

Safe Money Advisory

Can You Earn 16% Annually Risk Free?

**Houston, Texas
For Immediate Release**

I recently was presented an opportunity to earn a 16% annual return with only “modest risk”. The investment was called a “fractionalized life settlement” and the sales pitch was compelling... but I’m wondering if the risk is “modest”. This investment is fractions of the death benefits from life insurance policies on strangers. These policies were sold because the policyholder (insurer) no longer needed, wanted or could afford to pay the required policy premiums. The policies were not surrendered for their cash values, because the “present value” of the death benefits is worth more to Life Settlement Companies that could repackage them for resale. Such investments might make sense for institutional investors, but they are risky for individual buyers. Let’s see how they work.



A company selling fractionalized life settlements might start by buying ten life insurance policies from individual policyholders that no longer desire life coverage. The price they pay for a policy depends on the estimated life expectancy [medical age] of the insured, the size of the death benefit and the amount of the annual premium needed to keep the policy in-force. Each policy is then divided into ten pieces [fractions] with the ten policies yielding 100 pieces [fractional shares]. The pieces are then reassembled into ten investment pools consisting of one piece from each policy. The reassembled pieces are then sold to individual investors with each buying a fraction of ten separate policies. The fractions represent “diversification” which usually means “safety”. Based on the estimated remaining life expectancies, death benefits and premiums reserve, the forecasted annual return is 16%. What are the risks?

First, the medical professionals estimating the remaining life expectancies of the insured could be wrong. The individual investor simply has to take their word and hope there are no hidden agendas and no mistakes. The shorter the forecasted life expectancy, the higher the price the individual investor must pay; thus, the seller has a potential interest in underestimating the life expectancy of the policyholders. Even though the seller and the underwriting medical team are independent, the individual investor has no way of verifying such independence; thus, a potential conflict of interest is a risk to investors.

Second, the policies must remain in force until the policyholder dies. A premiums reserve is established [escrowed] from the sale proceeds and managed until paid out as annual premiums. If life expectancies are underestimated, reserves are mismanaged or escrow agents are not trustworthy, the premiums reserve might be inadequate meaning policies are in danger of lapsing. In such cases, the investors must pay the premiums to protect their investment: the result is lower returns or even losses.

Third, the life settlement business is largely unregulated, and in many states no licensing requirement exists for fractionalized life settlement companies selling to the general public. That means no background checks, no educational requirements and no oversight by the insurance and/or securities regulators. In other words, there is ample room for abuse and this represents another risk.

The dead giveaway of high risk is the promise of an exceptionally high rate of return. The one immutable law of investing is that “risk and reward” always travel together: where there is the potential for high return there is high risk, no exceptions. If this were not true with fractionalized life settlements, there would be long lines of sophisticated investors trying to take advantage of high return without risk. The old dictum “buyer beware” [caveat emptor] is appropriate for fractionalized life settlements.

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