

The Best-kept Secret of the Life Settlement Industry

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The life settlement industry is getting a lot of well-deserved attention these days, but the focus has been one-sided. Everyone, it seems, is looking for agents and brokers who have clients with unwanted life insurance policies to sell. But let me ask you two questions: How many of us have clients over the age of 65, in poor health, with multi-million-dollar insurance policies that they don't want to keep? Very few, right? But how many of us have clients of all ages with poorly performing investment portfolios — especially those clients nearing retirement age? We all do!

With all the focus directed toward the sale of insurance policies, we may have overlooked the biggest and most obvious opportunity: the opportunity for our clients to invest in life settlement policies, just like some large financial institutions have been doing for years.

Here's the secret — life settlements may be a golden parachute for your clients' golden years.

So, why have some large financial institutions quietly been purchasing life settlement policies? Because they obviously recognize the potential for a superior return on investment, with very little risk.

This is what first attracted these savvy institutional investors to life settlements, but they aren't happy to share their secrets.

If institutions are jumping headlong into this market, then it's probably worthwhile for individual investors to consider this as an added safeguard for their own portfolios. With the volatility of the stock market in addition to recent international political instability, many portfolios have suffered a free fall, just at the point where the boomers are approaching retirement. Who isn't ready to explore a new asset class that can help safeguard their life savings?

This is the perfect time to research a more reliable investment vehicle that may offer needed peace of mind for those hoping that they have enough of a nest egg to sustain them through their golden years. As agents and brokers, we owe it to our clients to investigate whether life settlements might be a key component to fill a void in their portfolios.

Life settlement investments offer us a unique new asset for our client's portfolio and we receive a nice commission for doing so.

So let's start with the benefits of a life settlement investment:

Uncorrelated to stock, bond, commodities, and real estate markets.
(This is probably the greatest strength of this new asset class—no matter what happens in the economy, life settlement payouts are unaffected.)

Not directly affected by interest rates, global economy, or political climate.

(Not affected by foreign currencies, who's in the White House, or any terrorist threats.)

Investment assets issued by some of America's largest and most financially stable companies.

(Life settlement policies are backed by such financial giants as New York Life, Prudential, and other highly rated insurers.)

Provides true portfolio diversification.

(Life settlements can offer balance and performance to any portfolio.)

Sounds good, doesn't it? But before you jump in, let's explore and evaluate the risks and rewards of the three most common methods of investing in life settlements: bonded life settlements, life settlement funds, and direct fractional ownership of a life settlement policy.

Bonded life settlements

This form of investing in life settlements is an asset-backed security that has also been referred to as "death bonds." A bonding company issues a bond to the investor, payable at a specified future date, like any other bond. If the insured lives beyond the date of the bond, the bonding company pays the investor a predetermined amount at that time. A death bond is simply a negative name for the flip side of the coin called "life insurance." In practice, no insurance company has ever marketed a life insurance policy as a death bond, even though it only pays its benefit when the policy holder expires.)

Pros:

Access – the client gains access to the Life settlement asset class.

Fixed maturity – the investor knows the maturity date of his investment.

Cons:

Company risk – the investor is relying solely on the strength and longevity of the underwriting and bonding companies. Research has shown that the bonding companies involved have been predominantly offshore-chartered companies with no regulation or oversight in the U.S.

No direct ownership – The investor does not receive any direct ownership rights in the insurance policy. If the bonding company does not pay, the investor has no recourse with the life insurance company for repayment of their investment.

Limited liquidity – This type of bond has very limited liquidity and would not be marketable in the U.S. bond market.

High cost – The cost of a bond is substantial and significantly reduces **Life settlement funds**

A life settlement fund is a collection of life insurance policies purchased and pooled together into a single fund, similar to a mutual fund. The investor purchases shares in the fund and is

paid a percentage of the fund's return based on their percentage of ownership.

Pros:

Access – Investor gains access to the life settlement asset class.

Diversification – Investor gains diversification within their investment portfolio.

Fixed maturity – Investors in a closed-ended fund have a predetermined maturity.

Cons:

No direct ownership – The investor does not receive any direct ownership rights in the insurance policies. The investor has no recourse with the life insurance company for repayment of their investment should the fund perform poorly.

Limited liquidity – Shares in a life settlement fund could not be easily converted to cash.

High cost – Management costs associated with a fund can be high and therefore diminish the return to the investor.

Pricing risk – If the fund becomes distressed due to poor management or poor underwriting, the investor's return is at risk.

Direct fractional ownership

Direct fractional ownership of a life settlement policy is the most secure method of investing, in our opinion. The client actually obtains ownership and beneficiary rights to a portion of the investment policy. By actually owning a portion of the policy, the client maintains individual control over their asset. Think of the similar concept of owning a condominium, but not the entire building. Our clients can enter this market at a fraction of the cost that large institutions are required to commit. This is discrete asset ownership with all of its privileges.

Pros:

Access – The client gains access to the life settlement asset class.

Affordability – The client gains all the benefits of this asset by owning a smaller portion.

Diversification – Investor gains true diversification within their investment portfolio through exposure to this new asset class.

Direct ownership – Gives the client control and beneficiary rights to the insurance policy.

Low cost – Direct ownership costs are lower than the other two methods of investing. All of the closing costs are paid by the policy seller.

Liquidity – An emerging secondary market for policy fractions gives the investor the

potential for limited liquidity.

Projected return – The yield on each policy fraction is known at the time of investing and double-digit returns have been the norm to individual investors.

Premium escrows – Policy premiums are escrowed for the maximum life expectancy on each policy. This ensures that the policy cannot lapse during this time.

Cons:

Liquidity – Although some liquidity is gained through an emerging secondary market, the asset is still considered a buy-and-hold investment.

Variable maturity – Since life expectancy cannot be medically determined with complete accuracy, variable maturities are a known factor with direct fractional ownership. Depending on a client's goals, some may be averse to variable maturities.

Premium calls – Investors are required to begin making fractional premium payments should the escrow account become depleted.

Key questions for you to ask when considering a life settlement investment:

1) How long has the investment company been in business?

(If they are new to the business, beware! It can take years to develop accurate underwriting techniques.)

2) How transparent are their operations? Are they publicly traded so the investor can evaluate the strength of the company through public records?

(If not publicly traded, how can you verify their claims?)

3) What is their policy underwriting experience and history? Can it be verified?

(If the company is young, they may still be experimenting with underwriting techniques.)

4) What is their historical return on investment? How long has that ROI been achieved?

(If you can't see years of verified return data, again – beware! The new kid on the block is someone to avoid.)

5) If bonded, where is the bonding company located? Domestically or offshore?

(If a bonding company is located offshore, watch out. They may not be around to pay off in a few years and they are not under U.S. jurisdiction.)

6) Is the bond rated by a U.S. company such as Moody's?

(Unrated bonds should always be avoided.)

7) What is the investor's recourse if the bonding company refuses to pay, or is not around at the time of maturity?

(There is no recourse in this situation. Let the buyer beware.)

8) In the case of life settlement Funds, who is managing the fund? What is their past experience and success?

(Fund managers can inject huge costs and greatly diminish the fund's performance.)

9) In the case of direct fractional ownership, who is managing the company?

(Make sure you investigate the track record and management team of any company you recommend. Your safest choice is to go with a company that is publicly traded.)

10) Will there be enough supply of life insurance policies for sale in the future?

(One thing for certain, as long as people keep buying life insurance policies, there will always be a portion who want to sell. With the maturation of the boomer generation, the supply should be plentiful for a long time.)

There are pros and cons to each method of investing in life settlement, just as there are in any other type of investment; but one thing is for sure: Life settlements are here to stay and we need to take advantage of all the benefits this investment opportunity has to offer. After an exhaustive two-year investigation, we are confident that the best life settlement vehicle to recommend to our clients is direct fractional ownership.

Everyone is looking for a superior return on investment in a vehicle with a high degree of safety, especially those in or near their retirement years.

Now that institutional-style returns are available to the individual investor, we have a new stream of income to tap into through life settlement investments. Are your clients aware of this investment option? If so, it could mean a soft landing in their retirement years.

The DFO secret is out — make sure your clients have strapped on their golden parachute before they jump into retirement.

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