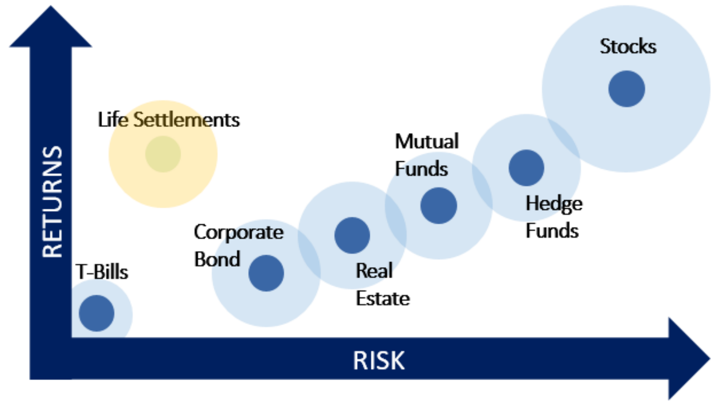
LIFE SETTLEMENTS: A PREMIER UNCORRELATED ASSET CLASS

For investors seeking an uncorrelated alternative investment with low volatility and predictable double-digit returns, there are few investments that deliver on this profile as well as life settlements.

Life settlements are an investment vehicle where investors purchase life insurance policies on seniors with a life expectancy of 3 to 15 years for an amount higher than cash surrender value and less than the policy face amount.



Source: crownlifecanada.com

HISTORY:

- 1980's AIDS crisis: The life settlement industry was born in the 1980's AIDS crisis, as afflicted individuals sold their life insurance policies for cash to pay for medical bills and enhance their final days. When the cure was discovered, the industry then focused on old-age mortality.
- 1990's – 2000's: Major Wall Street firms such as Goldman Sachs, Credit Suisse, Deutsche Bank, Berkshire Hathaway, AIG discovered the non-correlated nature of life settlements, along with healthy gross returns in the 16%-22% range.
- Increasing regulations in licensing: The industry became regulated in the majority of states, where licensing of life settlement brokers and providers became mandatory, along with transparency of the entire process and fee structure.

WHY SHOULD AN INVESTOR INVEST IN LIFE SETTLEMENTS?

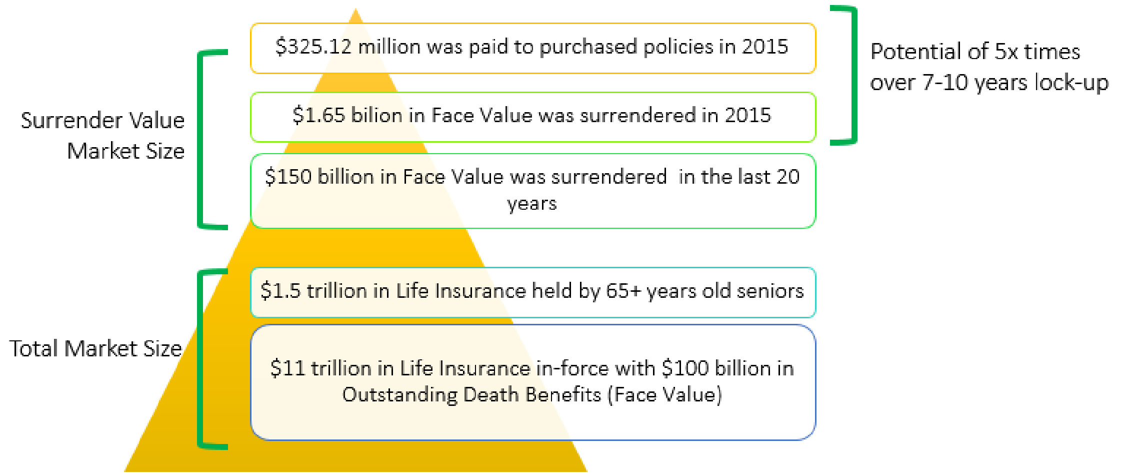
Pros:

- **Uncorrelated Returns:** Life Settlements give a yield bump in an alternative asset class that is not correlated to stocks, bonds, currencies, interest rates, etc. - a risk that is not correlated with other markets because the value of investment in life settlements depends on life expectancies of the policyholders. While short life expectancies create the expectation of a high return on investment, long life expectancies do the opposite.
- **Low Volatility:** Volatility in life settlements is impacted by the size of the policy, pricing, life expectancy and premium schedule and not traditional macroeconomic factors. The biggest factors are the size of the policy and life expectancy estimates. Therefore, because the underlying assets of a life settlement investment fund are large permanent life insurance contracts and life expectancy estimate is a more stable rate than others, the fund has low volatility compared to other financial markets.
- **Diversification:** Due to the uncorrelated returns as an alternative asset class, life settlements diversify investors' portfolios, therefore reducing beta and increasing alpha.

Cons:

- **Long Holding Period:** Since life settlements have a typical holding period of 7-10 years, investments in life settlements have a higher than average lock-up period than other asset classes. Investors have to consider a long-term plan when making such investments.
- **Valuation risks:** Possibly one of the key administrative dilemmas facing the asset class and one which many industry players struggle in mitigating. This phenomenon has resulted in investor disappointment particularly among the less sophisticated players.

MARKET SIZE: "The market is large"



Source: Life Insurance Settlement Association

LIFE SETTLEMENTS FUNDS:

Independent Niche Funds		Big Players	Insurance Company	Banks	Funds By Brokers
• **Laureola Advisors** • Corry Capital • BroadRiver • Carlisle • Monarch Alternative Capital	• **RiverRock Advisers** • Oak Tree Capital • Ress Capital • SL Invest • Texas Pacific Group • VIDA Capital	• Apollo • Blackstone • Berkshire Hathaway • Fortress Investment Group	• AIG • Crown Life Canada	• Goldman Sachs • Credit Suisse • Deutsche Bank	• GWG Life

Most of these funds are large and are forced, by their size, to deploy capital principally in the *tertiary* market (investor to investor) because the *secondary* market (policy holder to investor) is too small. Larger funds aim for returns based upon the mortality curve and seek to reduce exposure to any single policy by holding a large group of policies. Instead of carrying risk to any particular policy, they have the risk that changes to the mortality tables adjust the mortality curve the wrong way, in which case the prices of all their policies are effected. Historically, changes to the mortality tables have always extended life expectancies rather than shorten them (thereby reducing prices) and all the big funds rely upon the same mortality tables to price their assets.

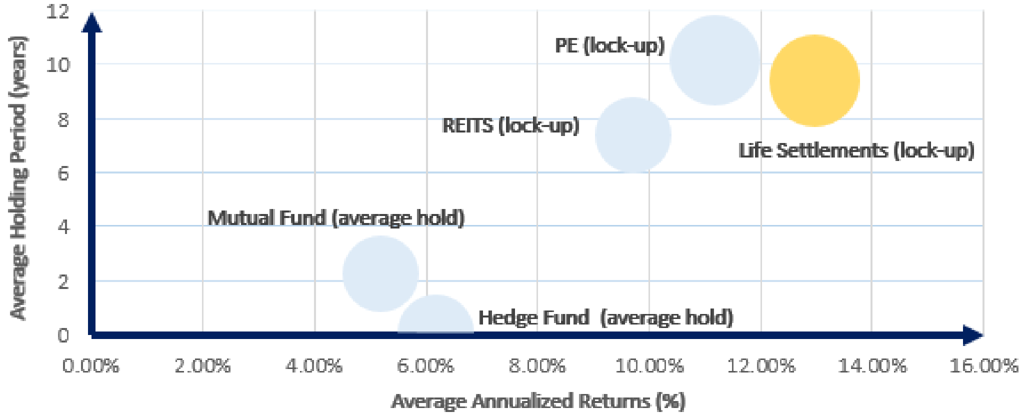
We believe that funds should not try to hit the mortality curve, but to beat them.

RETURNS OF INVESTMENTS:

- The typical life settlement affords the buyer with a 12% - 18% gross IRR. Net returns to investors' expectations of more than 10% are realistic. Importantly, the rate of return is wholly contingent on people dying on time. Best practices require a life settlement "pool" of at least 200 policies so that the actual results track the expected mortality curve, and volatility is reduced.
- The typical lock-up period of 7 – 10 years.
- Backed by the value of the insurance policies.

Source: University of Connecticut, RiverRock

Illiquidity Premia: Holding Periods and Annualized Net Returns Profiles (Illustrative)



Source: CreditDonkey.com, Blog.FolioInvesting.com, Brian A. Ciochetti, Investopedia, CNN, Alpha Clone, Pitchbook, Wall Street Journal, University of Connecticut, FinancierWorldwide.com

<u>TYPES OF LIFE SETTLEMENTS:</u>

Types of Life Settlements:

- Viatical Settlements: a situation where the insured has a life expectancy of <2 years
- Life Settlements: a situation where the insured has a life expectancy of <20 years

Transactions of Life Settlements:

- Direct Purchases: require a large outlay of cash with expertise to buy the right policies
- Direct Fractional: larger policies are divided into smaller portions and sold individually to investors
- Life Settlements PE Fund: involves purchases of portions of a fund comprised of hundreds of policies

<u>FUND STRUCTURES:</u>

- Hedge Fund Structure
- Private Equity Fund Structure
- Hybrid Structure: mix of Hedge Fund and Private Equity Structure
- Debt Structure:
    - Pay out a variable coupon based on returns
    - Pay out a yearly/quarterly fixed coupon after some time
    - Pay out a yearly/quarterly coupon at the end

<u>TYPES OF PLAYERS:</u>

Sell Side:

- **Policyholder:** The life insurance policy holder has a policy he/she would like to sell as a life settlement, and obtain the highest bid possible in the market.
- **Life Settlement Broker:** Life Settlement Brokers are licensed and regulated by the states. The brokers represent the policyholders, and hold auctions with institutional buyers in order to obtain the highest bids for their clients. Life Settlement brokers collect medical records, prescription drug history, life expectancy reports, copies of the life insurance policy, and perform dozens of process-driven tasks in order to compile a complete life settlement package that is ready for auction. There are approximately 20-30 life settlement brokers nationwide representing the majority of policyholders who are seeking life settlements.

Buy Side:

- **Life Settlement Provider:** Life Settlement Providers represent the institutional funds and large private investors who are seeking to purchase life settlements from policyholders. Providers, like their broker counterparts, are state-licensed and regulated entities. Providers bid competitively to win their bids on behalf of the funds they represent, and then help the funds complete the transaction by transferring ownership from seller to buyer.
- **Institutional Funds:** There are many institutional buyers of life insurance policies in the secondary market for their own portfolios, including banks, hedge funds, private equity funds, pensions, foundations, endowments, and single/multi-family offices.

EXAMPLE:

A male aged 77, with a life expectancy of 8 years based on his current and historical medical conditions, owns a Universal Life insurance policy with a $1 million death benefit. Because he no longer needs, wants, or can afford the policy, he understands that he can sell the policy in the secondary market instead of lapsing or surrendering the policy back to the insurance carrier for little or no cash. He contacts a licensed life settlement broker, who holds an auction on behalf of the insured with a life settlement Provider, also a licensed entity that represents institutional investment funds that purchase life settlements for their investment vehicles.

The Broker and Provider agree on a price, and the insured receives a lump-sum cash payment of $225,000, and the fund that purchased the policy becomes the owner and beneficiary of the policy. The fund then pays the policy premium until the death of the insured, when the fund receives the $1 million death benefit.

Institutional buyers pool thousands of these policies, with the goal of having the actual mortality results track the expected mortality curve. Life Settlement pools are non-correlated to the general markets, provide low-volatility, predictable returns, and are typically held in a passive “buy-and-hold” strategy. The fund purchases pools of these policies at an average projected gross internal rate of return (IRR) of 16% - 18%.

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