason is that the purchase price as well as the maturity payment is known at the time of the investment and cannot be influenced by market occurrences like inflation, interest rates or recession. The value of the policy is known, even though the calculation of the annual return only happens after the pay out of the insurance sum, since the death of the insurance holder is not foreseeable.