"Too Good to Last"

By Editor Test *Wed, Jun 30, 2010*

Curiosity about investments in secondary market annuities, which earn up to 9%, is growing. But these "factored products" are scarce—and virtually unregulated.

"HIGH YIELD," said the headline on the tiny 2" x 4" display ad in *The New York Times.* It was followed below by these words: "Pre Owned Annuities, Lottery Payments and Structured Settlements. Earn 7% to 9% in a 3% to 5% world."

Through a handful of ads like that and by word-of-mouth, retail investors are discovering that they can now buy the rights to "secondary market annuities" paid by A-rated insurance companies and get better—often much better—returns than conventional fixed income investments.

But, as *RIJ* learned in conversations with representatives at firms that either originate ("factor") these products or market them or both, secondary market annuities aren't for the unsophisticated, the unwary, the impatient or the meek.

At their simplest, "they're like real estate transactions," one specialist said. He didn't want his name used because he doesn't want to stir up undue interest in what is only a $600 to $700 million-a-year business—interest that would only drive up prices. "They're not too good to be true, but they're too good to last," he said.

Said another intermediary, who also asked for anonymity, "What has happened over the last seven months is that we've seen the inventory evaporate and the yields go down. To broadcast information about the products is to eat our young, so to speak."

The availability of such products to retail investors didn't even exist until a year ago. Structured settlement firms used to be funded entirely by institutional investors, which bought them to diversify their portfolios, or by investments banks, which securitized them.

At big structured settlement firms like J. G. Wentworth, that business appears to live on, in a fashion. But the financial crisis ended the era of inexpensive financing and for many smaller factoring companies the securitization option became too expensive. To survive, some firms have turned to retail investors for financing.

High returns notwithstanding, the new offerings have drawbacks. While the payouts are guaranteed by A-rated insurers, the investments are neither securities nor insurance products. The secondary annuity market is not regulated, nor are the factoring companies. The transactions aren't as transparent as some would prefer.

The products themselves aren't standardized, like primary market annuities. Each tends to be one-of-a-kind, like real estate, often providing idiosyncratic payment streams that adhere to the terms of the original structured settlement. And they're illiquid. If the owner dies, for instance, there's no immediate payout to beneficiaries. Then there's interest rate risk. If rates skyrocket, you're usually stuck with what you've got.

How they work

Secondary market annuities provide multiple or single-payment distributions over short or long periods. The distributions are paid by the insurance companies exactly as they would have been to the original owners. In this case, investors are not buying paper issued by an ad hoc securities firm or tranches in a murky pool of structured settlements.

"But you need to be careful, because both kinds of investments do exist," said one of the intermediaries mentioned earlier.

Rather than an investment, the transaction involves the reassignment of an insurance company obligation from the original owner—the plaintiff in a damage suit—to a purchaser. The yields are high only because of the obligations sell at a discount of about 20%, and not because the annuity issuer itself offers high returns.

"These are court-ordered assignments from insurance companies," said Scott Schwartz of Woodbridge Structured Funding, LLC, which has been in the structured settlement business since 1993, but only recently switched to selling secondary market annuities to retail investors after investment banks hiked their charges for securitization.

To purchase an annuity from Schwartz, you first have to get on his inventory list. Then he tells you what factored products are available each day, specifying the carriers, the purchase prices, the payout schedules and the effective annual yields.

The products are tricky but not impossible to resell. "But people buy them to diversify their portfolios, not to resell them," Schwartz told RIJ. Demand is strong. "We've had about 50 deals a month and we sell every one of them," he said. Investments usually range from $50,000 to $150,000, but can be as small as $15,000 or as large as $3 million.

Keith Singer, an attorney and CFP who owns Florida-based Insured Returns LLC, is also in the secondary market fixed annuity business. "The factoring companies are selling a receivable," he told RIJ. "It's an assignment of future payments. Buyers receive insurance company obligations. Whatever rights the original owner had, are assigned to the purchaser.

"[As an intermediary,] I may have access to three or four different future income streams at any given time. I tell clients, these are the rates, and if the product meets their needs, we proceed. However, prior to purchase we need to do a credit check and public records search of the seller.

"There is a possibility that if the seller has child support obligations or a divorce agreement, there may be other claims against those future annuity payments. The title search is not unlike the title search for a house. The process is similar to buying a house. Money goes in escrow, the buyer receives a court order and other documents from the insurance company providing good title to the future annuity payments, and then the funds are released to the seller," Singer said.

A slew of A-rated issuers

At Annuityfyi.com, where individual investors can view all kinds of annuity and find phone numbers to connect with broker dealers, you can see examples of recent offerings. For instance, there's a MetLife product that cost $48,186.44 and paid out an annuity-like $450 a month from 2017 to 2027 and $1,165 a month from 2027 to 2037.

The total payout is $186,810 over 20 years, which translates to an effective annual interest rate of 7.75%, according to the website. Alternately, you'll find a Prudential product that cost $62,166 and paid $310,000 in three payments, five years apart: $65,000 in 2026, $100,000 in 2031 and $145,000 in 2036. The yield: 7.75%.

A State Farm Mutual product, purchased for $109,000, paid a lump sum of $240,000 in 2021, for a 7% yield. A Monumental Life annuity cost $164,960 and paid out $3,400 a month for 105 months (a total of $357,000) from 2017 to 2025, for a 7.25% effective yield.

Other offerings include annuities originally issued by Allstate, American General, Aviva, Fidelity, Genworth Financial, John Hancock, New York Life and Pacific Life. As the examples show, payout rates can be lumpy or smooth. The original owners may have sold only certain portions of their annuities, depending on the timing and the amount of their need for cash.

One intermediary told RIJ that none of the products at Annuityfyi.com are currently available; if they were, he said, another factoring company might "poach" them from the current factor, much as one real estate agent might try to take a listed home away from another. Apparently, that's part of the strange and evolving world of secondary market annuities.