

## SL Investment Management (SL) – The Importance of Premium Optimisation

Effective premium optimisation is a key consideration for investors to maximise their returns from a portfolio of Life Settlement policies.

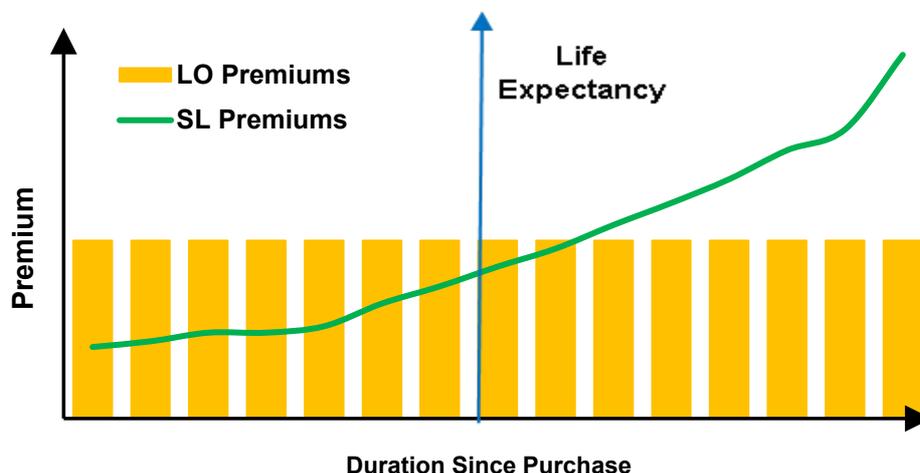
### Overview

A Life Settlement (LS) is the sale of a life insurance policy (usually based on the life of a senior US citizen) to a third party for a value greater than the policy's surrender value and less than the policy's death benefit. In analysing a policy, the three major sources of cash flow involved are:

- **Price** – the amount paid to the previous owner in order to acquire the policy;
- **Premiums** – a set of periodic payments (e.g. monthly or quarterly) paid to the issuing Insurance Company in order to maintain the policy in-force;
- **Death Benefit** – the proceeds received from the Insurance Company in the event of the death of the insured life.

When a policy is written, the Insurance Company is not only looking to ensure sufficient premiums are paid to keep the policy in force, but often aim to set premiums at a generous level to cover expenses and profit. Hence there is significant potential for the over-paying of premiums to the Insurance Company, particularly in the early years of a policy. As such, the process of premium optimisation (i.e. ensuring that a sufficient level of premium payments are paid just at the right time) is of critical importance to the secondary investor when looking to maximise returns.

A LS transaction generally consists of a specific type of life insurance policy and the majority of these policy types allow for the owner to pay a flexible premium amount. This flexibility allows for premiums to be variable and set at levels so as to not put the policy at risk of lapsing at any point, while also avoiding a large build-up of cash value - which can be lost to the Insurance Company in the event of the death of the insured life. The Insurance Company will often suggest a level premium stream to maintain simplicity, improve their profit levels and minimise their reserves. While this may maintain the policy into the future, it is likely to result in the policyholder paying more than is necessary in the early years and allowing the build-up of substantial cash value. Premium optimisation allows for significant savings when compared to Insurance Company projections over the expected life of the policy.



#### SL Optimisation Process

When conducting premium optimisation SL makes use of information sourced from policy documentation, the most critical of which is:

- **Original Policy Schedule** – SL reviews the particulars of the policy schedule to ensure that all individual features of the policy are captured for the optimisation analysis.
- **In-force Policy Illustration** – A projection of future policy values produced by the Insurance Company and usually based on a level periodic premium, designed to maintain the policy in force until the maturity date. For maximum effect, SL recommends that this document should be dated no more than three months prior to the analysis date. The Illustration is used (in conjunction with other information) to reverse out the underlying monthly deductions for the policy, allowing SL to use these figures to derive an optimised premium stream.
- **Up-to-Date Policy Values** – The issuing Insurance Company can often be contacted for the most recent values available in order to assist with the optimisation process and to check the validity of the SL premium model.

SL's experience since 2002 demonstrates that when it comes to premium optimisation, our methodology and process is both extremely effective and robust. SL's appraisal of Industry-standard software packages and third party automated systems is that they generate what we consider to be the ideal premium stream for only a small proportion of the policies seen in the LS market. Our experience also shows that there is a wide variety of policy features and charges even within policies issued by the same Insurance Company. At SL, each case is reviewed individually by a fully trained and experienced member of the Actuarial team. Only once we are satisfied that the underlying SL premium model created for the individual policy is running sufficiently accurately will the case be signed off.

Historically, we have found that Fund Managers using "off the shelf" solutions are likely to overlook non-standard (and even some basic) policy features. This can result in the production of a premium stream that either places the policy at risk of lapse or can build up a substantial cash value. Features that have been neglected (or incorrectly used) in SL's experience include:

- **Use of policy charges that are "typical" for an Insurance Company**
- **Incorrect assignment of the lapse trigger**
- **Non-utilisation of guarantee periods**
- **Failure to recognise required annual premium periods**
- **Incorrect interpretation of illustration assumptions**
- **Inability to model shadow accounts**
- **Ignoring cost of insurance increases**

Additionally, it should be noted that due to the experience of the staff performing the optimisation analysis, the optimisation process doubles as a due diligence exercise on the policy itself, which is vital when we are acquiring policies on behalf of investors. Any feature or information that appears to be inconsistent or inaccurate within the available documentation is likely to be uncovered at an earlier stage in the acquisition process.

### **Example Savings**

#### **Typical Life Settlement**

- ❖ Death Benefit = \$1,000,000
- ❖ Purchase Price = \$336,600
- ❖ Assumed Survival Period = 5 years

#### **Insurance Company Premiums**

\$24,157 payable annually over 5 years (totalling \$120,785)  
Investor Return = 18.7% p.a. (\$542,615)

#### **Provider Premiums**

Initial 4 year annual stream before switching to monthly (totalling \$102,171)  
Investor Return = 19.4% p.a. (\$561,229)

#### **SL Premiums**

Monthly premium stream from outset (totalling \$54,835)  
Investor Return = 22.0% p.a. (\$608,565)

### **Actuarial Team – Experience and Expertise**

The Actuarial team at SL Investment Management has combined experience of almost half a century in the LS market. As a consequence, SL has developed a vast knowledge base and deep understanding of a wide variety of LS policy types and the various features/characteristics that can impact premiums.

SL has been involved in the LS industry for almost 15 years and has analysed in excess of 50,000 policies. SL has provided a management or advisory role on over \$3Bn of combined death benefit (across over 2,500 policies), with the majority using optimised premium streams computed by our in-house actuarial team. SL has never had a policy lapse due to incorrectly generated premium streams and regularly reviews policies to ensure the premiums optimisation process remain effective.

### **Review Your Portfolio**

SL is often able to provide an extensive review of institutional portfolios of Life Settlement policies. Please contact [info@slinvest.co.uk](mailto:info@slinvest.co.uk) to discuss your requirements.