

# THE LIFE SETTLEMENTS REPORT

NEWS, INFORMATION, & ANALYSIS OF THE SECONDARY MARKET FOR LIFE INSURANCE

Vol. I, No. 15

November 15, 2007

## INVESTORS TARGET SMALL-FACE-VALUE POLICIES

### Emerging Market Expected to Grow in 2008

by Susan Romero

The life settlement industry has its eye on America's middle class and it's bulging with small-face-value life insurance policies.

Last year, there was virtually no market for settlements valued at less than \$250,000. Today, at least a dozen providers have either incorporated a small-face assessment program into their business models or are actively testing the waters in this territory. The bar has now dropped to \$25,000 in many cases and some institutional investors are eager to diversify their portfolios with an infusion of these smaller policies.

"People are excited about this emerging market. There is more than one player buying small-face policies and that validates the market," said Robert Stark, president of New York-based life settlement brokerage **Melville Capital**.

Stark said that during the past year, he's seen about a dozen providers open to the small face market. They include Newton, N.J.-based **Life Policy Traders**, Lancaster, Pa.-based **Milestone Managers & Providers**, San Diego-based **Life Settlement Solutions** and Minneapolis-based **FairMarket Life Settlements**. Baltimore-based **Cielo Life Settlement** is a new life settlement services provider that deals exclusively with small-face policies.

"This isn't some niche market. We're talking about hundreds of thousands of Americans," said Michael Quinn, senior vice president of Cielo. He estimated

that approximately 80% of in-force life insurance policies would fall into the small-face category.

In-force individual life insurance has a total face value of about \$10 trillion, according to the American Council of Life Insurers (ACLI), the trade group

*"There is more than one player buying small-face policies and that validates the market."*

*—Robert Stark, President  
Melville Capital*

representing large carriers. No one can say for sure how much of the \$10 trillion is composed of policies valued at up to \$250,000, but it's clear this segment of policyholders makes up the lion's share of in-force life insurance.

#### Providers Test New Underwriting Strategies

The law of large numbers combined with technological advances and proprietary underwriting processes has opened this large market to the settlement industry.

Multiple life expectancy reports, attending physician statements, and other standard underwriting documents that have been used for years to evaluate jumbo settlements aren't used much for the smaller settlements.

"With the smaller-face investments, you're buying hundreds of policies. The more lives you're invested in, the more predictable the pool," said Greg Schmitt, executive vice president of Life

Settlement Solutions. "It's a totally different side of the market that's not talked about much because the industry is just now moving into this middle market. [Small-face policies] offer institutional investors a very diverse portfolio."

Schmitt said his own company, Life Settlement Solutions, represents six large Wall Street investors that buy smaller-face policies.

Small-face policies that are eligible for settlement are easier to underwrite, but otherwise have a lot in common with jumbo policies. The smaller-face settlement programs usually are applicable to qualifying universal, whole life, convertible term, variable, joint, group, and key-person policies. There is no "rabbit tax" on small-face policies. If an investor is offering an 11% rate of return on jumbo policies, the same return is offered for the smaller-face policies.

Cielo uses a proprietary system to underwrite and process policies in-house. The company requires applicants to submit only an application and policy illustration. Usually, no additional information is required. Cielo uses the data to formulate its own life expectancy estimates and price bids. Because Cielo is a life settlements services provider, it doesn't work directly with the public. It's currently partnered with provider **Independent Funding** and expects to add three more providers soon.

"This isn't some junior varsity version of a life settlement. It's the real deal, dramatically cost-effective and

*Continued from front page*

fast," said Quinn. "I'm totally confident that in '08, we'll see a number of life settlements [providers] try to incorporate small-face policies into their businesses and they will [each] have different ways to try and overcome the cost barriers."

Quinn said he expects Cielo to process between 12,000 and 15,000 small-face applications in the coming year, but declined to speculate on what percentage he expects to close.

Milestone, which launched its small-face program in July, has streamlined its underwriting and broken it up into an assembly-line process. Providers typically assign a person to follow a case from policy input to closing and dispersal. Milestone instead assigns specialists to oversee each phase of the process. One team processes input, another does pricing, bidding, negotiations and acceptance, then another group oversees the contract and prepares closing. Assigning specialists for each part of the process allows Milestone to more efficiently and profitably process large numbers of small-face applicants and contracts, said Nik Volkov, a Milestone managing partner.

He added that Milestone is working with three institutional investors that are interested in investing in the smaller-face policies.

Jeffrey Thompson, a senior account manager at FairMarket, is optimistic about the small-face segment of the industry. He said he's been deluged with applications since September when FairMarket rolled out its small-face plan. In its first week, Thompson fielded about 20 inquiries.

"We're already getting a flood of cases from brokers. I was a little surprised," Thompson said. He described the smaller-face market as underserved at best and said there is pent up demand for smaller-face settlements. He added that the smaller policies tend to be mature and offer better

arbitrage. FairMarket works with one institutional investor for the small-face investments and a few others for larger life settlements.

All of the new small-face programs are less than one year old and getting word out about the market for smaller policies may be key for growth.

Life settlement transactions have been an investment tool typically available only to the wealthy. Settlement providers targeted the jumbo market through financial planners, estate and tax specialists, and attorneys.

Although America's middle class presents a huge market for investors, getting the word out that settlements are an option may be a challenge, since most Americans don't use financial planners to manage their money and investments.

"It's not a well known fact that investors will buy smaller-face policies. It's been ingrained in the referral sources that a life settlement requires a minimum face of \$250,000," said Stark of Melville Capital.

Increasing visibility for the smaller-face transactions requires re-educating referral sources and increasing efforts to educate smaller insurance brokerages and agents who work directly with the average consumer, Stark said.

Some firms are also attempting mass consumer marketing. Mark Freitag, an attorney with the law firm of **Locke Lord Bissell & Liddell** in Atlanta, said several of his clients are coming out with ads on the radio and in *USA Today* to educate the public about life settlements.

"Direct marketing is coming," Freitag said. "I think it's coming as the market evolves."

The life settlements market in general is poised to grow. A report last year by investment firm **Bernstein** speculated that the life settlements industry could grow from the \$13 billion logged in 2004 to \$161 billion over the

next decade or so. An aging population and increasing life expectancies may help fuel the growth.

### How Big Is the Small Face-Market?

Approximately two-thirds of Americans have life insurance, said Howard Drescher, public relations director of LIMRA International, a research and consulting association for insurance and financial-service companies.

The average face values of men's and women's life insurance policies are \$206,600 and \$129,400, respectively, according to LIMRA. The average face value of life insurance on people aged 65 or older is \$59,800, the association stated in a recent report on the life insurance market. Bernstein's report last year on the life settlement market estimated that 47% of Americans aged 65 and older are insured with an average face of \$23,600.

The ACLI reported that individual life is the most widely used form of life insurance protection and it comprised 53% percent of all life insurance in force at year-end 2006. Individual life insurance protection in the U.S. totaled \$10 trillion at the end of 2006 and has grown at an average annual rate of 4% since 1996. The average, new individual life policy increased 14% since 2004 to \$167,000, according to the ACLI.

While nailing down the size of the U.S. life insurance market is difficult, it's clear that demand for life settlements is expected to grow significantly as the population explodes with persons aged 65 or older. The Bernstein report cited U.S. Census Bureau data to report that over the next 25 years, the U.S. population of those 65 and older should grow three times faster than the rest of the population. The increase would push the number of Americans eligible for a typical life settlement transaction from 37 million to 72 million by 2030. **LSR**