

Viaticals: A Viable Investment?

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With the Halloween season upon us, we thought a ghoulish financial topic might be appropriate. We suspect many of you have heard the term "Viatical" on the radio, TV, or the newspaper. They have been dubbed as the latest "risk free" investment. We ask, "risk-free from what"?

Let us explain. A *Viatical* is an *unregulated* insurance product that arose from the AIDS epidemic of the 1980's. In it's most common form, a buyer company would purchase the life insurance policy of a terminally ill person with a life expectancy of 24 months or less for 60%-80% of the policy's face value. This allows the moribund policyholder to enjoy the discounted death benefit during lifetime. The company then packages multiple policies and resells fractional interests to investors. The investor is lured by exceptional market rates that are billed as "risk free".

The companies usually have a premium cash reserve to cover premium policy payments for at least one and a half times the projected life expectancy of the original policyholder. No problem exists if the insured dies a timely death. If not, the company that bundled the policies has to wait longer to receive the death benefits. This exhausts the reserves and ultimately lowers the rate of return to investors. Security regulators are reporting an increasing number of cases where investors' retirement account balances are becoming terminal because the original policyholders lived longer than expected.

Investors are lured by sales pitches that claim Viaticals are a "safe investment alternative to CDs and the stock market" with returns that range from "10% to 30%" annually. We have heard such advertisements on local radio stations. These exaggerated claims are targeted at the naive and the elderly. Buyer beware.

Are all viaticals always a bad deal for investors? Probably not. But when you combine a complicated product, an unregulated industry, pie in the sky promises, and high sales commissions (5-10%), you may get a trick or a treat. Risk-free implies predictability and we don't believe the laws of nature or an act of God can be inherently predictable. Alternatively, if you feel your portfolio needs more current income, we recommend sticking to more traditional investments. Inquire whether corporate and municipal bonds, high yielding utility stocks, real estate investment trusts (REITS) and CD's may be more appropriate for you.

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