Media Coverage

Daily Telegraph, October 31, 2009

Death bonds prove lively for some canny investors

Traded Life Policies have served up consistent returns

It's an ill wind that blows no good, and funds built on portfolios of Traded Life Policies (TLP) have served up some of the most consistent returns of recent years.

Alternatively known as Traded Life Settlements (TLS) in the US, the biggest market, investors buy life policies before they mature, calculating a discounted price they are willing to pay today against the known payout that will result on the death of the original life assured - hence the nickname "death bonds".

By using actuarial calculations of mortality and focusing buying activity on select policies being sold to the secondary market by the over-65s, it has been possible to deliver stable returns with low risk. While well known among institutional investors, their performance credentials are strengthening the argument for inclusion among retail portfolios, particularly those looking to add uncorrelated asset diversification to core holdings of equities and bonds.

Prof Merlin Stone, of the Bristol Business School, sees them as an "excellent replacement for with-profits products". These, of course, have suffered in recent years from cuts to annual and terminal bonuses.

According to Financial Express data, some of the best-performing with-profits funds struggled to return more than 20pc over the past three years. Compare that with a product such as the Guernsey-based EEA Fund Management Life Settlements Fund, which just reported its 45th consecutive month of positive returns. The annualised return for the sterling accumulation share class has been 10pc since inception, according to EEA data. Over the past two years, the fund returned 21pc. The FTSE All Share fell by 12pc over the period, while the IMA Sterling Corporate Bond sector achieved 4pc.

However, investing is not straightforward. Financial Services Authority (FSA) rules prohibit UK-authorised collective investment schemes for sale to retail investors from investing directly in life insurance policies.

Andrew Walters, financial director of Policy Selection Limited, confirmed that this means his company's Assured Fund, like others, is unregulated for British purposed, which means its distribution and marketing is limited to investment professionals, high-net-worth people and "sophisticated investors" as defined in the Financial Services and Markets Act 2000. "The offering memorandum can only be circulated by authorised persons only to persons who may receive marketing on unregulated collective schemes, that means we have to use brokers to market the fund to eligible investors," Mr. Walters said.

"Eligible investors being defined as such individuals whose net worth is sufficient to bear the risk of losing their entire investment. The fund is not regulated by the FSA nor does it come under the compensation scheme."

High minimum investments are another hurdle. Typically they are £30,000 or more. This is partly overcome by distributing through bonds, self-invested personal pensions (SIPPS) and "wraps" used by independent financial advisers (IFAs). It means MPL's Traded Policies Fund can be accessed through a minimum investment as low as £2,500.

Distributor status has been given or is being sought from HM Revenue & Customs for most TLP funds targeting British investors. This will mitigate the effects of next year's higher 50pc income tax rate. Leaving aside the regulatory, tax and ethical dimensions, a number of IFAs say they feel that on the basis of recent years' returns, they may have underestimated the benefits exposure to TLPs could have brought clients.

Time Cockerill, head of research at IFA firm Rowan, and Hilary Coghill, chief investment officer at City Asset Management - neither of which currently offer or recommend TLP funds to clients - said they were impressed by the performance of products such as EEA's Life Settlements Fund.

Mr. Cockerill describes the performance of TLPs as very good. Ms Coghill adds that City Asset Management, with the benefit of hindsight, "regrets" not using them: "It would have been great to have in the portfolio in the last two to three years."

There are alternatives, however, that also promise monthly positive returns with low volatility. Absolute-return funds are one example. Wider use of European UCITS III rules for authorised funds could have the same effect.

Liquidity risk, in the form of a mass exodus from the TLP market at the same time, or counterparty risk, as exemplified by the bankruptcy of Lehman Brothers but in this case regarding the strength of the policy insurers, are other challenges that prospective investors should bear in mind.

Life policies are highly opaque investments where actuaries can raise, lower or cancel terminal bonuses without warning and so, while death benefits appear fixed, it remains very difficult to be sure about future maturity values.