

■ The Stars Are in Alignment

The life settlement market will grow and prosper as long as we can avoid the enemy within

By Paul Siegert

I see the life insurance secondary market ("LISM") resting on two enriching paradigms: 1) it provides social value by creating liquidity in hidden assets for seniors, and 2) it provides stable, predictable and transparent profits to investors. Of course investments in stocks and bonds also create profits and social value by providing capital to businesses, which in turn creates jobs and economy. The main difference, as I see it, is that risk-adjusted returns are greater and more secure in the life insurance secondary market.

The life insurance secondary market is a sound and timely place to invest in spite of pressures on insurers by capital markets and the federal government. Does anyone really think the federal government will allow life insurance policies to default? If investing in life insurance backed assets to trade them, expect volatility in respect to capital market cost of money as well as IRRs which are driven by alternative investments having similar risks. But if investing to hold, returns can be predictable ... non-correlated ... and the mark-to-market issue is a non-issue.

The major challenge with investment in life settlements has been accuracy in predicting life expectancies. But this has been confronted for the time being with major adjustments in life expectancy tables and practices announced in late 2008. The pendulum may have swung a bit too far, but mortality improvements will catch up. It is a practice in probabilities ... not a precise science.

Will investors return to the investment markets? YES! Will they want to reinvest in the smoke and mirror of deriva-

tives or mortgages based on hyped property values? NO! Investors need to deploy their capital in order to make profits. Right now LISM is a "buyers" market ... IRRs are high. The time to get capital invested in this asset class is now.

To date, it seems LISM stakeholders have been their own worst enemy. There is still no "best practices and standards"

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established from within (but serious undertakings are in progress). Some have promoted unrealistic investment returns (but newer portfolio analyses tools deal with this). Transparency has been resisted (and this is changing as standard forms and disclosures are being adopted). Many have reacted to proposed life settlement regulations rather than proactively offer model laws (but lobbying is focused in cooperative efforts with legislators).

Securities regulations have been resisted (but the reality of securities laws when trading policies in tertiary transactions is becoming understood). And some excessively aggressive marketing has been practiced (which is being curtailed by life settlement laws). LISM stakeholders have been on a maturing curve for the past decade and have come to understand what is required to seriously play in the

institutional capital and credit markets. The errors of the past have been controlled ... partly by law ... partly by reality. The life insurance secondary market is now an attractive place to invest ... the only challenge is how and with whom.

Numerous investment choices are available:

→ Fractional interests in life insurance policies offered by Life Partners, Inc. can be attractive for those who cannot invest enough capital to create their own diverse portfolio of whole policies. But Life Partners has fought securities regulations applicable to the sale of fractional interests, casting a cloud on these investments.

→ Foreign mutual funds such as EEA Life Settlements Fund in Guernsey (none yet exist in the U.S.) enable investment of smaller amounts in diverse portfolios, but are subject to off-shore investment risks.

→ LifeNotes, offered by GWG Life, provide opportunity for accredited and institutional investors to purchase short-term and medium-term notes that pay a current coupon and are secured by a diverse portfolio of life insurance policies. These operate similarly to bank CDs.

→ Policy Value loans, offered by Legacy Funding Group, Inc., operate similarly to reverse mortgages and may be available to investors seeking to hold such paper.

→ Purchasing a few select whole policies or developing comprehensive proprietary portfolios to hold to maturity or to resale can be attractive to capital rich investors who want to carve out investments that fit their particular specifications. Doing this

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requires sophisticated operating staff or partnering with expert providers, and it requires time to aggregate portfolios of sufficient size (over 250 insured) to assure longevity risk stabilization.

→ Purchasing of whole portfolios that have become distressed because of liquidity or longevity issues can be opportunistic for aggressive investors with deep pockets ... but requires staffing and/or expert advisors who know how to assure target returns.

→ Stock ownership in industry stakeholders is available in the market and via privately negotiated terms ... thus enabling bottom line participation.

→ Also, Deutsche Bank offers synthetic life settlement contracts for the investor seeking pure speculation in mortalities. And, Credit Suisse, Swiss Re and Goldman Sachs offer investment structures based on indices they have created.

The critical element in selecting an investment venue is to understand the value chain, where to play in that value chain,

and with whom to play. Ultimately, value is created in four distinct categories:

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ries: a) intellectual property necessary to design and build products; b) tools necessary to analyze and support products for the secondary market; c) infrastructure necessary to deliver and implement products; and d) monitoring & servicing necessary to protect and realize investor returns.

Investment participation and returns are available in all categories, but quality in experience, leadership, management, transparency and integrity are essential for investors and the industry to succeed.

All in all, in only a little over a decade, the life insurance secondary market has grown from a small, eclectic, opportunistic group of businesses into a sophisticated capital markets driven industry. This market offers substantial and important value to seniors at a time when seniors are suffering real pain from major losses in 401(k)s and other assets. In addition, this market offers above average investment returns and security to investors. The life insurance secondary market is good, it is here to stay, and it will continue to flourish. ■ Paul Siegert is the Director, President and CEO of the Insurance Studies Institute (www.insurancestudies.org).

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