# Drawn by life policy funds

**The Business Times Feb 17, 2010**
**By Genevieve Cua**

INTEREST in funds that pool together second-hand life insurance policies is reportedly picking up, as the damage of the financial crisis has sparked a search for assets that do not move in tandem with stocks and bonds. The funds invest in whole-of-life insurance policies that are given up by their owners in the United States for a variety of reasons. The funds buy the policies at a deep discount to their face values. They undertake to pay policy premiums and returns are realised when the insured parties die.

As death is a certainty at some point in time, the asset has gained a reputation for steady returns of between 8 and 10 per cent a year, regardless of economic or investment cycles.

In Singapore, a new fund that invests in second-hand policies, also called life settlements, has been lodged for sale to accredited or sophisticated investors. This is believed to be the second-life settlements fund here. Harvey Athwal, Managing Partners Ltd's (MPL) sales director for Asia, says the firm has found a receptive ear among pension funds in Korea and Japan. He expects commitments of US$150 million from institutions in the Traded Policies Fund, which currently has assets of about US$200 million. MPL is the fund's manager. It has begun to set up offices in Asia. Says Mr Athwal: 'We've seen little interest from the retail market. But we've seen huge and intense interest from pension funds and companies which actually understand the asset class. They understand life assurance and mortality tables.' The firm has signed a distribution deal with a Japanese asset management company for the Japan market.

In 2008, the Life Settlements Wholesale Fund, domiciled in Australia, was registered for sale to sophisticated investors here. The fund, with US$1.2 billion in assets, is marketed by SG Life Settlements in Singapore. The interest comes on the heels of reports that US institutions are looking into securitising life settlements, in their search for the 'next big thing' now that sub-prime mortgages and collateralised debt obligations have gained a bad name. Last year, for instance, Risk Finance, a unit of AIG, arranged a securitisation of life settlement policies with a face value of US$8.4 billion. The transaction was rated by AM Best.

AM Best, however, believes rated life settlements securitisations are likely to be rare for a number of reasons. These include the difficulty in acquiring a critical mass of life settlements necessary for a stable cashflow profile; high transaction costs and the wide range of opinions on the life expectancy of portfolios.

Late last year, Goldman Sachs signalled that it is backing away from life settlements when it ended its involvement with a 'mortality index' that it launched in 2007, Reuters reported. There are also persistent concerns over the issue of fraud. In the US, former attorney-general Eliot Spitzer sued Coventry, one of the largest life settlement companies, accusing it of engaging in bid-rigging with rivals to dampen prices offered to people who want to sell their policies, reports The New York Times.

In the retail market and even among the high net worth market here, the investment may yet remain a niche option given its complexity and distributors' concern over the complexity

of the product, issues of client suitability and the necessary due diligence on the funds.

While the argument of a steady uncorrelated return is undoubtedly attractive, there are a number of risks. The biggest one is that of mortality, or the risk that the insured lives actually live longer than expected. This would depress returns. AM Best calculates, using an actual portfolio, that the internal rate of return could halve from 12.4 per cent to 6.5 per cent if the aggregate life expectancy is 24 months longer than projected.

Funds of course mitigate that by buying a large number of policies so that in aggregate the profiles should match actuarial tables. The Life Settlements Wholesale Fund, for instance, pools together nearly 560 policies as at October 2009 with a total face value of US$2.3 billion. The fund was incepted in May 2006. The more recent entrant here, Traded Policies Fund, comprises 247 policies with a policy value of about US$180 million. The average current age of the insured lives is 80. The fund has a five year track record.

The asset class is also not fully impervious to financial crises. The AAP Life Settlement Index, which compares the performance of 19 traded policies funds, fell sharply in October 2008. MPL said this was partly due to an adjustment in the Valuation Basic Tables which extended life expectancies for the US population. This caused funds to revise their expected returns downwards.

A second factor was the 'low investment levels' which weakened traded policies' prices in the open market. 'Several institutions raised money by selling their policies and other assets, which pushed prices down further, but also created a window of opportunity for buyers.'

MPL's Traded Policies Fund extended all life expectancies in the fund by 25 per cent in December 2008 and smoothed the impact of this adjustment. It has outperformed the AAP Life Settlement Index.

Meanwhile, investors in the Australia-domiciled Life Settlements Fund were dismayed when the fund was revalued downwards in November 2008 year causing NAV prices to drop by roughly 18 per cent. That's after it briefly suspended redemptions. The revaluation was prompted by the market's lack of liquidity and the adjustment in the valuation tables. Since then, NAV prices have posted positive gains for 13 months.

Investors should note that all underlying policies are issued by US insurers. Funds seek to buy policies that are more than two years old to avoid contestability issues. While most funds seek large or jumbo policies, the Traded Policies Fund is going for more modest insured values of about US$500,000 or less. Mr Athwal says this is because smaller policies better reflect actual mortality levels. 'A guy with million dollar policies has better medicare. He knows he shouldn't drink three cups of coffee; he doesn't reflect mortality tables.' In addition state guarantees kick in for a sum assured of up to US$500,000 depending on the state.

---