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America's life-settlement industry

From mortgages to mortality

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Wall Street makes a life-and-death bet

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SPECULATING on mortality is a sensitive business. So when a recent conference on the life-settlement industry—which allows global investors to bet on the life expectancy of elderly, ill and preferably rich Americans—was held underneath a Methodist hall in London, one speaker was spooked. “However you think about our industry,” he says, “we are waging in death futures. And we were meeting in what seemed like the crypt of a church.”

Touchy or not, the industry is in bouncy shape. It is even becoming a magnet for those Wall Street alchemists who brought the world the joys of mortgage-backed securities and credit-default swaps. Now they can wager on death as well as default.

Americans have been free to trade their life-insurance policies since a Supreme Court ruling in 1911. In the 1980s a small market took off when AIDS sufferers were enticed to sell their policies to speculators for cash. More recently, the credit crisis has battered the savings of elderly Americans, leaving their life-insurance policies as one of their more valuable assets. Seduced by advertisements, they can sell it to a life- settlement firm for many times the amount they would get if they cashed it in with the insurer. The buyer takes over payment of the premiums in return for the payout when the policyholder dies.

Although that gives investors a financial interest in the seller’s death, it does not, of course, mean Wall Street is about to go around bumping off American pensioners. Rather, the industry believes it can pay more to the policyholders than the life-insurance companies because it has selected those with a high risk of dying soon.

If that sounds morbid, practitioners say it is not much more so than the trading of endowment policies in Britain. But Scott Page, an industry pioneer and chief executive of the Lifeline Program, a life-settlement firm, admits that it is a business full of “headline risk”.

That makes it particularly dangerous territory for investment banks. Firms such as Goldman Sachs, Credit Suisse and Deutsche Bank have built big life-settlement desks—one employs about 100 people. Goldman and Credit Suisse have businesses that buy life-insurance policies from individuals. Deutsche Bank prefers to focus on derivative products. This synthetic market is now said to represent about $6 billion-7 billion, compared with a cash market of about $12 billion.

That is still tiny by Wall Street standards but demand is strong. Insurance-linked products, such as catastrophe bonds, are becoming more popular. Investors like the idea that death, like destruction, should be largely uncorrelated with the vagaries of financial markets.

There are pitfalls. Selling the policies is fraught with risks relating to transparency, tax treatment and insurance fraud. In May the Senate’s special committee on ageing called for more regulation of the industry. Like so many other “uncorrelated” markets, activity dried up late last year. At the same time, actuaries revised up their life-expectancy tables, battering returns. Litigation is on the rise, especially in grey-haired states like Florida.

As an instigator of the credit crunch, Wall Street is eager to improve not only its profitability but also its stained reputation. Life settlement offers it a chance to do the former. But there is a huge risk to the latter whenever life—and death—is involved.