



# Taking a view on life

**Peter Winders** argues that investing in life settlements could bring good value to investors, especially in times of volatility.

**A**t first sight, it might seem like immovable earnings from one of the financial world's oldest industries. The trading of US life insurance policies has taken off recently. Our own life settlements fund is seeing average inflows of over GBP20 million a month, while the industry in the UK as a whole attracted several hundreds of millions in 2009. It is not surprising, with some funds having consistently delivered close to 10 per cent per annum in recent years (and that through an appalling global financial crisis that sent investor returns plummeting across many asset classes).

Investors are seeking secure, stable alternatives. But are life settlements the answer?

Life insurance is one of the longest-established financial services industries, but life settlements are a relatively new asset class. Certainly it seems macabre when you first introduce the concept. Life settlement funds buy policies of Americans who want to cash them in. They pay more than the life company itself will, and then continue paying premiums until the policy matures – in other words, when the person dies.

The industry is based in the US because legislation there means life policies cannot

be contested after two years. Anyone buying a policy older than two years is assured of collecting the face value on maturity.

What you pay for the policy depends on how long you expect the person to live. And that's where the key risk lies. You know how much you must pay in premiums each month and what you will receive at the end, but you do not know when the end is.

Most funds base their estimations on actuarial models – the law of averages. We do it differently. We use medical experts and only buy the policies of life-impaired people. The average life

NAV per share performance at February 28, 2010

	Nav per share	YTD %	1 month %	3 month %	6 month %	12 month %	24 month %	2008 %	Annualised since inception %
USD Class A	144.77	1.30	0.66	2.07	4.26	9.03	19.68	9.32	8.91
Euro Class A	135.59	1.27	0.65	2.16	4.20	8.79	19.79	9.49	7.28
GBP Class Dist*	105.14	1.34	0.69	2.16	4.41	9.14	21.31	10.88	9.46
GBP Class Acc	134.11	1.34	.069	2.15	4.37	9.20	21.69	11.23	9.99
GBP Class A	123.82	1.27	0.65	2.09	4.21	8.69	20.55	10.72	9.59
USD Class Dist*	101.36	1.35	0.69	2.12	4.29	9.15	20.20	9.63	9.54
USD Class Acc	104.55	1.32	0.66	2.31	4.55				9.31
Euro Class Dist*	101.27	1.27	0.64	2.01					8.22

\* Distribution reinvested. Source: International Administration (Guernsey) Limited.

expectancy of the 552 policies we currently hold is 30 months. To our mind, this approach is smarter than average, reducing risk considerably for investors.

But both models are open to the question: is this ethical? Is it wrong to make money out of someone's death? Last year, the Pensions Institute in London produced a landmark report entitled "And Death Shall Have No Dominion: Life Settlements and the Ethics of Profiting from Mortality". It concluded: "There would appear to be no particular ethical issues associated with investing in this asset class...provided products and processes are fully transparent to all parties and provided the privacy of the policyholder is safeguarded." In the end, life settlements are little different from the pension industry, where annuities are calculated on life expectancy. And millions of us have pensions.

As for buying the policies of people with limited life expectancy, in many ways it's more morally clear. With actuarial models, you are gambling on life – and so is the

person selling the policy. In the case of the terminally ill, they have a good idea of how long they are going to live and they make their decision to cash in their policy in full knowledge of that. We pay significantly more than the insurer would and compete in an open market to bid for the policies. The seller can use that money to pay for care or special time with their families.

In the end, this is an industry that benefits everyone. And that brings us to the second big issue: the benefits. Near double-digit returns for many investors can look too good to be true in the current low interest environment.

Recent history offers many examples of funds and sectors that offered enticingly lucrative returns but with a nasty sting in the tail. Will this sector go the same way? Will investors get their money back when they want it? Can the funds continue to deliver strong returns?

This asset class is more liquid than practically any other because life settlement funds generate assured returns in cash, which can be used to meet

redemption requests. Compare that with equities or some property funds fire selling buildings at huge discounts to generate cash. Good life settlements managers, in addition, will hold cash surpluses to meet future premiums. They will have loan arrangements if required and ultimately can sell policies on the open market.

On returns, the key threat is getting life expectancy wrong (as the pension industry knows to its cost). We have mitigated that risk by our approach. Investors choosing the actuarial model should be confident about the basis on which the policies have been valued. Otherwise, the returns should be stable and consistent.

It is important to seek professional advice before investing in life settlements, but I would argue this can be an ethically-sound, reliable asset class worthy of consideration in a diversified portfolio alongside equities, property, bonds and cash.

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