TRACKING THE NUMBERS

Street Sleuth

'Viaticals' May Draw More Insurers

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Staff Reporter of THE WALL STREET JOURNAL
May 18, 2005; Page C3

One of American International Group Inc.'s recently disclosed numbers-crunching problems relates to one of its most obscure businesses: "life settlements."

As part of its earnings restatement due May 31, the New York insurance titan said earlier this month that it will correct the way it has accounted for this business. The fix is small for a company of **American International Group**'s size -- decreasing shareholder equity at the end of 2004 by $100 million -- but it spotlights AIG's participation in a controversial industry, which it entered quietly about four years ago and had never broken out in detail in its securities filings.

Relatively few other big life insurers are in the business, which involves buying life-insurance policies from living people at a discount to the policies' face value, making the premium payments and collecting the death benefits when the original policy owner dies.

However, a possible accounting-guideline change to be discussed this week by U.S. accounting rule makers could make the business attractive to more insurers and even hedge funds, private-equity funds and investment banks, industry executives say.

In AIG's case, the reduction in shareholder equity is necessary because the company previously booked the life settlements as investment assets instead of insurance assets, as currently required. As insurance assets, the policies would incur an immediate loss. AIG can only book gains from the assets when it collects the death benefits.

AIG has bought fewer than 1,500 policies since 2001, according to spokesman Chris Winans.

To date, major life insurers have mostly shied away from the life-settlements industry or even lobbied against it, turned off by its unsavory reputation, as well as the possibility that a thriving life-settlement business can hamstring an insurer's other insurance operations by throwing off the company's assumptions about the number of policies that will lapse over the years. However, life settlements can also help insurers hedge against losses in their traditional life-insurance business.

"The industry is not well-liked by most big life-insurance companies," says Larry Simon, president of Life Settlement Solutions Inc. in San Diego. AIG, however, has been more aggressive and smarter than most, he adds.

The practice of buying discounted life policies started in the wake of HIV/AIDS in the 1980s, as victims cashed in their policies to cover health-care costs. Back then, the policies being traded were called "viaticals," after the Latin word viaticum (making provisions for a journey), and were specifically those policies belonging to people expected to have less than 24 months to live. Despite various scandals involving viatical companies and investors who churned multiple policies for cash when drugs prolonged the life of HIV/AIDS sufferers, the business has continued to grow: Policies with a total face value of around $10 billion were bought and sold last year, according to the Viatical and Life Settlement Association of America.

The industry's annual returns of 10% to 15% first attracted European and Asian investors. And a few years ago, **Berkshire Hathaway** Inc., the investment vehicle of billionaire investor Warren Buffett, began buying life settlements, according to securities filings, and recorded an investment loss at the end of 2004 of $207 million on its purchases.

Currently, accounting rules require companies that buy life settlements to charge as a realized capital loss the difference between the purchase price and the policy's "cash surrender value" at the time of the transaction. A cash surrender value is the amount the policy would be worth if the original holder surrendered it back to the life insurer for cash. Typically, this value is much less than the price a company pays to acquire it, because, of course, the acquirer expects to hold it, possibly for years, and gain when it collects the face value upon the original policyholder's death. Buyers also have to take additional charges against net income each year for the amount the premium payments exceed the increase in the cash surrender value.

Industry executives hope that the potential changes by the Financial Accounting Standards Board will allow them to book policies they buy at their acquisition cost, and not as a realized capital loss.