How the Traded Policies Fund gives investors the steady returns they have always wanted

An advertorial article for International Adviser magazine by Jeremy Leach, Managing Director, Managing Partners Limited
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The rocky ride on financial markets over the last two years has left investors numb with shock. All they ever really wanted were steady, incremental returns but they have been left nursing major losses from equities, bonds and property. Even with-profits, hedge funds and so-called absolute return funds have let them down. So is there an alternative?

The good news is there is. The growing popularity of funds that invest in traded life policies are testament to the fact that investors are increasingly turning to an exciting new asset class.

A report by Professor Merlin Stone of the Bristol Business School, published last December, estimated that investment in TLP funds by both retail and institutional investors rose by more than 50% over the year to November 2008. Professor Stone said he expected TLP funds to grow in popularity among retail investors because they can be a good replacement for with-profits investments.

So what are TLPs? TLPs are US-issued, whole-of-life assurance policies sold before the maturity date to allow the original owner to enjoy some of the benefits during their lifetime. The transaction by which an existing life insurance policy is sold to third parties is known as a life, or traded, settlement. The reason why financial advisers should be taking a closer look at TLPs is that they offer steady, incremental returns that are uncorrelated with any other financial market.

With TLPs the value of a policy is known; what is not known - because they are whole of life - is when they will pay out, and the premiums have to be paid until they do. Therefore managers of funds that invest in them must use actuarial analysis to buy them at the right discounts and carry out sufficient diversification to control the risk. But with the right investment process, it is possible to deliver secure, incremental returns to a high degree of accuracy in the order of 8-10% per annum, year-in, year-out.

The proof of this can be seen in the performance of Managing Partners Limited’s Traded Policies Fund. The Fund recently celebrated its fifth birthday, having delivered outstanding performance over a period of time that included two of the toughest years ever for financial markets.

The Fund’s US dollar-denominated Institutional share class returned 53.22% over the five years to 1 July 2009. Other share classes have been launched subsequently, including retail share classes denominated in US dollar, sterling, Euro, yen and Swedish krona as well as a number of institutional share classes. All have delivered steady returns of the same order. In fact, none of them have delivered a negative return in any single quarter.

TLPs are not without risk, of course. It is essential to buy a large number of policies across a wide range of insurance companies in order to diversify risk. The life expectancies on the policies held must also be managed prudently. It is essential that any adviser looking to use a TLP fund takes a good look at the actuarial analysis used by the fund’s manager. The pricing of units and performance can all go horribly wrong if this is not carried out correctly. At MPL, we use an independent actuary to analyse the policies in our fund and we find that an average expectancy of 5-6 years optimises the risk-return.

Some investors may be unhappy with the fact TLPs are linked to people’s deaths and that people are selling their life assurance policies at deep discounts. But people sell policies for many different reasons, and not necessarily out of desperation. Furthermore, a ‘secondary’ market means policyholders can get a higher price for their policies than if they just surrendered their policies back to the insurance companies.

The gradual demise of with profits in the UK means the traded endowment policy market has a finite life. But whole-of-life policies continue to be sold in the US in ever greater quantities. Research in the Merlin Stone Report estimated that the TLP market in the US would potentially be worth $161bn by 2030, from estimates of $13bn in 2005.*

So the TLP market is set to thrive going forwards and the benefits of investing in it certainly deserve more attention among investment advisers with clients who still like the idea of steady, incremental returns.

Source: US Census Bureau and Bernstein estimates/Bernstein Research Call, March 2005