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Life Settlements: Impact Investing with House Odds or "Trafficking in Tragedy"?
By Alan Snyder

Investing in life settlements, if done prudently, can offer investors low double digit returns, low volatility, and the diversification benefit of an uncorrelated investment. However, some question this type of investment as our subject line highlights.

Life settlements (one of the allocations in our alternative lending model portfolio - see www.shinnecock.com/articles/alternative_lending_presentation.pdf) provide cash to seniors who find they no longer need the death benefit from a life insurance policy, or can no longer afford the premium payments. The life settlements investor assumes the burden of paying the premiums and receives the death benefit upon passing of the insured. The policy owner's other alternatives are:

1. Stop paying premiums and let the policy lapse – loss of value.
2. Surrender it to the issuing insurer for the cash value – not much of a payment.
3. Roll the cash value into a new policy with a possibly more affordable premium and lower death benefit – more costs.

In a recent study, policy owners received an average of 400% more than the cash surrender value offered by their insurance company, by choosing the life settlement option. Life settlements provide seniors with a financially compelling fourth alternative to the three relatively unattractive ones above.

More flexibility, more cash, and greater piece of mind for the policy owner are substantive social benefits that regulators have recognized. The National Association of Insurance Commissioners ("NAIC"), whose insurance commissioners regulate insurance practices at the state level, have established regulations requiring insurance agents to proactively offer this fourth alternative to policy owners.

"Not so fast" screams the skeptic… life settlement investors are "traffickers in tragedy" because they are profiting from people dying. Really? In effect, the investor is lending money to the policy owner, paying the financing costs in future premium payments, and ultimately hoping to be repaid from the future death benefit. For comparison, a reverse mortgage lender calculates how long the homeowner will live before they, as lenders, inherit the home. The seller of a life insurance policy does so of their own volition and for their own benefit. Furthermore, a competitive life settlement market ensures that the policyholder has a choice of buyers.

Okay, so we have a socially responsible investment, impact investing, but is it a good investment? The "Cool Hand Luke" investor reviews the facts, requirements for success, and determines the economic merits.

Life settlements are essentially an arbitrage based on actuarial science and traditional investment controls.

1. Before a life settlement purchase, the policy and insured are carefully analyzed. The health of the insured is re-underwritten based on current data. The terms of the policy are reviewed to optimize premium payment.
2. Portfolio diversification counts: counterparty risk (e.g., the insurance carrier), average age of the portfolio insureds, health impairments (i.e., avoiding overconcentration in any single category such as cancer), a minimum number of policies to achieve the "laws of large numbers" for statistical robustness, etc.
3. Cash reserves and standby lines of credit make sure premiums can be paid. Sparing use of leverage, if at all, protects against the unexpected.
4. Quality people with regulatory compliance must undertake all of the above.

Finding an expert specialist in life settlements takes work and due diligence. We have done this for our Shinnecock Income Fund, which has a modest allocation to this space. The investment results are noteworthy. Over the years, "low- to mid-teen" returns have been achieved with low volatility and very few (modestly) negative monthly returns.

Institutional investors such as Berkshire Hathaway, Apollo, Fortress, AIG, and CalPERS are significant investors. Nevertheless, Conning & Company, talented insurance research specialists since 1912, write in their 2014 report "Life Settlements: Growing Unmet Need, Increasing Opportunity," that this $180 billion market offers $3 billion in new opportunities a year and $35 billion of trading potential in the tertiary market.

Is this compelling investment opportunity guaranteed, risk free, and easy? Not at all! Expertise, duty of care for the investor, ongoing monitoring, "skin in the game" to align interests, and investment scale are all requirements. Life settlements, we believe, offers an uncorrelated and attractive allocation for Shinnecock Income Fund.

P.S. - Please browse our online data room for even more information on Life Settlements. If you don't already have a logon, drop us a note and we'll set up access for you.