

■ Restoring The Balance

In 2010, The Industry Regains Its Firm Footing



By Jim Connolly

If 2009 was the year of trying to stay balanced, 2010 will be the year of regaining that balance and returning to a firmer footing.

“The market will rebound. It will come back. Capital is coming back to the marketplace,” according to J. Mark Goode, CEO of the Peninsula Group, LLC, Washington. Capital will start coming back into the market in late first quarter, he says. And, that return of capital will “bring the market back in balance. Balance is needed for a healthy market.” It is not a healthy market, he says, if there are more buyers than sellers. “We need to grow the supply of policies to create a balanced marketplace, according to Goode. “A healthy sustainable market is a balanced market. This year has been out of balance.”

Goode says that he believes there are a number of important efforts that need to be initiated in 2010. The life settlement industry needs to focus resources on more consumer protections including mandatory carrier disclosure of the settlement option when a policyholder chooses to receive the cash surrender value for a policy that is no longer wanted. “We need to make this the law of the land,” Goode emphasizes.

Doug Head, executive director of the Life Insurance Settlement Association (LISA), Orlando, Fla., agrees that in 2010, one of the major issues for the industry will be the consumer’s right to know about the real value of a life settlement option. “We

need to advocate where reasonable and provide more consumer education. We will have to be as nimble as we were in 2009.”

Peninsula’s Goode also thinks that the life settlement industry needs to make sure that carriers cannot discourage a producer from educating clients about the life settlement option. Toward that end, there will be an initiative to educate producers about life settlements, Goode says. Other initiatives that need to be advanced, he continues, are ensuring that VOCs are completed in a timely manner and that a carrier cannot refuse or delay a change of a beneficial interest in a contract.

In 2010, according to Goode, it will be important to proactively attract capital into the marketplace which is why the LISA, in conjunction with the European Life Settlement Association (ELSA), is planning a major investor trade mission in Europe from Feb. 23-26. That mission will, in all likelihood, be followed up with an Asian road show later in the year, he says.

Meir Eliav, president of Legacy Benefits, New York, says that he is looking forward to the European trade mission next year because “I would like to believe that it will increase business. However, this won’t happen overnight. It is not like going to a store and buying a shirt. We have to educate people about the business.”

Eliav says that he believes more money will come into the life settlement market in the coming year. The change in LE methodologies will have a positive impact over the long term, he continues. “LEs are becoming more accurate. There are serious market investors and the in-

dustry has shown that it is taking steps to clean itself up. As an industry, 2010 will be a better year than 2009.”

IRRs will drop somewhat but they haven’t reflected the real risk associated with life settlements, according to Eliav. As more money comes into the market, prices will increase and IRRs will decrease, he predicts. But that will bring balance back to a marketplace where some offers for policies are too low to encourage sellers to enter the market.

“I think that we have bottomed out and we are clawing our way from the bottom,” says Scott Kirby, co-president of business development and compliance issues with Advanced Settlements, Orlando, Fla. “The liquidity iceberg is being chipped away.” But this does not mean that the industry will necessarily see a movement toward securitizations, he maintains. “This is good water cooler conversation. But it is not the instrument that is going to save the industry.”

However, according to Kirby, there will be more investor confidence in this asset class. “2009 ended better than it began and I am very confident that 2010 will end better than it began,” Kirby concludes.

Michael Fasano, president of Fasano Associates, Washington, also believes the market will come back in 2010, although he notes that “I can’t say if it will be in 3 months, 6 months or 9 months but what we’re seeing is that investors are organizing to enter the market. They will be doing more homework and due diligence which is a good thing.”

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Regulators have also become active during the past two years. This past fall one of the top three life-settlement-transacting states, California, put legislation in place that prohibits STOLI transactions, implements more stringent broker/agent licensing requirements and promotes greater consumer availability.

Life settlements are consumer-friendly transactions, affording additional options to sell unneeded life insurance policies that generate more capital than surrendering a policy and taking the cash value.

Many firms have been heavily scrutinizing every policy that comes through their doors for potential STOLI transactions or questionable ownership/financing structures to protect the institutional client. These efforts are taking away the funding that STOLI transactions rely upon. The regulations provide the legal framework to outlaw these transactions and the insurance carriers are working harder to prevent these transactions at their inception.

The combination of these trends has severely deterred STOLI transactions and has laid the groundwork to virtually eliminate them going forward. The lack of capital in the market during the past year certainly accelerated the demise of many STOLI transactions. Purchasers have been buying mainstream policies at attractive rates of return and see no reason to take on the risk of STOLI policies. However, as the insurance industry, regulators and settlement industry develop capabilities to detect and weed out these transactions, many of them have already occurred and the policies are in force currently. Therefore, the effort must continue.

Institutional buyers are more cognizant of STOLI transactions and the pitfalls of investing in STOLI policies and are demanding clean, straight-forward portfolio parameters when developing an invest-

ment strategy in this asset class. It is very important to work with firms that understand these transactions and are experienced in originating portfolios that screen out these types of policies.

High-quality life settlement portfolios are a valuable asset for institutional buyers and can offer multiple exit strategies, all of which are dependent upon the quality of the assets and the origination process utilized. Rating agencies are focusing more attention on the origination of the life settlement asset and its servicing quality as key aspects of the rating evaluation. Simultaneously, carriers and regulators have focused more attention on insurable

interest for the underlying life insurance policies at the time of sale. Policies that pass all of these processes over time will obviously have much higher quality and the portfolios comprised of these policies will command much better terms in the resale market and in the securitization marketplace as well.

While many states are enacting regulations that are fair and balanced to consumers and the life settlement market, there are also a few states that have enacted regulations that have driven business out of their states and have significantly harmed their states' consumer rights. Our industry continues to work with these states to enact fair and balanced regulations that properly define and outlaw STOLI transactions until they are gone for good. In the meantime, the efforts of the settlement and insurance industries along with the regulators will continue to curtail and eliminate STOLI. ■

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And, according to Fasano, "it will make for a more rational market and one that will sustain itself over the long term. No market can grow unless there is rational pricing and previously there was irrational pricing." LEs were too short, producing windfalls for those who could get in and out of the market quickly, he says. Consequently, too many investors were burned, Fasano adds. "The industry will be "stronger and better aligned for the future."

David Mickelson, president and founder of Mickelson Capital Consulting, Oceanside, Calif., says that "I'm confident to say that there are a lot more investors of every stripe considering it [life settlements.]" But, he adds, 2010 "won't be like it was in 2007. People will be more flexible and keep their eyes open for opportunities." And, he continues, "there are no new shoes to drop," such as LE changes.

While securitizations may still be as big as everyone says they will be, rating agencies are still "making people jump through hoops," according to Mickelson. Consequently, there may be other structured transactions that do not require ratings, he says. Such transactions will not require ratings, but rather just a solid business plan, he continues.

Philip Loy, owner and founder of AVS Underwriting, LLC, Kennesaw, Ga., says that there are a number of people that his firm has had discussions with and those parties indicated that they intended to go ahead with new projects. "If everyone does what they say they will, it will be a very good year for the life settlement industry," he adds.

And, Rob Haynie, managing partner, Life Insurance Settlements Inc., Fort Lauderdale, Fla., maintains that in early 2010, "we will see a pickup as a result of the tire kickers getting into the space

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■ J. Mark Goode

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cial markets in late February on a highly coordinated and publicized basis. The LISA roadshow is intended to build investor awareness and confidence while encouraging investor participation in this asset class.

So, is the industry on the cusp of major growth?

In 2010, I believe the capital will return to life settlements and the growth of our market will resume its acceleration. Someone in our industry will build a \$1 billion life settlement fund. It is going to happen and in this abundant market that success need not be limited to only one player. Today the market benefits from updated methodologies from medical underwriters based on current mortality tables to assess longevity. With that important correction in medical underwriting and mortality projections now available to us, longevity risk is further mitigated. With greater returns for less risk, capital can no longer sit on the sidelines.

Who will benefit from that growth?

After what the industry has been through in 2008 and 2009, there will clearly be a flight to quality. The most compliant and talented originators, service providers and investment managers will be the winners. And, this is not a winner takes all situation. The industry is big enough for several players to profit and win.

Will Peninsula be one of the winners?

Yes, I believe so because we are well positioned with complete vertical integration, experienced and innovative managers and a highly disciplined team. It comes from my Marine Corps background. We are well prepared and vigilant on the compliance, having a level of expertise and market knowledge that is valuable.

How important is data to developing the life settlement market?

Transparency is critical for the healthy development of any market and reliable market data is essential. Nearly two dozen industry leaders have seen the value of contributing data to our annual Life Policy Dynamics market study. The annual study that we have developed over the past three years look at many important policy and insured dynamics and market trends. Prior to this LPD study, there was literally no micro level market data available for new investors to measure the marketplace and to measure risk.

In 2006, the first year of the study, we had a few hundred lives. In 2007 the sample size doubled and for the 2008 study we had 1,000 lives. We are now collecting data for the 2009 market analysis and intend to have 1,200 data points in this year's report, to be published in late February.

The more reliable data we have, the more transparency there will be. A transparent market attracts more capital.

So, what is the essence of what you have learned from being in this business?

Oscar Wilde said that the real purpose in life is to realize one's true potential and it is my goal to reach my own potential, as well as fulfilling the remarkable potential of our company, while doing my best to help this industry realize its magnificent potential to serve both insurance consumers and investors.

From this conversation it seems that your work is one passion in your life. Are there any others?

Beyond this business my other passion is polo. It is a team sport that combines strategy, endurance and skill. First and foremost, the player relies upon the performance of his horse as well as his team-

mates. No wonder Polo has endured for centuries, it's a passionate game played with intensity at high-speeds. I have had the privilege of playing in the Heritage Cup during July at the Royal Military Academy at Sandhurst. Recently, I participated in the World Snow Polo Championships in Aspen Colorado. My team Captain was the legendary Carlos Gracida, a three-time triple-crown polo champion. In order to win a Triple-Crown, one has to win the three major tournaments – the Gold Cup in England, the Argentine Open at Palermo and the US Open in Florida. ■

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and competing for business.”

More money will come into the business and the paper of more carriers will be held, he maintains. But as more participants enter the market, IRRs will also get smaller, he adds.

Haynie maintains that a highlight in 2010 will be the trade mission for European investors looking for opportunities in the life settlement market. It will help address investor concerns and educate prospective investors in the industry, he adds. “I have got to believe it will increase business. If we don't tell our story better, we will be spinning around in a circle.” ■