WHITE PAPER / Life Settlements as an Investable Asset Class:

Best Practices to Achieving Uncorrelated Returns

Life Settlement Industry Background

A life settlement is the transfer of ownership and beneficiary rights of an unwanted or unneeded life insurance policy in exchange for a cash settlement. This secondary market landscape for life insurance is dominated by insureds typically aged 70 and older, some of whom have medical impairments that result in increased mortality risk and shortened life expectancies for the insured. Life settlements provide individuals with liquidity options for what was once considered an illiquid asset. In the past, policy owners who no longer needed or could no longer afford their existing coverage had few options, and would typically return the policies for a lesser cash value or simply cancel the policy entirely. The need to buy a home, purchase more affordable coverage, pay medical bills or eliminate debt are often cited by insureds as the reason for divesting their life insurance policies.

The life settlements market has become more sophisticated over the last several years. As evidence of this transition, the same actuarial techniques and advanced financial analyses used as part of the life insurance industry's underwriting process have now been incorporated into the life settlement underwriting process as well. Similar models, mortality tables and underwriting guidelines were implemented as institutional investors became the most prevalent source of capital for life settlements. As the market has evolved, valuation, underwriting and transaction standards have been developed and recognized - further solidifying life settlements as an established financial market.

Investors are interested in life settlements as an asset class because they can provide several attractive qualities as part of an investment diversification strategy. Some of these qualities include:

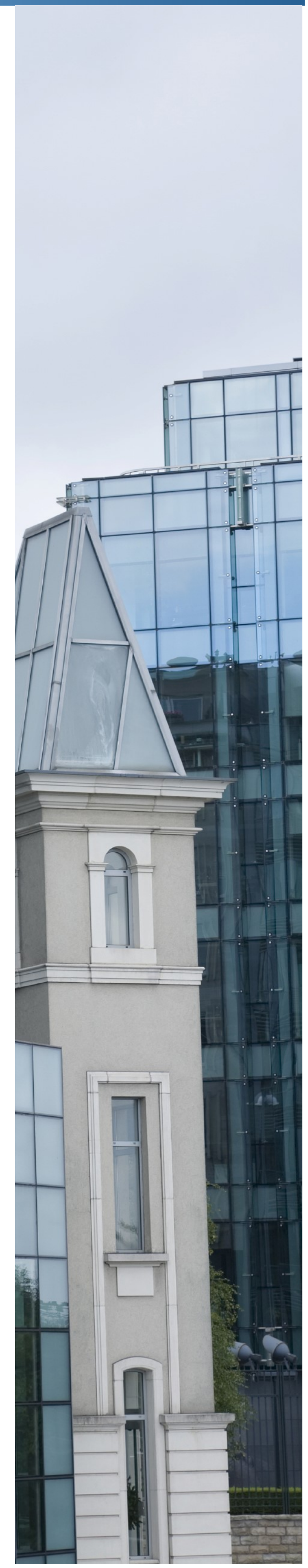
- Uncorrelated Returns – since cash flows are based on mortality events of individual policy holders, investment returns are independent of traditional financial markets.
- Strong Credit Worthiness - returns are backed by some of the world's largest insurance companies.
- Attractive Yields - many investors are experiencing strong double digit returns.
- Regulatory Structure - the industry is highly regulated and structured.
- High Growth Potential - given the projected growth of the senior population, the industry is expected to continue growing – offering more investment opportunities.

The U.S. life settlement industry continues to experience significant growth, with an estimated ***$10 to $15 billion*** in current annual transaction volume, and is expected to reach ***$160 billion*** within the next two decades. The driving forces behind this expansion are the increased awareness of life settlements as an investing asset class and the demographic trends driving sharp increases in the retirement age population. Today's seniors are active, financially savvy, and own a significant stake in the over $20 trillion of life insurance held by consumers and businesses. In addition, a sizable portion of these individuals are seeking additional financial options to meet the needs of their lifestyle. As life settlement transactions become an ever more popular tool for the financial advisors of these individuals, we believe that much growth lies ahead for the industry as a whole.

Life Settlements in an Open-Ended Investment Fund Structure

In recent years investors have increased liquidity in the life settlement asset class by trading blocks of life settlements amongst each other. This tertiary market for life insurance (secondary for life settlements) continues to grow, and as it does so too does the attractiveness of the opportunity that life settlements present to the investment community. Larger and more sophisticated investors continue to enter the tertiary market, and as a result block trading is becoming an attractive option – both for investors not wishing to venture into the secondary market as well as those looking for liquidity events. As this sector of the life settlement market continues to evolve, a larger and more diverse group of investors will begin to be involved.

Due to this evolution of the tertiary market, life settlements can now be found as part of open-ended investment funds, which in turn offer a wider array of investors the ability to invest in this asset class. The increased liquidity and turnover available in the market today, as well as the use of standard practices in mark to market valuation and accounting, give way to an ideal environment for life settlements to be provided through open-ended funds around the globe. Because liquidity events occur more frequently in an open-ended fund environment, the tertiary market provides the liquidity required to allow these structures to offer asset adequate redemption terms to investors.



Performance Drivers of Life Settlements in an Open-Ended Fund

Mortality and the Passage of Time

One of the primary performance drivers of life settlements as an investment is the passage of time. The projected cash flows of a life settlement portfolio are based on the probabilities of death of the insured population within the portfolio. These probabilities are calculated using specific data for each insured, with one of the most important being age. As the insured gets older, the projected positive cash flow from a death claim becomes more likely and the net present value ("NPV") for the policy will therefore increase. In this sense, life settlements operate the same way that a zero coupon bond does, where the value increases as the maturity date approaches. As a result, when the insured population within a portfolio of policies gets older the portfolio will increase in value to a certain extent. In addition, each year the portfolio is expected to provide cash inflows through mortality events. These death claims are recognized as income in the portfolio's performance and will further increase the investment vehicle's value.

Market Rate Movements – Mark-to-Market Valuation

An open-ended investment fund offering subscriptions and redemptions on a periodic basis should utilize a mark-to-market valuation system. This valuation methodology provides entering or exiting investors with an accurate depiction of the current market value of the fund's life settlements portfolio. In order to do this in a robust way for a market with relatively low transaction volume (such as life settlements), a probabilistic model must be used.

A probabilistic model takes into account a mortality 'curve' produced by actuaries. The curve provides the probability of death for a given year, based on those who have survived. These probabilities and survivorship numbers are used to determine a net cash flow between the expected death benefit and premiums to be paid. After an expected stream of cash flows is developed they are then discounted utilizing the discount rate that is reflective of the current market to determine the NPV of each life settlement contract. This is the general concept of how a mark-to-market probabilistic model works.

As mentioned above, the portfolio must be valued using the current life settlement market discount rate because it determines the cash inflows the fund could receive by selling policies in case liquidity is required. Therefore, changes in the life settlement market discount rate will (as they would in any bond fund) affect the current valuation of the fund. If the discount rate decreases, the result will be an increase in the portfolio's NPV, and vice versa. Hence the life settlement market's internal rate of return acts as a performance driver to the value of an open ended mutual fund investing in life settlements. Again, this is the same phenomenon experienced in a bond fund where movements of the underlying market rates influence the value of a bond portfolio.

Trading Acumen:

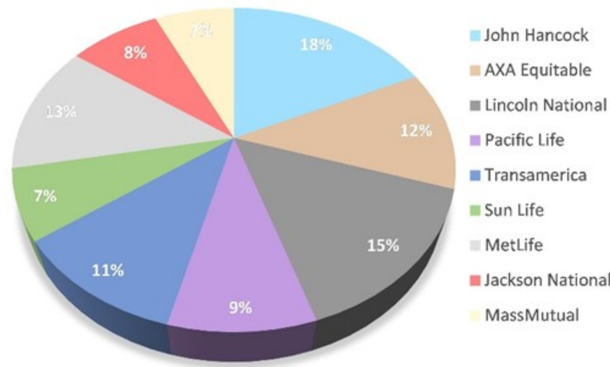
In an open-ended life settlements investment fund, the portfolio of policies is not static. The investment manager can buy or sell policies based on the needs of the fund. If the fund is underinvested the investment manager will seek to buy additional policies. If the fund is overinvested and its liquidity reserves begin to deplete, the investment manager will sell policies to generate additional cash. The buying and selling of policies above or below their market value will impact the fund's performance. A good investment manager will be able to purchase policies at a discount from market prices, and will have a good handle on the tertiary market so that policies can be sold at market values if liquidity needs arise. In this way the trading acumen of the fund's investment manager can enhance the fund's performance over time.

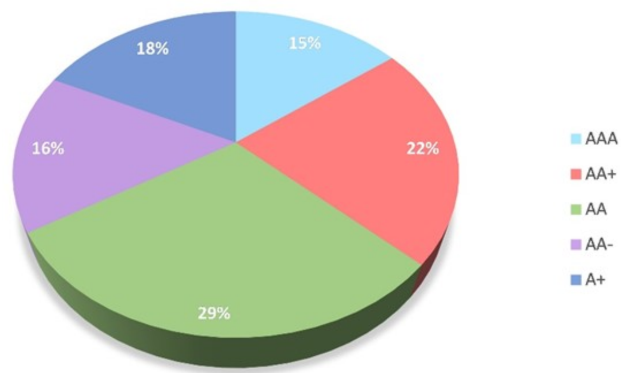
Risk Types and Mitigation of Life Settlements in an Open-Ended Fund

Credit Risk

Credit risk is the risk that the counterparty to a financial instrument will fail to discharge an obligation or commitment that it has entered into with the fund. When a fund invests exclusively in U.S.-based life insurance policies, the insurance carriers represent the primary concentration of credit risk. The fair value of the life settlement policies includes the consideration of the credit worthiness of the life insurance issuer, and accordingly represents the maximum credit risk exposure to the fund. U.S.-based life settlements have marginal credit risk because each insurer is required by law to maintain stringent reserve requirements. In addition, no U.S. life insurance carrier has ever failed to pay a legitimate death claim. The risk of default is considered minimal.

However, in order to further mitigate this risk, open ended funds should seek to purchase policies issued by life insurance companies with at least an investment grade rating by a major credit rating agency. Furthermore, a well-constructed investment portfolio will diversify across a wide array of insurance carriers to minimize risk exposure to any one company. A traditional well diversified life settlement portfolio will provide at the very least the following types of carrier diversification:





Liquidity risk

Liquidity risk is the risk that the fund may not be able to settle or meet its cash obligations on time. An open-ended life settlements investment fund must have sufficient capital on hand to pay premiums on the insurance policies it holds in the portfolio, and must also be prepared for redemptions by investors. Liquidity risk is managed by placing the majority of the fund's assets in investments that can be readily disposed of in the tertiary market when necessary. In order to ensure that the fund will receive the amount of liquidity it requires when it sells policies, it is important that it has utilized accurate mark-to-market valuation and accurate accounting practices. A strong investment manager can effectively manage and mitigate liquidity risk by using such practices and by executing the following steps:

- ◊ Diversify policies within the portfolio.
- ◊ Diversify the face value of the policies, avoiding a concentration.
- ◊ Hold enough cash to cover significant redemption event scenarios
- ◊ Properly distribute the expected maturities of policies held by the fund, to provide consistent expected cash inflows.
- ◊ Maintain access to the markets to facilitate the rapid sale of policies if necessary.
- ◊ Establish the redemption period of the fund so that it provides sufficient time to sell policies.

Longevity Risk

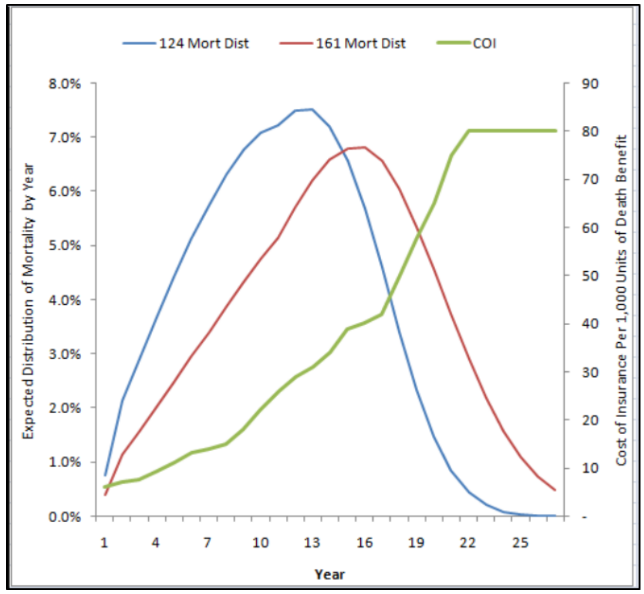
When evaluating the value of life settlements, each policy must be reviewed for multiple quantitative aspects of the insured and their health to get a firm handle on the probability of death over a given timeframe. Understanding the broader implications of these small details within a life settlement transaction is important. One of the key pieces of data used during the underwriting process is the medical underwriting report, which is performed by an independent medical underwriter. Utilizing the latest mortality information, premium data, mortality tables and verification of coverage, an asset profile is developed and a valuation is produced by an independent valuation agent. A thorough review should then be conducted by a number of parties to create redundancy, and a detailed checklist utilized to ensure uniformity such that all criteria and regulatory requirements correspond to accurate underwriting and quality standards.

Longevity Risk (cont'd)

Longevity risk is the biggest quantitative risk factor in the valuing of life settlements. In general, investment managers focus on reducing the economic impact of unexpectedly increased policy holder longevity. In order to ensure this, a fund must review actual versus expected results and stress test different scenarios of mortality expectations in order to determine the impact that these stressed scenarios have on the value of the life settlement. This stress testing is typically performed on the current portfolio as well as on policies available in the market that are being evaluated for purchase.

The primary driver of a policy's sensitivity to longevity risk is the cost of insurance ("COI"). COI increases every year until a mortality event because premiums must be paid to maintain the policy. A policy's sensitivity to longevity can be found by reviewing how probable it is that mortality will occur when the COI would produce an unacceptable return.

The graph to the side is provided to help illustrate this concept. The blue and red curves show different mortality distributions under different assumptions – the blue curve (124) shows a "typical" probability distribution over time, while the red curve (161) shows a "stressed" distribution that is shifted to the right due to increased longevity. The green curve shows the COI increasing over time, and eventually hitting a point at which the policy doesn't provide a return anymore (approx. year 22). By comparing the three curves, it is clear that the typical distribution will provide a return, but in the stressed scenario with increased longevity there is a significant probability that the insured will live long enough to make the COI too high to make a return.



Given that longevity risk is difficult to predict, thorough statistical analysis is the best way to mitigate its potential negative impacts. A common way to accomplish this is to perform a Monte Carlo simulation on the fund's portfolio on a periodic basis. This analysis provides the investment manager with insight that can then be used to make purchasing and liquidity management decisions. The analysis also provides a long term view of the portfolio's investment strategy and expected results.

Conclusion

The Life Settlement market is growing, and is also evolving into a more professional and liquid market that opens up opportunities to a greater number of investors and investment vehicles. One of these vehicles is an open-ended fund, which can provide investors with a structured solution into accessing the asset class while providing ample liquidity and robust reporting. The investment community is taking note of this and taking advantage of this value proposition.

Open ended fund managers must challenge the life settlement market by closely monitoring actual versus expected mortality results, find ways to mitigate longevity risk, and implement a sound mark-to-market valuation methodology. In addition, the investment vehicle must be sufficiently diversified to provide risk mitigation in multiple fronts. If executed properly these variables will provide an open-ended fund with a diversified asset pool that can help investors generate uncorrelated returns that will significantly bolster their diversification strategy.

In conclusion, investors must be educated and made aware that Life Settlements has a medium to long term investment horizon. In order to receive a completely uncorrelated return policies are meant to be held through mortality events, however, in an open-ended fund due to liquidity needs, investment returns will be correlated to the tertiary market for life settlements. However, with the correct investment vehicle, utilizing the relevant mitigation tools and a mark to market valuation system, investors can enjoy attractive investment returns will minimal correlation to traditional financial markets.