



CHAPTER 13

Risk Mitigation for Life Settlements

Nemo Perera

Managing Director, Risk Capital Partners

Investors in the secondary market for life insurance are exposed to many complex underlying risks that are unique to the insurance sector. Although some risks can be adequately mitigated using traditional portfolio management principles, others may be more economically managed with risk transfer techniques that utilize both financial and insurance-based risk coverages. As the life settlement market evolves, attracting even greater interest from prospective investors, risk mitigation will have an increased importance in reducing cash flow volatility, thereby enabling institutional participation. As with any type of investing, it is vital that prospective life settlement investors fully understand all the risks and risk mitigation solutions available in today's marketplace.

The most widely used tool for risk mitigation is insurance as it addresses situations where the timing of an incident is uncertain but still predictable. Underwriting risks like those associated with life settlement assets, hinges on the Law of Large Numbers in order to quantify the uncertainty of life, making it more predictable. It would be quite difficult for an actuary to determine the risk of a unique catastrophic event that occurred with little or no predictability. An event is generally only suitable for risk coverage if said event occurs on a relatively frequent basis. Inversely, as a risk occurs less frequently the cost to insure that risk substantially increases making it prohibitively uneconomic for both the insurer and the purchaser of the policy. These last risks are generally better handled with equity capital.