**The Role of the Life Settlement Provider**

As any industry grows from infancy to maturity, there are a number of milestones that usually take place in this natural progression. One of these milestones is simple disintermediation. As information begins to flow more efficiently, it is written in most economics textbooks, that free markets will require less and less intermediaries to facilitate market activity. This holds true in a number of examples throughout economic history, and also holds true in the life settlement industry. However, it is also important to note that some intermediaries, even though some feel obsolete, still serve a very important role in market activity as valuable outsourcing partners, compliance watchdogs and vital points of reference.

The Life Settlement industry was characterized in the past as a Wild West environment with no rules, where the largest part of the economic value created by market activity was absorbed in great part by intermediaries. For those who have been around for a while, you know that for many participants, it wasn’t about quality, or efficiency, it was about being in the right place at the right time to control the right deal. This created the first step into the evolution to efficiency, markets where intermediaries are needed, begin to attract efficiency. Because the commissions for intermediaries were high, this attracted more and more intermediaries to the marketplace. Now some may think that this was bad, but when you have competition you also begin to create efficiency. Without realizing it, intermediaries where setting the stage for the evolution of the marketplace into a more efficient and fluid environment.

A couple of years ago, there was a call for disintermediation in the industry, and many of the institutions began to question the need for brokers and providers. When dealing with the wrong broker or the wrong provider, an investor can walk away with a negative experience, however it is important to recognize that it is every investor’s responsibility to perform proper due diligence. Intermediaries can be valuable resources offering tools and weapons to assist in your due diligence. No matter how much money or resources one has, it is no substitute for knowledge and experience. Internalizing these tasks is not the answer; firms wearing too many hats breed compliance issues and conflicts of interests, which is why many of the larger institutions are now divesting their provider operations. Selecting the right intermediary is extremely important, and perhaps the trend should not be to disintermediate completely, but seek out quality intermediaries through proper due diligence and hold them to a higher standard.

One of these intermediaries is the Life Settlement Provider. Traditionally, the role of the life settlement provider is to provide compliance in the transaction, to provide deal flow and sourcing capacity. In today’s environment, many argue that sourcing is easy and that having deal flow is just a matter of a phone call. Well those people maybe correct in some instances, but going bear hunting is a lot more than just going into the woods, putting yourself in a bear infested area and calling out to them. It does not mean that you are qualified to hunt a bear, and no matter what you think, without the proper preparation, resources and experience, you are asking for an unpleasant accident. So is any financial market without proper experience and guidance. And as a side note, the unpleasant accident doesn’t always mean that you will buy a bad asset, but it can also be that after hundreds of thousands of dollars in research and structuring you may not even invest the funds. Think about that. As an investment manager is simply irresponsible to take your investor, bear hunting without proper and accurate experience, compliance and guidance.

So what is the role of a Life Settlement Provider, well that’s the question we intend to answer in this paper. First, let’s look at the regulatory environment.

The Regulatory Environment

Currently 39 states, covering approximately 85% of the population, regulate life settlement purchases. Many other states are considering proposed regulation. An effective provider should not only be licensed
in a large number of states, but must have a complete understanding of the regulation in each specific state. Although regulatory provisions among states are similar, there are differences to be understood and communicated by a provider to be effective in the transaction. Additionally, an impeccable compliance track record within each state and strong relationships with regulators and legislators is important as the industry evolves toward more regulation.

A provider will extend this knowledge to their investors, and ensure that every transaction is compliant with the specific regulation, in order protect the investment from regulatory and compliance risks. A provider will also maintain appraised of all changes in the regulation and create a prompt mechanism to communicate to an investor, when regulation is changing adversely or beneficially. As an investor, it is not unreasonable to ask your provider to provide proper warrants and representations as to the regulatory compliance of each transaction in order to provide long term regulatory protection for your investment.

Policy Analysis and Transacting at Fair Value

An institutional investor will have developed guidelines governing policy selection, pricing methodology and other decision parameters; nonetheless, because the provider often has additional information and experiential data which may impact the inputs into the decision, the provider should become an informed, collaborative partner in the process in order to support the investor in making a fully informed decision. Leading providers have developed sophisticated systems to assist in policy selection, pricing analysis and documentation of clean collateral for institutional purchases.

The key elements in pricing include the pricing model, the estimated life expectancy reports, projected minimum premiums to maturity, and an estimate of fair (market) value for a policy. Although most investors have developed a proprietary pricing model, an effective provider should have pricing models and pricing competency in order to certify proposed offers.

Typically, investors will determine which life expectancy underwriter or combination of underwriters to use. Nonetheless, a best practices approach communicates all life expectancies known by the provider to the investor and any significant discrepancies discussed and reviewed as appropriate. Recently, leading life expectancy underwriters have begun to develop an industry standardized methodology to provide data, which compares actual to expected life expectancy results. This is a significant positive step forward for the industry. Life expectancy underwriters unable or unwilling to report under a uniform methodology, or unwilling to share performance results based on their actual predictions, should be discouraged from use in transactions.

Many investors project minimum future premiums using industry standard tools which may not reflect the specific provisions of different carrier’s products. An effective provider should have an experienced staff with a deep understanding of each carrier’s products to enhance these projections. A static analysis can develop an estimated value of a policy; however, dynamic market factors such as the current view relative to such factors as policy size, life expectancy, carrier rating, premium financing, and seller’s expectations, will assist the investor in acquiring the policy at a fair market value relative to the current environment. An effective provider will have databases to assist in this evaluation.

Once again, years of experience in the trenches can make a provider a very valuable partner and weapon in an investor’s arsenal. An investor needs to have continuous market data flow, and a qualified provider is a perfect source for this. I am not urging investors to put themselves at the mercy of Life Settlement Provider and use their processes and systems. An investor should always design their purchasing parameters, underwriting procedure and pricing methodology after careful research and design with the use of expert advisors. However, there is nothing wrong with directing a Life Settlement Provider to perform this duty with the measures you have put in place, and simply take the role of controller and reviewer. A provider will be able to put out many more bids in the market and increase your closing pipeline, while absorbing a substantial amount of the liability of making a mistake. This puts the fund manager in a supervisory role and doing what they do best, managing the fund.

Transactional Due Diligence

Reputational risk is a significant concern to institutional investors. Leading providers will provide significant due diligence assistance to ensure only “clean” policies are acquired and reputational risk is mitigated.

Obtaining verification of coverage (VOC) from the life insurance company is but a starting point in providing transactional due diligence. Background checks of all interested parties, the complete history of the policy and reasons for the sale are very important in understanding the risk that the policy is anything other than clean collateral. Broker licensing, where required, needs to be confirmed.

Verifying that a clear insurable interest existed at issue is critically important in the transaction. Understanding the history of the policy from origination until the current date (including VOC) is necessary to ensure the policy was not the result of a STOLI transaction. Additionally, identifying the source of the funds used to pay all premiums helps mitigate the risk of a STOLI transaction.

As a significant number of policies are owned by trusts, a thorough review of the trust documents and trustees is necessary. Not only is it important to determine the ability of the trustee to authorize the sale of the policy, but a provider should have databases to identify abusive trust structures and trustees as this may be another indicator of a STOLI transaction. If there has been any change in ownership since the policy was issued, the reasons for such change(s) need to be understood.

Let’s face it, with this new “securitization” frenzy, many organizations are putting additional scrutiny, security and focus on the need for verification and clean title. A well qualified life settlement provider is aware of this, and satisfies this requirement. As an investor we demand a minimum level of documentation for every transaction, and the level of resources we would have to deploy to complete each transaction would be costly. A life settlement provider will take responsibility to ensure that each file is worthy of a rated securitization, and most important they are incentivized to do so, unlike other third parties like brokers, who work for the seller, and or trustees and/or law firms.

Transactional Transparency

In order to attract more widespread institutional interest to the asset class, effective providers must provide complete transactional transparency. Access to information such as the source of the policy, due diligence findings (including any “exceptions” the investor has chosen to accept), provider fees, broker fees and net proceeds to the seller. Original documents should be transferred to the investor, but adequate back-up must be retained by the provider, which oftentimes assumes a post acquisition management role due to the logical efficiencies involved.

Transactional and market transparency provided to investors is critical in expanding the investor base. Leading providers have established sophisticated databases of valuable historical, market and transactional data which, when effectively communicated, provides new investors significant knowledge with which to understand the asset class. The effective provider will provide new investors (and current investors) assistance in the selection and due diligence of life expectancy underwriters as well as introductions to prospective trustees, escrow agents and law firms. This is a key area. As an investor, one must demand the absolute highest level of transparency. Perhaps one of the most beneficial parts of a provider relationship is that you know what you are paying your provider, and in turn the provider has to give you absolute transparency over each transaction. It is not unreasonable for an investor to demand this, and to ensure that a provider is their window to the market, and not a stepping stone. Many have made the mistake of buying deals from a life settlement provider, instead of realizing that a provider should be giving access to the market, its policy flow and market rates, not simply reselling you policies from their acquired portfolios and profiting on the spreads. After all you don’t buy a house from your real estate agent, your title insurance company or your escrow agent; you buy it from the seller, in complete transparency and simply pay each entity their part for doing their work.

Given that today’s life settlement market considerably more efficient, we can all agree that intermediaries have become extremely more transparent and their function much more defined. However, a quality Life Settlement Provider, still serves a very important and vital role. From a regulatory perspective to fluid market knowledge they provide the necessary part to a complete life settlement transaction. Investors must be aware of this important service provider, and clearly understand their role and the specific value they add to each transaction, but as always, ultimately the due diligence is your responsibility, so when choosing a life settlement provider, make sure you employ a strict revision and due diligence process to ensure you are working with a quality service provider, and remember, they work for you, so hold them to higher standard.