

## Longevity bets offer profit opportunities for investors

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If there is one thing that worries a pension trustee more than tumbling stock markets, it is longevity risk, or the chance his members will live longer than expected.

Some banks have begun to offer derivatives that promise to swap away this risk, notably JP Morgan and Goldman Sachs. Although it is early days for such longevity hedging, investors may be able to benefit from rising life expectancy by investing in an obscure form of asset that is linked to it, according to one academic.

Merlin Stone, professor of marketing at Bristol University, said institutional investors should consider investments in traded life settlements. These are life assurance policies sold by their holders before maturity. Funds that invest in portfolios of these policies have yielded 7% to 9% a year over the past decade, according to Stone's research, and are uncorrelated with capital markets.

Funds from Centurion Fund Managers, a specialist firm based in Guernsey, returned between 6.9% and 8.1% last year, while other asset classes were hit by market turbulence. The Lehman Brothers Aggregate bond index produced 7% while the S&P 500 advanced 5.5%.

Stone said that as life expectancy rose, more people tended to sell these life policies early, because a common reason for taking them out was to provide for dependent children. If the children became financially independent while the parent was still alive, the policyholders might want to realise the value they had built up.

Stone said: "The great advantage of traded life policies over many other asset classes is that investors know with great certainty what policies will pay out, but they don't know when."

The investment strategy works by acquiring policies from holders and assuming responsibility for the regular premiums paid to the insurance company. In return, the fund manager receives the lump sum payable on the holder's death. The manager depends on its actuarial and medical nous to pick sellers who are likely to die sooner than expected – typically aiming for an exposure lasting about five to 10 years.

Larry Simon, president of Life Settlements Solutions, a San Diego-based firm that acquires such policies, said: "The value in a life settlement is the unexpected change in the medical condition of the insured.

"For example, if a person takes out a policy at 65, at which time the actuarial tables expect him to live to 80, and then, at 72 has a heart attack – which is, for his age, premature – his life expectancy is now, say, 76 years. The decrease makes his policy more valuable to us as there are fewer anticipated premiums to pay before we collect the death benefit. We can therefore offer the seller additional money as a result."

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