BREAKING DOWN TRANSPARENCY IN COVERAGE RULES | THE HEALTH DISRUPTER MYTH | HOW DIVERSITY & INCLUSION HELPS YOU

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LIFE SETTLEMENTS

Could You Use Another Tool in Your Toolbox?

COVER STORY

COULD YOU USE ANOTHER TOOL IN YOUR TOOLBOX?

Help clients diversify while adding additional revenue to your practice — all by just using your life license in a new way

BY BRIAN J. CLARK

Did you know that it has now been over 20 years since California passed Senate Bill 1837? Do you even know what CA SB 1837 did for you and your clients? Perhaps not, but after you read this article, you will. Then you may have a new way to use your California life insurance license to help your clients add meaningful diversification to their portfolios while adding significant revenue to your business. Hopefully I have your attention!

If you are an independent life agent or a registered investment advisor with a California life license, and you have California clients with a net worth of at least $250,000 — not counting their primary residences, cars or home furnishings — this article is for you. In the year 2000,

California passed CA SB 1837. It modified California law such that it exempts the offering of certain investments from securities licensing, and provides for regulation of these investments. It says who can offer these unique, non-correlated investments, who can invest in them and what all must be done and disclosed to be compliant with the law. If you don't have your FINRA licenses, like the Series 6 or 7, you are limited in what you may offer clients when it comes to investments. So life insurance and certain annuities may be a large part of your practice.

Wouldn't it be nice to be able to have an additional tool in your toolbox to help clients add meaningful diversification while giving them attractive performance potential? No matter what is happening with the stock or real estate markets or how low interest rates might be? Wouldn't it be nice to offer something that won't be affected by geopolitical events like elections, pandemics, oil prices or conflicts? Well, as you now know, you do! With just your California life license, you can help your California financially qualified clients and prospects with an investment that is essentially immune to all of those things. Life settlement investments is that tool.

You may already be familiar with life settlements as a concept from the recent article by Lisa Rehburg, a well-known life settlement broker, as a way to help clients sell unneeded, unwanted or unaffordable life insurance policies, usually later in their lives (Cal Broker's September 2020 issue, page 18). Once a policy is sold, historically to large institutional investors like hedge funds, it becomes a non-correlated investment for them as part of their overall portfolio. CA SB 1837 allows you to offer this asset class to some of your California clients, rather than leaving the profitability and diversification they can provide just to the 'big, smart money.'

Because it is a California law that

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regulates the investment, it is prudent to only work with California residents. Additionally, the phrase, ‘financially qualified’ has a specific meaning in the law. The investors that may participate must either be (i) accredited, meaning they have a net worth of at least $1 million not counting their primary residence or (ii) be ‘qualified’ and have a minimum net worth of at least $250,000 not including their primary residence, cars and home furnishings. If they are ‘qualified’ but not accredited, they are limited to investing no more than 10% of their stated net worth as defined here. Since this type of investment is primarily meant to be a hedge to an investor’s other ‘primary’ holdings anyway, this 10% rule isn’t a bad one to apply to most everyone. There are other ways to qualify financially using certain income tests, but for the purposes of this article, we’ll stick to the asset-based qualifications since you always want clients to have adequate liquidity.

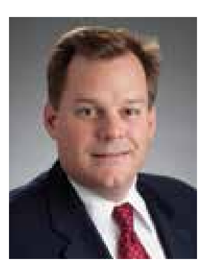
With all of this said, it is critical that you choose a trusted partner in this space with the knowledge and experience to help you and your clients access this unique opportunity. Make sure you understand how the policies are owned and how the investment works. Make sure the client understands these things and that it is an appropriate option for them.

A brief note on the financial qualifications standards that are spelled out in the law: They are not meant to keep the little investor out to prevent them from participating in a potentially attractive and rewarding investment, but rather, the requirements are meant to help ensure that an investor has the liquidity and sophistication to understand and properly service such an investment while they own it.

Time horizon is another important consideration for an investor in life settlements. Life expectancies are estimated from a review of the insured’s medical records by an underwriting laboratory as part of the process. We therefore have an idea of when policies may mature and gains realized. As we all know, nobody knows for sure when an insured individual will actually pass away. Since that is the triggering event for the maturity payout, this investment is a bit like a zero-coupon bond with an uncertain maturity date. The investor knows how much they will be receiving, and they have an estimate as to when they may receive it, but it could be much sooner or later than the estimate. And since we all know that premiums must be paid on life insurance policies until maturity to keep them in force, this uncertainty on the long end results in probably the most significant risk to this investment: longevity risk of the insured. Some policies that an investor may own might mature quite early, resulting in outsized, rather fantastic rates of return, while others may mature later than anticipated and will thus temper the overall average return from life settlement investments. Thus, a portfolio approach may be better than just owning an individual policy as an investor.

Speaking of performance, using data from 2001 to 2011, the London Business School conducted an empirical study published in 2013 and concluded better than a 12% average annual return from a large pool of policies. This partly explains why large investors like Warren Buffett, Blackstone and national pension funds have utilized life settlement investments for many years. But it isn’t just the performance potential of the asset class that they like. They certainly like the non-correlation to all the risks their other investments have. They also appreciate the fact that the payouts are not a matter of if, but when, and that those payouts are coming from some of the strongest and largest companies in the world: highly-rated U.S. life insurance companies. Some of your clients may also appreciate what this type of investment can bring to their portfolios. You will appreciate the new revenue stream from being able to work with additional money, like IRA or Roth IRA funds, perhaps to help clients diversify with life settlement investments.

You may or may not be a fan of all the work California legislators do in Sacramento, but CA SB 1837 can be quite meaningful for your clients and your business, especially at this time with all that is going on in our world. You may wish to consider learning more and leveraging this new tool today!



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