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The FSA's warning last week that "high risk" traded life policy (TLP) investments should not reach retail investors was not only met with agreement by many advisers but also echoed by TLP providers themselves, eager to point out that the products are targeted at sophisticated investors.

According to the FSA, TLP investments, also called life settlements or 'death bonds' are pooled investments that invest in American life insurance policies, with investors buying the right to the insurance payouts on the death of the original policyholders. TLPs are generally considered to have a low correlation to capital markets.

As a result of concerns regarding the products' complexity, inherent liquidity risk, structure, and the fact that investors may find their money locked in for longer than expected, the FSA released guidance last week, in advance of a consultation on a ban of all marketing of life settlements to mass market retail investors. Many life settlement fund providers say they intend to participate in the FSA's consultation process.

It was not the first time the FSA has raised the concern. However, the regulator says the market still shows signs of growth and as the failure of some these products in the past has led to significant consumer detriment, it fears new investors will "suffer" unless it steps in. One of the more notable examples in Britain were Keydata's Lifemark products, which had life settlement policies as underlying assets.

Britain has recently been one of the more active markets for investment in life settlement funds, according to the 2010 Merlin Stone report on the market for TLPs. The report claims growing awareness and favourability towards the asset class from both retail investors and the IFA community.

Yet many advisers say they agree with the FSA that the products are generally unsuitable for retail investors.
(News analysis continues below)

"It's what I would call a sophisticated asset class and you need to have a really strong level of understanding of exactly what it is that you're buying," says Darius McDermott, the managing director at Chelsea Financial Services, who says he does not recommend TLPs to clients because of difficulties in quantifying the downside risk.

Jason Witcombe, a director at Evolve Financial Planning, says his firm also does not recommend these products. This is because of their opaque nature and lack of a clear return mechanism, which he says are "alarm bells".

Following the FSA's announcement, many providers of TLP investments also echoed the sentiment that the products are aimed at sophisticated investors.

"We have continued to maintain that TLP funds are complex investment vehicles and are therefore only suitable for those investors that are sophisticated enough to understand all the risk implications. We fully support the FSA's intention to prohibit IFAs from recommending such investments to 'retail' clients [as opposed to sophisticated investors] as this action will assist providers of highly complex financial products to focus on their target market, which is certainly not the retail sector," says Jeremy Leach, the managing director of Managing Partners Limited, which specialises in TLP and life assurance settlements funds.

Peter Winders, a marketing director of EEA Fund Management, which runs a life settlement fund, says the company agrees with the FSA's desire to "ensure that investors understand product risks and are placed into suitable investments," which is why they make clear the fund is for sophisticated investors under advice.

While it does not suggest the assets are, as the FSA says, “toxic”, SL Investment Management, which manages funds based on traded life insurance policies, does say the way which some funds have been structured or marketed has “over simplified what is a complex investment proposition where the risks need to be carefully understood as well as the significant potential for rewards.”

Among the problems, says Patrick McAdams, an investment director at SL Investment Management, are that many advisers did not understand all the moving parts involved in a life settlement product, and some firms in the past did not have enough experience in the asset class.

Witcombe says one of the main problems with TLPs is the way some have been sold to retail investors as being “low-risk and steady”.

“I think its all down to the marketing of these products being rose-tinted and advisers and consumers not really understanding what the risks are in the main, but risk isn’t a bad thing, that’s what we need to keep reminding people, but it is a bad thing if a consumer isn’t aware that they’re taking that risk,” he says.

While the future of these products in the British retail space remains under consultation, McAdams says life settlements is an emerging asset class that “still has quite a ways to go before it reaches a level of maturity where it can be safely packaged for retail investors.”

“I believe that this asset class could be a stable alternative, non-correlated investment in the market as we move forward into 2012, but the market needs to be reasonable in valuation, realistic for returns, deal with advisors and service providers that are knowledgeable and trust worthy and as the FSA position correctly stated, conduct extensive research and be able to provide robust justification that a particular investment might be suitable for a particular retail investor,” says Michael Fugler, the deputy chair of the European Life Settlement Association.

In the meantime, the effects of the FSA’s guidance have already been felt in the industry. In the days following the announcement, EEA Fund Management reported that its board decided to suspended dealings in the Life Settlements Fund as a result of higher than normal redemption requests and cancelled subscriptions. EEA says the suspension will not affect the fund’s ability to pay premiums on policies.

From an adviser’s perspective, Witcombe says the FSA’s guidance on TLPs raises a much wider point regarding where the regulator draws the line.

“There’s plenty of other products out there that, you know, you could argue could cause consumer detriment and usually its only with the benefit of hindsight that we know which products blew up and which products didn’t and this is my concern - that if it was so clear that these products were seen as sort of dangerous by the FSA, why had the clampdown not happened earlier?,” he says.

McDermott agrees: “It is a little late for this from the FSA, this is the sort of guidance we would expect the regulator to be giving before problems come out with products, not always with hindsight,” he says.
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