CREDIT SUISSE

Recent Innovations in Securitization

TESTIMONY OF KURT GEARHART

on behalf of Credit Suisse

Subcommittee on Capital Markets & Insurance
House Financial Services Committee
September 24, 2009

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Introduction

Good afternoon. My name is Kurt Gearhart and I am Credit Suisse's Global Head of Regulatory & Execution Risk in the firm's Life Finance Group. The Life Finance Group employs approximately 90 professionals located primarily in New York and London and the group's mandate is to intermediate mortality and longevity risk. I am also the current President of the Institutional Life Markets Association which is separately providing testimony today.

Prior to joining Credit Suisse nearly three years ago to assume my current role, I was a Partner in the Insurance and Financial Services Group of Sidley Austin where I represented banks, insurance companies and other financial institutions in connection with insurance linked securities and other capital markets transactions relating to mortality and longevity risk.

Credit Suisse has been an active participant in securitization markets with considerable experience involving insurance securitizations. Based on this experience we would like to make three basic points today. First, insurance securitizations are nothing new and as we will describe there are any number of types of securitization structures that have been utilized by the life insurance industry with little risk to investors with none of the experiences found in the mortgage markets. Securitizing life settlements would be comparable to any of these types of traditional insurance securitizations. Credit Suisse has never in fact done a securitization in the area of life settlements so we have no direct experience to offer.

Second, Credit Suisse conducts its life settlement business in complete conformity to industry best practices. We have been a leader in creating industry best practices and we believe that they protect consumers as well as institutional investors.

Finally, Credit Suisse also welcomes greater federal regulation of life settlements. We would also be pleased if a strong federal regulator such as the SEC were given jurisdiction over life settlement practices.

We appreciate the Committee's invitation to be here today and our discussion will be divided into three parts relating to life settlements. They are: (1) life insurance securitizations, (2) Credit Suisse's activity in life settlements, and (3) regulation of life settlements and life settlement securitizations.

Life Insurance Securitizations

To begin with, I think it is important to understand that securitization of longevity and mortality risk is not a new concept. For purposes of clarification, longevity risk is the risk that a person lives longer than expected, such as the risk that a pension fund has with its pensioners. Mortality risk is the risk that a person dies earlier than expected, such as the risk a life insurance carrier has when issuing a life insurance policy. Insurance companies have securitized these risks for quite some time, with at least $18 billion in publicly announced securitizations being completed in the last decade. The face amount of the underlying policies in a securitization is typically many multiples of the amount of the securities issued. Thus, it is likely that the completed securitizations represent hundreds of billions of dollars in policy face amount securitized.

Examples of common types of securitizations in the life insurance industry include the following:

1. Closed Block Securitizations. In connection with the demutualization of several large life insurance carriers, including Prudential, MetLife and Axa, large blocks of life insurance policies were securitized to facilitate the initial public offerings or acquisitions of the carriers. These were large transactions that involved the securitization of millions of life insurance policies.

2. XXX Securitizations. These securitizations are a means for insurers and reinsurers to transfer their regulatory reserve requirements that are in excess of their economic reserves, to investors. Insurers and reinsurers who have completed transactions include Banner Life, Genworth, RGA and Swiss Re. Investors in these securities are exposed to mortality risk.

3. Embedded Value Securitizations. These securitizations allow carriers to monetize the captured value of a block of business by moving the block of business off balance sheet. In this situation the carrier in essence transfers all of its risk in the block of policies to investors. In this respect, the securitizations are similar to a reinsurance arrangement but they allow the risk to be distributed to a wider group of institutions. Swiss Re is an example of one carrier that has engaged in embedded value securitizations.

4. Extreme Mortality Securitizations. This type of transaction has the carrier transfer the risk, and resulting losses, of a catastrophic event that would cause a significant reduction in length of time that people are living.

Securitizations of life insurance policies have allowed the risk of these policies to be distributed more broadly, which results in lower cost of insurance to consumers.

Turning to life settlements, a life settlement securitization transfers the same general type of risks to investors as any other life insurance securitizations. The only difference is that a life settlement securitization, in theory, provides income and liquidity benefits to consumers rather than to the life insurance carriers themselves.

The reality is that there have been very few life settlement securitization deals done in the last decade. Although we expect the securitization market to be relatively small, we believe that a potential securitization market for life settlements can be good for consumers and institutional investors.

For consumers, securitization will bring two primary benefits. First, securitizations will provide increased liquidity to the life settlement market which results in higher cash offers for their policies. We estimate that for every $1 billion of face amount securitized, consumers would have received approximately $120 million in excess of the amount offered by the insurance carriers. We think that this is the primary advantage of securitizations for the policy sellers. Second, securitizations would ensure protection of the insureds' privacy as institutional investors will not have access to any information which would allow them to identify the insureds.

For institutional investors, including those that recently experienced significant losses across asset classes, life settlement securitizations provide a tool for portfolio diversification and satisfy investor demands for investments that are not dependent on capital markets. Insurance companies and pension funds by definition have mortality and longevity risk and life settlement securitizations could allow them to more efficiently hedge these risks.

On this basis, Credit Suisse would not rule out participating in properly structured life settlement securitizations – built on longstanding concepts of insurance securitization -- where benefits to consumers and institutional investors can be well-established.

Credit Suisse's Activity in Life Settlements

The Life Finance Group of Credit Suisse began participating in the life settlement market in 2006, initially by purchasing policies through licensed third parties, referred to in the industry as life settlement providers. In 2007, the Life Finance Group formed Credit Suisse Life Settlements, LLC, its own licensed life settlement provider to purchase policies. We opted to form our own platform to purchase policies to ensure the quality of the policies purchased and adequate protection of policy sellers. We employ the following best practices in our purchase of life settlements:

a. Policy sellers must be represented by a financial and/or legal advisor;

b. Advisors undergo a Credit Suisse due diligence background check;

c. Policy sellers are typically higher net worth (average size policy purchased by Credit Suisse is over $2M);

d. Insureds do not have catastrophic or terminal illnesses; they generally are seniors and have life expectancies of 8 to 12 years;

e. A comprehensive anti-fraud review is completed to ensure that there are no indicia of fraud in connection with the transaction or the original issuance of the insurance policy;

f. Comprehensive disclosure statements are provided to policy sellers which

(1) identify alternatives to life settlement transactions that may be available and

(2) include full disclosure of all transaction fees including payments made to brokers and other third parties; this way the policy seller knows exactly how much Credit Suisse is paying for their policy;

g. Closing interviews are conducted with policy sellers and insureds to ensure that they understand the substance and economics of the transaction; and

h. All cases are subject to Credit Suisse's strict legal and compliance standards and each case is reviewed prior to closing.

Since commencing activity in this industry, Credit Suisse has paid approximately $500 million more to seniors than they would have received by surrendering their insurance policies to the issuing insurance carrier. On average, Credit Suisse paid policy sellers approximately 10 times the surrender value offered by the insurance carriers. Without a robust secondary market for life settlements, U.S. seniors would not be able to realize the fair market value for their life insurance policies when there are changes in their needs for life insurance. Seniors typically sell their policies for the following reasons: (1) premiums become unaffordable, which has become even more relevant as a result of recent economic times, (2) estate planning needs have changed, (3) funds are needed for long term health care, (4) to raise funds for other investment needs, (5) beneficiaries no longer need coverage, or (6) they no longer need or want life insurance for a variety of other reasons.

Credit Suisse sells portfolios of the policies to, or otherwise manages and distributes the risk with, sophisticated institutional investors including insurance companies, fund managers and pension funds.

Apart from Credit Suisse's core Life Finance business, Credit Suisse through a private equity fund, owns a majority stake in another life settlement provider that is in the business of purchasing life settlements for institutional investors. This ownership stake was acquired as a private equity investment and Credit Suisse does not exercise management control.

Credit Suisse employs rigorous risk management practices to limit the amount of exposure, including quantitative and qualitative limits that Credit Suisse maintains in connection with its life settlement business. Moreover, Credit Suisse encourages prudent behavior through compensation practices that seek to align compensation more closely with the risk we as a firm are taking. For example, Credit Suisse has broad compensation claw backs as a condition of bonuses on all senior employees. Last year Credit Suisse paid bonuses to investment bankers largely in distressed assets.

Regulation of Life Settlements and Life Settlement Securitizations

In the event they occur, life settlement securitizations would be regulated as securities transactions subject to the Securities Act of 1933 and SEC regulation. They also would be subject to any general securitization reforms currently being considered by Congress as part of the Administration's Financial Regulatory Reform proposal.

The acquisition of life insurance policies from policy sellers is currently left to regulation by state insurance departments. Credit Suisse has worked with the other industry participants, the NAIC and the National Conference of Insurance Legislators (NCOIL) to develop model laws, and with states to enact their own regulation. Today, 35 states regulate life settlements.

Notwithstanding the efforts of the NAIC, NCOIL and state regulators, consumers in 15 states still have no regulatory protection. In addition, the separate models and various debates at the state levels have led to a patchwork of inconsistent regulation across the country. While possibly providing adequate protections at the local level, this regulatory framework unfortunately causes market participants to use different form agreements from state to state, and adopt different business and anti-fraud plans from state to state, which can be confusing to consumers and impact the effectiveness of regulation. This increases the frictional costs to consumers. Many states do not have state of the art consumer protections and the laws truly do not apply as intended. For example, the laws are intended to protect policy sellers, insureds and beneficiaries, but life settlement laws apply only in the jurisdiction where the policy sellers reside. Thus, if a policy seller resides in an unregulated jurisdiction, neither the insured nor the beneficiaries will have any regulatory protections even if their own state regulates life settlements. In addition, the life settlement market, like most other capital market products, is dynamic and it is difficult for all of the states to ensure sufficient resources to continually update their regulations and laws as necessary to ensure effective regulation.

As I mentioned above, Credit Suisse has implemented a variety of best practices in our life settlement business to protect consumers regardless of whether required by state law. We do this because we value our reputation and because we believe it protects our institutional investors who do not want to own assets that were acquired with abusive practices. Credit Suisse would support federal regulation and oversight of this business by the Securities and Exchange Commission or another federal regulator as a means to provide greater protection to policy sellers and insureds.

Federal regulation adds to the state level protection of investor interests in life settlements as well. Investors could benefit from assurances that insurance carriers and the life settlement industry abide by best practices. Clear laws mandating insurance carriers' and the life settlement industry's obligations and responsibilities will protect investors and lead to more certainty in the market.

Accordingly, federal regulation could lead to (1) standardized origination practices, documentation, disclosures, (2) consumer protection, (3) market and operational efficiencies and (4) protection for investors, all of which could be important to the responsible growth of the life settlement industry, without which seniors will have limited options for their unneeded or unwanted insurance coverage.

Conclusion

To close my testimony, I would like to restate our three primary points -- 1. Life Insurance securitizations are nothing new and -- while Credit Suisse does not have direct experience -- any application of securitization practices to life settlements should be the same as traditional insurance securitizations; 2. We believe strongly in the implementation of industry best practices; and 3. We would welcome strong Federal regulation in the form of the SEC or other appropriate federal agency.

As discussed, life settlements provide seniors with a valuable option for disposing of their unneeded insurance policies. The life settlement industry has provided billions more dollars to seniors than they would have received if they surrendered their policies. The entrance of banks and institutional investors such as pension funds and insurance companies into this market has enhanced standards and industry best practices. Life settlements investments are independent of returns in the capital markets and can be a valuable option.

Thank you for the opportunity to appear today and I will be happy to answer any questions that you may have.