

## Life Settlements

### Life Settlement Due Diligence



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- Dr. Andrew Spence

*“All available patient information will be exhaustively analysed, and a confidential report issued - including an opinion on each (life) policy as to its relative conformity, or deviation from, the mean.”*

#### Why do you believe there is a niche for what you do?

This is a growing market, with a real asset base. Given the recent crisis was caused in great part by a lack of awareness of the underlying true value of investments, it is essential that investment managers perform as thorough a due diligence as is possible. This is where we can help make a difference as our service provides unique insights on the real value of each policy held within a fund, or when taking a decision on whether the policy should be acquired or not. Thus far, it has been actuarial analysis that has largely been relied upon to steer the decision making process. However, the medical data utilised in such analysis may be incomplete, rendering the conclusions drawn probably worthless. It is our belief that an in-depth medical analysis by a practitioner, would result in greater accuracy, which in turn would support better decision making for an investor considering an investment in such (a) policy/policies.

#### Could you elaborate on why you believe you are particularly qualified to undertake what you do - and how many years of experience you have in this field?

Many medical underwriters are insurance professionals who have undertaken a training course in the evaluation of medical files. This could be as short as just four weeks ... in contrast I have 28 years of active medical risk analysis expertise in the real world of anaesthesia and intensive care (if I make mistakes with such analysis, my patients may not wake up). In addition I have developed a solid understanding of the life settlement industry and how the two correlate. I am also an active investor in the field.

#### How much time does it take on average to evaluate such a life policy? How many would you and your team be able to complete in a month?

A proper forensic analysis would take 3-4 hours per policy, and may include direct communication with the responsible physicians. An average fund that comprises 60-100 policies could be fully screened within one month. My team is comprised solely of experienced physicians selected and trained by me.

Much information is written "between the lines" - i.e. needs to be deduced from medical charts. It is my belief that experienced active physicians are better positioned to draw such conclusions. Diseases which add to mortality multipliers must be cross-referenced with other available relevant details - for instance, rheumatoid arthritis receives a standard multiplier - yet the way it surfaces in a patient could range in severity from suffering slight morning stiffness in the fingers to something as severe as a lung and heart disease. Or patients with heart diseases may be prone to higher levels of risk, if for e.g. they also suffer from a spinal disease which prevents them from exercising.

#### What is your client profile like and what are the benefits in performance terms that they can accrue? Losses they could potentially arrest? What on average is the cost to benefit ratio?

Typically we are asked to examine high value policies - i.e. greater than USD 3mn; as within senior life settlements, this is where the investor focus has tended to be. Of course, this need not and does not always have to be the case, as the determining factor is the expected cost benefit. Given the high premium payments that become due once an investor has invested in a policy, the earlier any anomaly can be identified (positive or negative), the better. Let us assume the annual premium was 3.5% per annum (USD 350,000) of a policy's face value which is say USD10mn. From an investor's perspective, being able to identify as early as possible, those that should and should not be funded, is critical. Particularly since many years of funding (read as premium payout) could eventually be required.

#### Do you track the expected vs. actual outcomes of policies you examine? If yes, what is your “strike ratio”? (for e.g. out of a 100 life policies reviewed - accurate vs. skewed outcome)

Yes, we monitor all policies we evaluate - however, it is too early to provide statistically significant data on the outcome. Based on our experience, what we have observed is that most policies have an average life expectancy stated in terms of 5 - 15 years. To date a significantly statistical portion - i.e. in some cases, as many as 30% of the policies held in a portfolio we examined either had incomplete or inaccurate medical analysis.

#### What if an investor held 1000s and 1000s of policies ... would not the law of large numbers apply? Is your “value add” most effective when a specified number - concentration - (within range) of policies are to be reviewed?

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Our clients are usually holders of small numbers of high face value policies - a typical fund tends to hold around 100 policies averaging USD 3 -10 mn each. 1000's of policies would indeed be a large fund - and even then the actuarial cohorts of this group of older individuals are very much smaller than those used for all age-ranges - but there would indeed be a higher adherence to the law of large numbers ironing out the skews. In funds of less than 200, the skew may be substantial and will severely affect value.

### **Why do you believe what you do cannot be easily replicated? Would you say there are high barriers to entry in your field of speciality?**

My medical speciality does indeed have a very long "live" training period. I know of no others in my field that combine this with the additional knowledge and experience of the life settlement market. Of course, having said that all things stand to be and can be replicated - so it is our expertise, discretion and the quality of information that we are capable of offering that will continue to differentiate us.

### **Other observations, research or comments you would like to share?**

Remember that when a policy is first issued, the issuer gets only one bite at the cherry, and sets the premium.

They may not re-visit the policy beyond this stage. It is only when this policy comes to the secondary market that we have a renewed opportunity to examine what has changed. After having done so, we are in a better position to reassess the profitability of the policy as an investment - it behooves us to make sure we have all the information we can get.

Knowledge is key - hence making investment decisions based on knowledge we know is incomplete benefits no one.