
The Scoop on Pre-Owned Annuities

By Editor Test *Wed, Oct 12, 2011*

When buying a secondary-market annuity that offers a 7% or 8% effective rate of return, make sure you deal with honest brokers.

A financial planner friend of mine e-mailed me a long list of pre-owned annuities that he was excited about. No wonder. The effective rates of return were as high as 8%.

You may or may not be acquainted with pre-owned annuities. These are contracts that were purchased from a highly rated insurance company as part of a structured settlement.

In many cases, the original owner won a damage suit—product liability, medical malpractice, industrial accident, etc.—and the damages were paid, in full or in part, with an annuity. In other cases, the original owner may have purchased the annuity himself or even won a lottery prize.

When the owners of the contracts would rather have cash, they sell them (or a portion of them) at considerable discounts. The initial buyer is likely to be a large structured settlement company, such as J.G. Wentworth. This “factor” may distribute them through annuity brokers, who sell them to individuals. The original discount, needless to say, must be large enough to create value for everyone along the chain, perhaps including a lawyer who steered the contract to the factor in the first place.

I downloaded my friend’s pdf and scanned an eight-page spreadsheet of over 200 pre-owned contracts. Without exception, the issuers were well-known, A-rated life insurance companies. The start dates ranged from next week to September 2036. Most of the effective rates of return were above 5% but not higher than 8%.

No two contracts were alike, because structured settlements tend to be tailored to the needs of specific plaintiffs. The contracts made uniform or non-uniform, annual, monthly, or lump-sum payments. Many were guaranteed for a specific period. Most were “life-contingent.”

In those cases, as annuity broker Bryan J. Anderson of Annuitystraighttalk.com of Whitefish, Montana, explained to me (he was not the source of my friend’s spreadsheet), the contract is contingent on the life of the original owner, who was probably in his or her 20s or 30s. These contracts generally come bundled with a life insurance policy that guarantees either the full promised payout or merely the new owner’s principal.

Here’s one pre-owned contract on the spreadsheet that might be perfect for a 55-year-old client: A life-contingent contract from an insurer rated A (Excellent) by A.M. Best offered a monthly payout of \$4,900 for 99 months starting in mid-2021. The price: about \$223,000. The sum of the payments: about \$541,000. The effective yield: 6.75%.

If you’d rather not invest as much and you want a guaranteed payout, you could try this one: a \$100,000 lump-sum payout 10 years from now. The price: \$58,500. The effective yield: 6.0%.

Wow, many people have said. Then they say, What's the catch?

If you're dealing with a trustworthy middleman, who has ascertained that the original owner has clear title to the contract, there may be no catch. The middleman should be able to assure you that: No ex-spouses or dependent children have unknown claims; there are no hidden liens or trusts with claims on the assets; the owner has not already sold the contract; an independent court has ruled that the sale of the contract is in the best interest of the owner. If I were buying a life-contingent secondary market annuity, I would want to see copies of the original court documents and the life insurance policy on the original owner.

Regarding taxes, any income from a secondary annuity that was purchased with IRA money would presumably be taxed as ordinary income after age 59 1/2, like any other IRA withdrawal. Income from an annuity purchased with after-tax money would be partially taxable. (The broker may be able to provide an amortization table that shows how much of each income payment comes from interest. There's no 1099 from the insurance company, however.) Should your own lawyer get involved in the transaction? That may be redundant when you're dealing with a trusted broker, but it's highly recommended if you try to circumvent a broker and negotiate a deal directly with a factor, I'm told.

These bargains appear to be for real and safe—if you work with the right people and do careful due diligence. The biggest concern for the honest brokers in the business is that too many competitors might jump in, making it harder for existing brokers to obtain access to contracts and narrowing the margins.

If you have had any experience, good or bad, with pre-owned annuities, please send your story to kerry.pechter@retirementincomejournal.com.

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