

Should You Invest in Life Settlements?

Overview: Life settlements can be an option for individuals who are in need of liquidity, and they aren't correlated to the overall performance of the economy in general. There are, however, several concerns when it comes to life settlements, such as the fact that they aren't regulated and are facing legal uncertainty.

A life settlement is a transaction in which an insurance policy owner can access liquidity from his or her policy by selling it to a third party. The payment received is typically greater than the policy's cash surrender value but less than the expected death benefit.

For individuals who need cash and hold a life insurance policy that is no longer needed, a life settlement remains a practical option for liquidity. In fact, it was estimated in 2009 that approximately \$7 billion of face amount in life insurance was sold in life settlement transactions.¹

Once third-party investors purchase life insurance policies from their owners, they can either wait to collect the death benefits themselves or securitize the policies to sell to investors. As an investor, your investment helps pay for the premiums to keep the life insurance policy in force, and when the policyholder dies, your return is tied to the death benefit. Although it may seem unsettling to get paid when someone you don't know dies, the transaction is legal.

There are, however, several concerns regarding these investments:

- σ The transactions are not regulated, and according to the SEC, as of July 2010, there were no reports of life settlements registered with the SEC.²
- σ There is legal uncertainty regarding the ability to transfer insurable interests, so life settlement transactions could be prohibited. Insurance companies have already begun to take aggressive action against selling policies to unrelated third parties.
- σ The number of life settlement transactions has decreased over the past few years, reducing the number of policies available for an investment pool.³
- σ Cash flows and returns are linked to death benefits. But because it is difficult to time when someone will die, the timing of cash flows could be mismatched, making the investment riskier.
- σ The investments are practically illiquid.
- σ You are subject to the credit risk of the insurance company that issued the original life policy.

The biggest benefit to investing in life settlements is they aren't correlated to stocks and bonds or the financial performance of the economy in general. The performance of life settlements depends solely on the death rate of the insured individuals.⁴

But the risks involved with investing in life settlements overshadow the benefits. Until the life settlement industry is regulated, individual investors are vulnerable to sales pitches and promises that cannot be enforced and they instead would be better served by building a broadly diversified portfolio that matches their ability, willingness and need to take risk.

¹ **Life Insurance Settlements: Regulatory Inconsistencies May Pose a Number of Challenges.** U.S. Government Accountability Office, GAO-10-775, 2010.

² **Staff Report to the United States Securities and Exchange Commission.** Life Settlements Task Force, July 22, 2010.

³ Ibid.

⁴ Sam Rosenfeld, **Life Settlements: Signposts to a Principal Asset Class.** Wharton Financial Institutions Center, Working Paper No. 09-20, 2009.

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