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Guide and Workbook

LIFE INSURANCE AS AN ALTERNATIVE INVESTMENT DUE DILIGENCE/DISCOVERY GUIDE and WORKBOOK

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ISI is a non-profit research think-tank focused on: a) researching and analyzing challenges and opportunities within the many paradigms of insurance-based risk management; b) publishing research findings on industry relevant topics; c) educating industrystakeholders, public policy makers and consumers in insurance-based risk management, and advancing relatedscholarship; and, d)promoting dialogue to foster industry advancements, fair public policy and greater risk protection for consumers.

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This is a guide and workbook for life insurance as an alternative investment and for due diligence/discovery. It is written for institutional investors, investment broker-dealers, BD representatives, registered investment advisors, and trustees responsible for investment decisions. It does not determine good or bad investments and is not intended to provide investment advice. Its purpose is to provide investment professionals with a practical guide and workbook that enables them to pursue the knowledge and understanding needed to make life insurance policy investment decisions.

The format of this workbook separates broad topics into separate sections. Within each section, space is provided for evaluation of each topic. At the beginning of each section is space to enter summary comments about the separate topics within the section. It is the intent of this format to enable a reader to address each section separately, make notes and when done, assess all information such that investment decision-making is enhanced.

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I – ALTERNATIVE INVESTMENTS

SUMMARY NOTES FOR ALTERNATIVE INVESTMENTS:

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What is an "alternative investment?" Most simply, it is an investment that in some significant manner performs independent of the major investment markets, i.e., its performance generally does not correlate with cycles and risks found in active financial markets. Another benchmark for an alternative investment is an asset for which there is no active trading market, thus making it difficult to determine a fair market valuation of the asset. Alternative investments include assets such as real estate, oil and gas, life insurance policies, managed futures, commodities, financial derivatives, CAT bonds, non-market securities (i.e., private trades), and similar tangible assets. It also includes exotics such as gems, art, metals, livestock, intellectual property, patents, etc. Investment offerings may be structured as a special bond and stock issues from corporations, hedge funds, private equity funds, REITS, venture capital funds, commodity funds, offshore fund vehicles, fund-of-funds, bank common/collective trust funds, non-market securities (i.e., private trades) and partnership interests. Alternative investments may be structured as limited partnerships, limited liability corporations, trusts or corporations.

In 2007, the American Institute of Certified Public Accountants (the "AICPA") issued comprehensive procedures for auditing investments in alternative assets.[1] In addition, FINRA has issued numerous advisories about the need to undertake comprehensive due diligence and discovery on alternative investments. On July 15, 2010, Congress passed the Dodd-Frank Act which takes a giant step toward imposing a fiduciary duty upon broker-dealers when they conduct business with retail customers. While the Dodd-Frank Act does not immediately impose a fiduciary standard on broker-dealers, it empowers the SEC to do so. SEC Chairman Mary Schapiro has stated that she has been an advocate of such a uniform fiduciary standard. More to the point, Investment advisers are considered "fiduciaries" and already have an obligation to act in their customers' best interests. The SEC has notified investment advisers that they "have a fundamental obligation to act in the best interests of your clients and to provide investment advice in your clients' best interests. You owe your clients a duty of undivided loyalty and utmost good faith. You should not engage in any activity in conflict with the interest of any client..."[2]

[1] Auditing Alternative Investments, 2007, PriceWaterHouseCoopers
[2] Information for Newly-Registered Investment Advisers, U.S. Securities and Exchange Commission

NOTES:

The direction of the wind is clear – greater due diligence and discovery is required, particularly as regards alternative investments. This responsibility cannot be outsourced without primary responsibility (see FINRA RN10-22). Investor entity management and fiduciary investor advisors may look to the investment management for relevant discovery and to third party reports, however, “they must have sufficient independent understanding and supporting information to evaluate and accept or reject the investment management’s valuation of the offering. This includes: a) the investment strategies and the manner in which they are employed, and b) the underlying investment portfolios and the reasonableness and reliability of the inputs and methodologies used for their valuation.”[3]

What is being said about alternative investments?

“Alternative Investments on The Rise in Retail World,” Investment News, Jeff Benjamin, April, 2011

- A way to differentiate
- Smooth volatility and reduce risk
- Traditional investments have become commoditized
- Emerging as a top priority

“Using Alternatives to Your Client’s Benefit,” Bank Investment Consultant, Keith Weber, June, 2011

- Protect downside
- Part of modern portfolio theory
- Add negatively or neutrally correlated assets

“Risk-minded Investors Shift Focus to Alternative Funds,” Investment News, Andrew Osterland, May, 2011

- More tactical
- Diverse sources of return
- Avoid losing money

“The Mainstreaming of Alternative Investments” FA News, Lisa A. Ditkowsky, June, 2011

- Offset beta in a large portfolio
- Necessary for income and return
- Diversification with specific niches
- Seek yields while maintaining principal
- Cutting-edge transactions

“Pension Funds Favoring Alternative Investments,” Alternative Investment Analysis, Michael Edwards, July 2011

- Falling popularity of equities
- Reduce and spread risk
- Shun traditional risky investments

“Alternatives Becoming the New Core,” Advisor.ca, Steven Lamb, July 2011

- More tactical asset allocation with focus on risk management
- Adds to use of all the strategic tools

“An Alternatives Expert Viewpoint on Alternative Alternatives,” AllAboutAlpha.com, July 2011

- Insulated from the vagaries of financial markets
- Offers unique risk-return profiles
- Risk that cannot be replicated easily or is nonreplicable

“Mainstream investors embrace alternative strategies,” NASDAQ Global Newswire, Transamerica Capital, July 2011

- Low correlation to the broad equity market
- Manage risk and potentially improve returns

[3] Auditing Alternative Investments, 2007, PriceWaterHouseCoopers

II – LIFE INSURANCE INVESTMENTS AS AN ALTERNATIVE INVESTMENT

SUMMARY NOTES FOR LIFE INSURANCE AS ALTERNATIVE INVESTMENTS:

NOTES:

The life insurance investment asset class is life insurance policies that are acquired through the life settlement process. It includes policies purchased in the secondary market and in the tertiary market. It typically does not include policies sold in the primary market. What are these respective markets?

1. Primary life insurance market: The business of selling life insurance policies by an insurer to original policy owners having an insurable interest in the insured. These policies are not part of the asset class.
2. Secondary life insurance market: The business of selling life insurance policies owned by the original policy owners to investors. These policies are included in the asset class.
3. Tertiary life insurance market: The business of reselling life insurance policies that were acquired in the Secondary life insurance market to other investors. These policies are included in the asset class.

Understanding the difference between a "life settlement" and "life insurance investments."

1. A "*life settlement*" is the legal process of selling a life insurance policy to a third party not having an insurable interest in the insured. Today life settlements typically involve insureds whose ages range from 70-90 and who have life expectancies ranging from 3 years to 14 years. Such life insurance policies typically include term, whole life and universal life policies. However, there may be exceptions to these general parameters.
2. A "*life insurance investment*" is the direct or indirect ownership of life insurance policies or an investment in a financial product that is secured or backed with life insurance policies that were acquired in the secondary or tertiary markets.

What makes life insurance an alternative investment?

1. Non-correlation to major financial markets
2. Unique risk set
3. Tangible asset classified as personal property
4. Subject to an array of individual state regulations
5. Absence of open market trading

Why are investors considering investments in life insurance policies?

1. Higher yields over comparable credits – Compare AA Rated Bonds offered by life insurance companies to yields offered in purchasing life insurance policies from the same company.
2. Returns exceed US Treasuries by 200-300%
3. Maturity certainty based on mortality
4. High credit ratings of insurance underwriters
5. Available investment structures offer asset management options
6. Maturing of laws provide stability
7. No correlation with traditional financial markets

NOTES:

Where do investment opportunities exist within the primary, secondary and tertiary life insurance submarkets?

Life insurance investments are about financial arbitrage, i.e., the cost of capital used to purchase and maintain the policy is less than the returns that are generated by the policy when it matures.

Life insurance policies originate through a collection of transactions between life insurers, policy owners and insureds (the "primary market for life insurance"). At some point after a policy is issued on an insured, the policy may again follow a collection of transactions through which the policy may be sold to a third party purchaser (the "secondary market for life insurance"). Thereafter, the policy may be held to maturity, traded to another purchaser or liquidated in a sale (the "tertiary market for life insurance"), or lapsed to the insurer. There are opportunities for investors to play at many of the steps within these collections of transactions, each offering low to high ranges of risks, returns and volatility.

Stemming from the early years of the secondary market for life insurance, the most common investment structure has been for the investor to secure a direct ownership interest, in whole or a fractional share, in a life insurance policy. As of 2011, the weaknesses of direct policy ownership have been addressed within numerous alternative structures for investment. Also, the SEC and many state securities departments have stated that the sale of investments in life insurance policy assets, whatever the structure may be, constitute an investment security and is subject to such regulations.

What are the major structures as of 2011 for investing in life insurance-based assets?

1. **"Mutual Funds"** formed in foreign countries such as Australia, UK, Ireland, Luxemburg, Germany, and a few other countries use investor funds to purchase and hold portfolios of life insurance policies. Investors purchase units in the funds which in turn give them an indirect interest in the portfolios. Some funds provide liquidity arrangements, but most units are only liquid on a program basis. Most of these funds are not available to U.S. investors unless they have some foreign account with assets from which such investments can be arranged.
2. **"Fractionalized Policies** "are life insurance policies for which ownership has been fractionalized into multiple ownerships. Investors hold specific ownership or beneficial rights to specific life insurance policies, receive their share of cash flows and death benefits, and are responsible for all premiums to maintain the policies in good standing.
3. **"Partnerships (LLCs)"** are entities funded by a group of investors, which funds are used to purchase life insurance policies in the secondary or tertiary life insurance markets. The partnership units entitle the investors to a share of the portfolio values, cash flows and liabilities.
4. **"Unit Trusts (or similar entities)"** are entities, typically funded with seed capital, that acquire a portfolio of policies and then sell investment units to investors. The investor units entitle the investors to a share of the portfolio values, cash flows and liabilities.
5. **"Premium Financing"** is a business that provides loans to life insurance policy purchasers in the primary market to pay premiums. Such businesses typically are funded with institutional or corporate funds, but investment interests in such businesses could be offered to investors. The primary issue with this business is the risk that the loan arrangement violates the insurable interest in the policy, causing the policy to become a STOLI which is illegal. The other issue is that most financed policies are intended to be sold in the secondary market for a profit within 2-3 years, but policy valuations can be highly volatile, and such policies have been prone to challenge by insurers.
6. **"Portfolio Bonds"** are issued by entities that have acquired portfolios of life insurance policies. Rather than selling direct interests in the entity or the portfolio, they issue bonds backed by a specific portfolio of life insurance policies. The bond provides the investor a right to fixed returns based on the portfolio's cash flows and the portfolio owner is responsible for all premium payments and receives the upside after paying the bond holders. Under such bonds, the investor is not responsible for additional cash calls to pay premiums, but is at risk if the portfolio becomes underfunded.
7. **"Corporate Bonds"** are issued by corporations and are backed by the general assets of the corporation. Typically such entity's assets are all life insurance policies or a substantial proportion of its assets are in life insurance policies. Investors in such bonds receive fixed income for a fixed period and are at risk to the corporation's business success. Some bonds may be redeemable and may be exchangeable into common stock.
8. **"Corporate Stock"** may be preferred stock or common stock offered by corporations. Typically such entity's assets are all life insurance policies or a substantial proportion of its assets are in life insurance policies. The stock may or may not be tradable on a stock market, and if it is, the value of such stock will be influenced by the corporation's business performance and stock market volatility.

NOTES:

What are the historical highlights of the Life Insurance Secondary Market (LISM)? Much of the confusion about life settlements is caused by erroneously putting Life Settlements, STOLI, Viaticals, and Investing in Life Settlements in the same bucket. A brief review of the LISM history helps put this into perspective:

1911 - U.S. Supreme Court ruling established that life insurance is "private property" and can be sold, including sale to a person not having an insurable interest in the insured.
Late 1980s – AIDS epidemic provided opportunity for Viatical Settlements which is the selling of a life insurance policy on an insured who has a life expectancy under 2-3 years.
Early 2000s – STOLI (Stranger Originated Life Insurance) policies were promoted by insurance agents and insurers with the goal to sell them in the Life Insurance Secondary Market. Most states have passed laws making it illegal for anyone not having an insurable interest in the insured to participate in a STOLI transaction.
2006-2007 – Premium financing was offered to policy owners to enable them to purchase policies with the intention of waiting through the 2-5 year holding periods and then sell the policies in the Life Insurance Secondary Market at a profit. Premium financing became somewhat mixed with STOLI, but premium financing is legal where the policy owner has an insurable interest in the insured.
2007-2009 – Most states passed comprehensive life settlement laws to regulate the business of selling life insurance policies. The general purpose of these laws are to protect policy owners and investors.
2008 – VBT (Valuation Basic Table) extended life expectancies by 20-30%. This is a mortality table that most life settlement agents, brokers, providers and investors use to price and manage investment in life insurance policies. The timing of this change coincided with the 2008-2009 disruption in world financial markets and led to distress in many life insurance portfolios, i.e., the life expectancies on which investments were made were suddenly materially longer, resulting in lower yields and some portfolio insolvencies.
Today – The Life Insurance Secondary Market is maturing as it establishes "best practices" and is represented by several associations including the Life Insurance Settlement Association (LISA), Institutional Life Markets Association (ILMA), European Life Settlements Association (ELSA), and International Secondary Markets for Life Insurance (BVZL). Other more focused associations seek to represent special segments of the market such as Life Expectancy Providers (LEPr) and others. According to Conning Research & Consulting, the secondary market for life insurance policies grew from $2 billion in 2002 to over $11 billion in face value of life insurance policy benefits being purchased in 2008. Conning further reported that the 2009 market decreased to about $8 billion of policy face benefits sold and in 2010 again decreased 50% to about $3.8 million.[4] In 2011 there was general evidence that volume increased but no conclusive factual data is available as of this publication date. As the LISM matures, tertiary trades are becoming more common, which adds opportunity for liquidity to the market. Searching the websites of these associations will reveal current events, articles, issues, etc:

- LISA: www.thevoiceoftheindustry.com
- ELSA: www.elsa-sls.org/
- ILMA: www.LifeMarketsAssociation.org
- BVZL: www.bvzl.de/ (available in German, Spanish and English languages)
- Numerous research reports and whitepapers published by the Insurance Studies Institute can be found at www.Insurancestudies.org.

[4] Insurance News Net, October 2011, A.M. Best Company, Inc.

III – RUMORS – WHAT BDS, REPS AND RIAS ARE SAYING ABOUT INVESTMENTS IN LIFE INSURANCE.

SUMMARY NOTES FOR RUMORS:

NOTES:

"The asset class is risky" Risks are inherent in the asset itself, information used to value the asset, operators purchasing policies and managing portfolios, insurers seeking to avoid payment of policy benefits, investment structures and offerings, and compliance with life settlement laws as well as investment laws. The questions to be answered are: a) How do the risks balance with risks in other investment classes; and, b) How should investors include the risk/reward value and considerations in their portfolios?

"It's the only truly non-correlated asset class [besides catastrophe bonds]." Investments in life insurance policies are generally non-correlated but not perfectly non-correlated. Mortality is the major variable in life insurance policy ownership. While mortality has very low correlation to financial markets, there is some historical evidence that stress of financial disasters have led to premature deaths. Value of life insurance policies can be impacted nominally by how interest rates affect investor return thresholds and direct earnings in the policies. Also capital withdrawal from financial markets in bad times and absence of buyers affects policy valuations. But generally, the economic and financial attributes of life insurance policies have very low correlation with financial markets, enough that it has been classified as a "non-correlated" asset.

"My BD doesn't like life settlements." Many media articles have described life settlements in disparaging terms, referring to them as "Death Bonds." Major life insurers have attempted to undermine investments in life insurance policies … although insurance companies have been some of the major purchasers of life insurance policies in the secondary market. A report by Insurance Studies Institute, "*Portrayal of Life Settlements in Consumer-Focused Publications*," (www.InsuranceStudies.org/Research) reveals how media has negatively impacted the understanding of life settlements and investments in life insurance.

"I've heard reps talk about it but I don't know much." There are many books, white papers, webinars, training classes, conferences, etc. available to learn. Go to these websites:

- www.InsuranceStudies.org
- www.lifemarketsassociation.org
- www.thevoiceoftheindustry.com
- www.elsa-sls.org
- www.bvzl.de

"It's mostly fraudulent." Most of the fraud that has surfaced in this asset class has involved false information when policies were originally issued, false life expectancy reports by devious operators, investment offerings, and advisors making promises to investors based on non-reputable life expectancy calculations. Life settlements are now regulated in 42 states.

"It's sophisticated but simple at the same time." First the simplicity … a policy is purchased, premiums are paid until the insured dies, and a death benefit is collected. But it is not that simple. Investing in life insurance policies requires understanding of mortality curves, health impairments and their impact on life expectancy, analysis and understanding of insurance policy terms, evaluation of insurer solvency risks, and life settlement laws, to name a few. Various investment structures and offerings range from high risk direct policy ownership (in whole or fractional) to indirect investing in corporate debt offerings where the company handles all the policy risks and the investor is insulated from policy management issues while participating in a portion of the earnings spreads.

NOTES:

"There are a lot of mixed messages floating around … I'm curious about the "real" facts of this asset class." There are many bits of disconnected information that have surfaced in the media, statements from people with fragmented knowledge, SEC and FINRA issuing advisories, and insurers resisting investments in life insurance policies, to name a few. Some of the messages are based on very old information from 5-10 years ago, some reflect the 2009 financial market crash, and some tell the story of a maturing and expanding life insurance secondary market. Numerous laws regulating this asset class provide a national and international market infrastructure that helps assure that the asset class is here to stay. Risks range from low/conservative to high/adventurous. The size of the industry shrunk in 2009-2011 to about one fourth of its peak volumes in 2008.

"This is the best thing on the street." Not so fast! Who are the promoters? What laws govern it? Were the life insurance policies acquired as life settlements in the secondary market, or from the tertiary market? What are the characteristics of the policies? Are the projected cash flows reliable? Are the life expectancy analyses independent and from reputable firms? Are the projected yields realistic? Does the portfolio aggregator/manager offer transparency on how they operate, their financials, track records, etc.?

"This seems like mortgage-backed securities." YES in the sense that an investment security in some form of note, fund unit, partnership unit, hedge contract, etc., for which the underlying assets are a financial asset. NO in the sense that life insurance policies are totally different than mortgages and represent materially different risks and returns. Investments in mortgage-backed securities are at full risk when financial markets devalue mortgages based on general market conditions and changing mark-to-market methods. Contrarily, valuation of life insurance policies is based on mortality curves which are not as directly affected by market changes and thus remain more level and predictable.

"I'm not comfortable profiting off people dying." Life insurance investments are about financial arbitrage. It is priced to participate in the high profit margins enjoyed by life insurance companies. Everyone confronts "death" risks every day, most notably pension and annuity providers, health care providers, long-term care providers, reverse mortgage providers, nursing homes, etc. Most of them profit more when their insured or clients die early. Investing in life insurance policies focuses on when the insured dies only when too few policies are held. For example, if only one policy is owned, the investor will be focused on when the insured dies. But if the investment is in a large diverse portfolio of policies, then the investor looks to profit margins based on population mortalities, the same as insurance companies.

IV – WHERE TO OBTAIN INFORMATION

SUMMARY NOTES FOR OBTAINING INFROMATION:

NOTES:

The LISM is a young industry and very few investments have been registered as public offerings. Thus most information is private and most of the information needed for due diligence and discovery will be provided by the Sponsor. There are no well established databases that confidently represent the LISM, no rating of sponsors by the rating firms, no regular and reliable analyst reviews, and no regular industry or government reports. There are industry conferences that, if attended, provide substantial information and opportunity to have discussions with industry stakeholders.

The first and foremost source for information is the investment sponsor, but do not rely exclusively on the sponsor's disclosures and representations. The following are other resources that offer information on the industry and asset class:

The Life Settlement Report, Deal Flow Media: www.lifesettlements.dealflow.com/
The Life Settlement Directory, Deal Flow Media: www.lifesettlements.dealflow.com/directory/
Life Settlement Planning, National Underwriters, Life & Health: www.nationalunderwriter.com/servlet/the-85/Life-Settlement-Planning/Detail
AAP Life Settlements Index, AA-Partners, Ltd., www.aa-partners.ch/go2/en/aaplifeindex/berechnung
Life Insurance Settlement Association publications, www.thevoiceoftheindustry.com
International Secondary Market for Life Insurance, website by BVZL, www.bvzl.de/ (German, Spanish and English)
European Life Settlement Association, website by ELSA, www.elsa-sls.org/
Securitization of Period-Certain and Life-Contingent Structured Settlements, 2011 by A.M. Best, www.ambest.com/ratings/methodology/StructuredSettlement.pdf
Life Settlements Securitization, 2009 by A.M. Best, www.ambest.com/debt/lifesettlement.pdf
FINRA investment advisories, www.finra.org/Investors/index.htm
Numerous in-depth articles and research reports by ISI, www.InsuranceStudies.org
Search the Internet for "life settlements," Focus on links dated within the past 12 months.
Major recurring Life Settlement Conferences:

The Life Settlement Conference, by Deal Flow Media
Life Settlements & Longevity Investments Summit, by IQPC
Annual Life Settlement Conferences, by Life Insurance Settlements Association
Fasano Life Settlements Conference, by Fasano Associates

V – EVALUATING THE INVESTMENT MANAGEMENT

SUMMARY NOTES FOR INVESTMENT MANAGEMENT:

NOTES:

Fundamental due diligence and discovery applicable to all investments are applicable to investments in life insurance, and those who exercise thorough due diligence and discovery are more likely to be on the winning side of investments. The first task is to “know who you are doing business with.” The following documents and information should be requested from the life insurance investment sponsor. Typically most of this information should be pre-prepared and offered by the sponsoring company.

1. **Learn the Sponsor’s general corporate background.**
   a. A “Certificate of Good Standing” from the Secretary of State of the state where the company is incorporated, plus articles, bylaws, operating agreement, and limited partnership agreement, as applicable.
   b. Background of the investment sponsor including an operating history which can be provided in a comprehensive corporate resume. If any information appears unusual or inconsistent, ask for in-depth explanations.
   c. Organizational chart and list of major or dominant shareholders with number of shares held by each. Also ask for information related to options, voting trusts, warrants, puts, calls, subscriptions, and convertible securities, i.e., any such arrangements that can change control of the company.
   d. A list of all states where the company is authorized to do business. Ask for disclosure of any violations for which the company has been cited within last three years.
   e. Resumes of key management and copies of their employment agreements.

2. **Understand the Sponsor’s financial situation.**
   a. Audited financial statements for the past three years including the auditor's reports, plus unaudited reports with comparable statements of the previous year and most recent quarters.
   b. Detailed explanation of all major financings and indebtedness that materially affect the company’s operations, plan of business and solvency.
   c. Analyses of financial projections, capital budgets, strategic plans, fixed and variable expenses and gross margins.
   d. The company's credit and analyst reports.
   e. A description of the company's internal control procedures.
   f. A schedule of fixed assets and their locations, including sales and purchases of major capital assets during the last three years.
   g. Reports of all disputes with government regulators for the last three years.

3. **If the investment offering is dependent on the sponsor’s ownership or rights to unique “Intellectual Property,” seek the following:**
   a. A schedule of all unique intellectual property that is critical to the continuation and success of the investment offering.
   b. Description of risks that may cause availability of the intellectual property to cease and the affects if the property ceases to be available.
   c. A description of important and unique technical know-how and methods used to protect trade secrets and knowhow.

NOTES:

4. **<u>What and who are the Sponsor's material contracts and servicers</u>?**
   a. A schedule of all subsidiary, partnership, or joint venture relationships and obligations.
   b. All other material contracts that may affect the offering, e.g., sources of life insurance policies, and third-party servicing.
   c. A schedule (including contact information) of all banks, trust firms, escrow services, law firms, accounting firms, consulting firms, and similar professionals engaged by the company.

5. **<u>Understand all of the Sponsor's product and/or service lines, and how they affect the offering</u>.**
   a. Reports related to regulatory approvals or disapprovals of the company's products or services
   b. Results of all tests, evaluations, studies, surveys, and other data regarding existing products or services and products or services under development.

6. **<u>What is going on with customers and are they happy</u>?**
   a. Reports of customer complaints, claims and lawsuits for the past three years. All surveys and market research reports relevant to the company or its products or services.
   b. The company's current advertising programs, marketing plans and printed marketing materials.

7. **<u>How do the Sponsor's competitive advantages stack up?</u>**
   a. Industry Experience
   b. Operational Platform
   c. Origination and Underwriting Practices
   d. Origination Relationships
   e. Life Expectancy Methodology
   f. Pricing Software and Methodology
   g. Closing checklists and transaction document preparation and packaging
   h. Diversification of Funding
   i. Availability of Credit Facilities

8. **<u>Identify and understand all litigation issues.</u>**
   a. Request a schedule of all pending litigation.
   b. Ask for descriptions of any threatened litigation.
   c. Get descriptions (but preferably document copies) of injunctions, consent decrees, or settlements to which the company is a party.
   d. A list of unsatisfied (outstanding) judgments and understand their ramifications relative to the company's continuing operations and the offering.

9. **<u>Articles and public relations published on the Sponsor can reveal successes, opportunities, communication prowess, damage control and issues.</u>**
   a. Copies of advertising and marketing articles relating to the company within the past three years.
   b. Press releases and clippings announcing actions of the sponsor company.
   c. Look for endorsements and issues within independent analyst reports.

10. **<u>Research independent and third party sources for information is critical to assure an objective view.</u>**
    a. *<u>SEC</u>*. If the sponsor or the offering is registered with the SEC, check current status and recent public reports.
    b. *<u>FINRA</u>*. Ask if the offering has been approved regarding advertising materials and selling broker/agent fees.
    c. *<u>State insurance commissioners</u>*. Ask if the sponsor or the offering has any known issues and have any complaints been filed.
    d. *<u>State securities commissioners</u>*. Ask if the offering is in compliance with Blue Sky laws. Also ask if the sponsor or the offering has any known issues and have any complaints been filed.

NOTES:

e. *Audit reports*. In addition to fundamental financial questions, look at the cover letter and footnotes for comments about the sponsor's solvency, changes in accounting practices, compliance with critical financings, etc.
f. *Industry trade associations*. LISA (Life Insurance Settlements Association), ELSA (European Life Settlement Association), ILMA (Institutional Life Markets Association). Verify the sponsor's membership, active involvement, leadership, and whether they are members in good standing. Also ask the associations if they are aware of any issues related to the offering that is being considered.
g. *Litigation searches*. If you do not have access to a legal search engine, ask your legal counsel to do it for you. Look for past and pending litigation involving the sponsor.
h. *Lender references*. Ask the sponsor for contacts at its major lenders and call them. Ask lender if the loans are in good standing or in default. Ask the lender when the financing arrangement comes up for renewal. Ask lender if it knows whether or not the sponsor's financing facility will be renewed.
i. *Reports of independent investment researchers*. Ask the Sponsor for contacts at all firms that have provided independent research and analysis of the sponsor and/or the investment offering. Ask the research firm for a copy of its report and look for disclosures of risks identified by the research firm.
j. *Media articles.* Media articles are an excellent source for insights to potential problems and can be found on the internet, Wall Street Journal, and trade publications. The articles may discuss current events that relate to the sponsor but more likely to the investment class and/or the type of investment offering. Whatever issues are identified, present them to the sponsor for comprehensive answers.
k. *Independent background checks* on the Sponsor's senior and critical management can reveal prior successes and/or issues.

VI – OVERVIEW OF LIFE INSURANCE INVESTMENT STRUCTURES

SUMMARY NOTES FOR LIFE INSURANCE INVESTMENT STRUCTURES:

As of spring 2012, numerous investment structures and offerings have been introduced within the life insurance investment asset class. The following schedule attempts to provide a brief synopsis of each but does not endorse any, does not represent all possible structures and does not represent full disclosure information for any of them. ***For practical purposes, except where one individual purchases one entire policy, all investments in life insurance policies should be considered a security, and investment in any fractional ownership of a life insurance policy should be considered a security.***

NOTES:

STRUCTURE	DIRECT/INDIRECT POLICY OWNERSHIP	Risk Exposure	OPEN CLOSED ENDED
Full ownership of large and/or multiple portfolios with 300+ policies	Direct policy ownership	Full exposure to statistically diversified risks	Closed
Full ownership of small portfolio or one policy	Direct policy ownership	Full exposure to statistically non-diversified risks	Closed
Partnerships/Closely Held Trusts	Generally direct ownership but some might be indirect	Depends on structure and if 300+- policies are held	Closed
Unit Trusts	Generally indirect ownership but some structures might be direct	Depends on structure and if 300+- policies are held	Closed
Foreign Mutual Funds	Indirect	No direct exposure and most are 300+ portfolios	Open
Fractional Policy Interests	Direct policy ownership	Generally full exposure to statistically non-diversified risks	Closed
Debt/notes/bonds backed by policies	Indirect	Depends on structure and if 300+- policies are held	Depends on structure
Debt/notes/bonds backed by Company	Indirect	No direct exposure, but check if 300+- policies are held	Depends on structure
Stock of Company	Indirect	No direct exposure, but check if 300+- policies are held	Open
Synthetic mortality risk contracts	Contractually determined	Contractually determined	Closed
Longevity Hedges	Contractually determined	Contractually determined	Closed
Irrevocable beneficiary contracts	Contractually determined	Contractually determined	Closed
Beneficial interest units	Contractually determined	Contractually determined	Closed
Policy option contracts	Contractually determined	Contractually determined	Closed

VII – UNDERSTANDING THE INVESTMENT OFFERING

SUMMARY NOTES FOR THE INVESTMENT OFFERING:

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Understanding the life insurance investment offering begins with due diligence and discovery, including both top-down and bottom-up analyses to determine if a prospective investment meets the investor's objectives. This typically involves both quantitative and qualitative analyses of the sponsor's business operations, management style and processes for the investment assets, and an assessment of the effect the investment would have on the investor's overall portfolio. Often this requires on-site front office and back office reviews as well as reviews of the key legal, tax and compliance issues.

The investment decision-making process can take on a variety of approaches and procedures. Large investors often have very sophisticated and well-established policies and procedures to identify and select alternative investments, which incorporate quantitative and qualitative analyses, dedicated teams, comprehensive due diligence questionnaires, and formal review and approval processes. Some rely on third parties to perform pre-investment due diligence. Others rely on professional investment managers to resolve all investment decisions. Unfortunately, most individual investors have to rely on investment advisors, broker-dealers, CPAs, attorneys, and others for investment discovery, due diligence, and advice. Discovery and due diligence should continue after an investment is made. In addition to an ongoing analyses of investment results and risk/return objectives, post-investment monitoring Involves ensuring that the investment management and the investor's advisor maintain adequate controls, systems, policies and procedures.

Ongoing investment monitoring is necessary and requires continued access to the investment's management for information on performances and risks. Unfortunately, ongoing full transparency of the underlying investment life insurance policies may not be available. For example, hedge funds have historically been reluctant to provide such information. Nevertheless, a broad view of transparency will include all forms of information and a variety of activities to obtain information, including:

1. Watch for changes in cash distributions, calls for investor cash contributions to pay premiums or other cash flow irregularities.
2. Conduct periodic interviews including on-site visits with the investment management to update understanding of management's strategies, life insurance policy purchasing, risk exposures, key performance drivers, etc.
3. Ask about changes in the valuation of life insurance policies and monitoring procedures.
4. Ask about changes in the life insurance portfolio, e.g., number of policies added, policies sold, changes in purchase criteria, etc.
5. Compare the investment performance to benchmark returns, peer groups and/or historical returns, to the extent applicable, to determine if the return is reasonable.
6. If the sponsor operates more than one investment offering or multiple life insurance portfolios, compare valuation practices across all sets of assets to identify differences in methodologies or key inputs. Look for intra-account transfers, debts/credits, shifting of assets, and changes in which life expectancy reports are used to value policies.
7. Study periodic investment reports and letters, including performance and risk statistics, and other information related to leverage exposure, large concentrations, etc.

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8. Obtain and review annual audited financial statements and quarterly or semi-annual unaudited financial statements, to the extent available. For audited financial statements, note whether the opinion is qualified and, if so, why. Also note whether there is a change of auditors, a change in valuation policies, a major change in the amount of adjustment from GAAP to non-GAAP values used for the investment assets, or other unusual disclosures associated with related party transactions or otherwise.
9. Review press reports for significant management changes, ownership changes, legal developments, major achievements, and personnel developments. When key personnel changes occur, consider making background checks, ask for references, and search the FINRA and SEC websites if the investment sponsor is regulated.
10. Review the Schedule K-1 for each investment fund taxed as a pass-through entity, e.g., limited partnership or limited liability company, to determine if it has resulted in any major tax considerations.
11. For hedge funds, inquire and understand movements to/from “side pocket accounts” and related valuation changes for “side pocket investments.”

VIII – FINDING CRITICAL ANSWERS

SUMMARY NOTES FOR CRITICAL ANSWERS:

NOTES:

The amount of transparency that the investment sponsor is willing to provide is the first benchmark in determining if the investment is worthy of consideration. This chapter identifies in detail the information that should be made available and should be evaluated for each life insurance investment that is considered.

1. **Is the Sponsor and the offering in regulatory compliance with the SEC, FINRA, and state Blue Sky laws?**
   a. If the Sponsor or the offering is registered and reporting with the SEC, go to EDGAR.com and search for all reports for the Sponsor and/or the offering. Look for disclosure of issues, non-compliance, late reports, changes in the business or offering, etc.
   b. Contact FINRA to ask if any complaints or reports exist on the Sponsor.
   c. To determine if the offering has been properly registered under Blue Sky laws, if necessary, in the state where the offering is being sold, contact the respective State Securities Commission office.
2. **Review audit and financial reports specifically covering the investment offering**. Look for three years of trends in earnings, cash flows, solvency ratios, and debt coverage ratios.
3. **Security of investor money.** If investor capital is invested in corporate bonds or stock, or in partnership interests, the company or partnership will hold and manage all investor money. However, if investor capital is invested in direct ownership of policies or in unit investment trusts or other structures where investor capital flows into direct ownership of policies, find out who holds and manages the money for the investors. Does the sponsor company hold it or is it held by an independent third party firm, thus separating it from risks of the sponsor's operating business?
   a. *Controls on use of money:* If investment funds are restricted to specific uses, who and how is use of the money controlled?
   b. *No commingling:* If the Sponsor is selling multiple direct policy investments (multiple funds, multiple policy interests, etc.) what steps are setup to assure that money from investor A is not commingled with money from investor B.
   c. *Reports of usage to investors:* Does the Sponsor provide periodic reports showing the usage of investor funds? Do the reports provide analysis of cash used versus budgets and projected uses?
4. **What are the life insurance policy purchase practices and purchase controls.** Understand the purchase criteria used by the sponsor:
   a. Insurance policy selection criteria:
      i. Permanent life insurance, term life insurance, contestable policies, whole life, universal life, variable universal life.
      ii. Minimum and maximum face value of policies.
      iii. The life insurance policy does not have a provision limiting payment of death benefits other than for non-payment of premiums.
      iv. Minimum and maximum life expectancies.
      v. Minimum and maximum age of the insured.
      vi. Acquisition of the original life insurance policy was in compliance with all restrictions or obligations imposed by applicable laws.
      vii. The life insurance policy is in full force and effect.
      viii. The policy is not regulated by any state that prohibits the purchase or transfer of ownership of such life insurance policy.
      ix. The life insurance policy provides for a level death benefit through the entire life of the insured.

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x. The life insurance policy is not purchased in a jurisdiction where the transfer of such life insurance policy is subject to the payment of sales or other taxes except where such sales or other taxes have been paid.
xi. The life expectancy report concluded that the insured is not HIV positive or has not been diagnosed as having AIDS.
xii. The life insurance policy meets such other criteria as the Sponsor may determine from time to time.

b. If premium financed policies are purchased, request explanation of: the criteria used; assurance that the policy insurable interests are valid; risk of insurers challenging payment of death benefits.
c. What steps does the sponsor undertake to identify prior policy owners, i.e., is it possible for prior policy owners to give cause for an insurable interest issue? Is the policy purchased in the secondary market or tertiary market, and does that matter?
d. Range of insurer ratings, i.e., are any below investment grade ratings and if so, do these represent risks of insurer defaults, changes to policy premiums and servicing charges, etc.

5. **Who monitors and services the policies?** Holding life insurance policies as an investment requires someone to: a) assure that the correct premiums are paid in a timely manner; b) accept and follow-up on notices from insurers that announce information that may impact specific policies; and, c) assure that title to the policies remain intact and are defended if the insurer challenges their obligations on the policy. Finally, it is necessary to track the insured and determine when mortality occurs, get the death certificate and file for the policy benefits. Some companies handle some or all of this in-house and some out-source this to third party firms, such as banks, trust companies, CPA firms and others specialized in such services. Find out how this is done to assure continuity of servicing if the sponsor company fails.
6. **Who provides life expectancy estimates? Is it internal or external?** Life expectancy reports represent a range of probabilities for the insured's mortality against a group of cohorts with the same age, sex, and smoking status. These mortality probabilities represent a mathematical curve known as a mortality curve, which is then used to generate a series of expected cash flows from the life insurance policy over the expected lifespan of the insured. A discount rate is used to calculate the net present value of the expected cash flows. The discount rate represents the internal rate of return the Sponsor expects to earn on investments in a policy or in the portfolio as a whole. Historically the accuracy and objectivity of determining the life expectancies of the insured has been a major issue within the asset class. Several established firms within the life insurance secondary market specialize in evaluating medical records and providing written estimates of life expectancy of insured individuals. The major and most reputable firms include: 21st Services, AVS Underwriting, ISC, EMSI and Fasano Associates. There are others that also provide such services with some highly specialized and focused in their technologies. No one can have a perfect record because it is not possible to determine exactly when a person will die. These firms use various techniques ranging from statistical quantification of data to subjective reviews by experienced medical professionals. A primary issue to identify is the risk of the Sponsor to surreptitiously obtain short life expectancy estimates that result in unrealistically high investment return projections designed to attract investors.
7. **What are the contingent plans if something goes wrong?** First, try to identify what might go wrong, e.g., financing arrangements cease, mortalities are materially past the estimated life expectancies, critical management depart, the investment offering fails to raise the target amount of capital, regulators shut down the operation, a hurricane wipes out the operations, etc. How will management of the investment be continued?
8. **Is the investment exposed to STOLI?** STOLI are "Stranger Originated Life Insurance" policies which are illegal in most states. There have been promotions by life insurance agents and financing companies to sell life insurance policies pursuant to an arrangement where the finance company owns the policy but has no legal "insurable interest" in the insured's life. Typically it has been the intent of such financing firms to sell the policy in the secondary market for a profit after the legal contestability period has expired. Whether or not a policy issued in such an arrangement actually has in insurable interest has been tested in various states with mixed results, i.e., it seems to depend on whether or not the policy was factually subject to a predetermined agreement or if the insured only had an intent to transfer the policy to the financing firm. If an actual agreement did not predate the

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policy issuance, then it is not a STOLI. However, this issue is vague and subject to insurer challenge. Investing in such policies may offer higher returns but may also incur greater risks.

9. **Is the investment exposed to "wet" policies?** Wet policies are those that are within their legal contestability period. All states have established a window of time during which insurers may verify information provided by the insured in the policy application, e.g., the insured's net worth, medical records, family facts, etc. If such information is found to be incorrect, the insurer may rescind the policy or change its structure. Most state contestability periods are two years. Life insurance policies bought in the LISM during this period are considered "wet policies." Purchase price of such policies may be lower and yields higher, but risk of losing the policy or realizing lower yields are greater.
10. **What is the exposure to potential insurer challenges on payment of death benefits?** The life insurance industry has resisted the life insurance secondary market by waging negative media campaigns, legislative lobbying, onerous pressure on their life insurance sales agents, lobbying to the SEC, FINRA, state securities commissioners and state insurance commissioners, and by pursuing litigation to avoid payment of death benefits. It is the litigation that can adversely affect investment yields. All litigations have focused on claims that the original policy application contained fraud and/or failure of the policy owner to demonstrate an insurable interest in the life of the insured. Either argument is valid ground for the insurer to void the insurance policy; however, the issue is can the insurer claim such argument after the initial policy contestability period. Some courts have concluded "yes" and some "no." It varies from state to state. The sponsor of an investment offering should disclose steps that are taken to avoid purchasing of policies that may be vulnerable to such litigation risks.
11. **Understand the funding for payment of premiums and policy servicing.** Maintaining the policies in good standing is essential to assure that policies do not lapse. Some companies will do this in-house and some outsource to third party servicers. The critical issue is to assure that funding is sufficient to pay policy premiums and servicing until the mortality of the insured. If for any reason funding is insufficient, what is the arrangement and plan to obtain additional funding. Will the sponsor call upon investors to ante-up more money? Does the Sponsor have other resources to assure payment of premiums and servicing? What is the probability that existing funds will be insufficient? The Sponsor should provide clear answers to these questions.
12. **Where do the sponsor, lenders, and investors stand in the water-fall?** As policies mature and benefits are received, where does the money flow and who stands in what order of payment? The issue is whether the Sponsor stands to receive material profits before the investors, on a par with investors or after investors receive their investment and profits?
13. **What is the exposure to life expectancy (LE) error, and how is such error mitigated?** LE error can occur in four aspects: a) mistakes in the insured's medical records, b) errors in the evaluations provided by the life expectancy estimators, c) utilization of mortality tables that do not fairly represent the senior population, and d) changes in living practices and medical advances that extend longevity. The issue is what steps has the Sponsor taken to minimize risk of such errors, including: a) relying on LE estimating practices that have proven records of accuracy, b) staying informed on new developments including new mortality tables that may be more representative of the senior population that sells life insurance policies, and c) anticipating mortality improvements in its projection of portfolio mortalities.
14. **What are the sponsor's daily operating processes, staff meetings, reviews, oversight, buy decisions, etc?** Knowing how the Sponsor routinely manages its business and how it controls decisions can reveal potential risks, e.g., is the Sponsor sufficiently reviewing the policy cash flows to know well in advance if and when more money will be needed to pay premiums. How does the Sponsor review policy purchases to assure compliance with represented purchase criteria? What procedures does the Sponsor use to assure compliance with applicable regulations?
15. **Probability and stochastic analysis of cash flows, returns, breakeven.** These analyses are the primary considerations for evaluation of the risk that the investment will payback a reasonable return, or not. They are complex and will vary substantially among investment offerings.
16. **Longevity Risks.** The paramount risks associated with life insurance investments are longevity risk and underwriter error, with longevity defined as the risk of the insured living longer than the estimated LE. Because longevity risk is the single largest variable affecting the return on life insurance investments, the number of insured

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lives represented in a life insurance investment determines the volatility to longevity risk. It is essential to understand that most life expectancy estimates represent the point at which there is a 50% chance of having died, or 50% chance of continuing to live. A person with a 72 month LE could have a life duration of 144 months or longer. Plus, there is the chance that medical treatments and advances can extend the insured's life. Based on statistical analyses of A.M. Best[5] and Insurance Studies Institute,[6] the following guidelines should be considered:

a. *Small portfolios and investments in a few individual or fractionalized policies.* If one or only a small portfolio of policies are purchased in the investment, whether whole policies or fractional interests, vulnerability to longevity volatility will be at the highest level. This high risk can be ameliorated by factoring in arbitrary extensions to LEs, sponsor guarantees of returns to investors, or other techniques that need to be transparently described and that are reasonable.
b. *Investments backed by large portfolios*? Portfolios having 300-400 or more insured lives start to show stability in longevity volatility, and beyond that, improvements in stability measurements become incrementally smaller as portfolios expand. For such portfolios, the question is: "How have actual cash flows compared to projected cash flows, i.e., have the projected mortalities and premium costs been reasonably accurate?" If the number of insured lives are not yet in the portfolio, what hurdles and risks may delay fulfillment of the portfolio and how may this affect expected yields?

17. **How are policies and portfolios valued (GAAP, non-GAAP, Mark-to-market)?** Verify the steps used to value individual life insurance policies. If the investment is in a portfolio of policies, verify the steps used to value the portfolio and how often is the value updated. Is the valuation based on "hold to maturity," "trade it in the tertiary market," or "liquidation?"
    a. <u>*Valuation of individual life insurance policies*</u> for purposes of investment should include at least the following steps and considerations:
        i. Evaluation and validation of medical records used to create the life expectancy reports.
        ii. Evaluation of at least two professionally prepared (ideally by independent providers) life expectancy reports, including reasonable procedures to resolve extreme differences in the reports, e.g., get a third report, average the reports, elect to use one of the reports for a rational reason, ask for a report to be redone or justified, rejecting the policy.
        iii. Obtain a current insurance policy illustration, policy status report from the insurer, original policy application signed by the person that originally purchased the policy, original or certified copy of the policy, and record of all subsequent policy owners.
        iv. Evaluate the insurer's financial ratings and their practices with regard to life settlement transactions.
        v. Evaluate the financial or other life/business circumstances used to justify the original face amount of the policy, i.e., look for fraud.
        vi. Validate all information provided by the policy seller and insured.
        vii. Adjust life expectancies and policy illustration to current valuation or projection date, noting all changes and assumptions used to establish the current profile of the policy and insured.
        viii. Determine an appropriate mortality table to use in the pricing of the policy.
        ix. Enter all current profile data into a pricing model that considers the selected mortality table, policy illustration data as adjusted if needed, and resolved life expectancy. The model should calculate probable future cash flows based on the mortality curve and optimized premiums calculated on projected monthly cost of insurance. A variety of acceptable models exist, but be wary of any pricing model that assumes payment of premiums for the life expectancy months plus some factor on the expectation that the insured will die on or before that point in time.
        x. What determines the discount rate that is applied to the model to calculate the present value of the policy? Does it include cost of funds, target yields/spreads, market competitiveness, risk premium, etc?

[5] "Life Settlement Securitization," 2009, A. M. Best Methodology
[6] "The Effect of Life Settlement Portfolio Size on Longevity Risk," 2008, Insurance Studies Institute

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xi. What policy stress testing is done, e.g., target yields, longevity risks, policy earnings, premium certainty, cost of money, mark-to-market discount rate adjustments, market-to-market future liquidation values?

If the above steps and considerations are not used by the investment management, alternative procedures need to be described and be reasonable.

b. *Valuation of life insurance policy portfolios* for investment purposes should include at least the following steps and considerations:
   i. Periodic updates of not less than annually.
   ii. Checking of mortality records, obituaries and Social Security Death Index for deaths of any insured in the portfolio, and remove all policies of deceased from the active insurance policy portfolio.
   iii. Contacts with all insurers for policy updates and determination if new policy illustrations are needed.
   iv. Age adjustment of life expectancies to current date; otherwise, obtain new medical records and new life expectancy reports.
   v. Update probable cash flow projections based upon premiums, policy earnings, and recalculated mortality curves for all policies in the portfolio.
   vi. Review and update insurer ratings.
   vii. Evaluate concentrations, e.g., exposures to insurers, medical impairments, and other concentration limits that are designed to maintain balanced risks in the portfolio.
   viii. Establish an appropriate discount rate to be used in the portfolio valuation calculations.
      1. Hold to maturity: Current discounts and trend of discounts used for policy purchases from sellers in secondary market, competitive activities, general business and economic trends.
      2. Plan to trade: Same as Hold to maturity, plus seek discounts used in other traded portfolios within past 12 months.
      3. Liquidate: Seek discounts used in other liquidations where portfolios and policies are similar within the past 12 months.
   ii. Application of valuation models, e.g., MAPS or equivalent, with all policy data to calculate a portfolio present value.
   iii. Verify that the portfolio's audit firm accepts the valuation methodology.

If the above steps and considerations are not used by the investment management, alternative procedures need to be described and be reasonable.

18. **Investor suitability standards?** The investment sponsor should provide guidelines describing suitability of the investment for various classifications of investors.

19. **What hedging arrangements are utilized to reduce risks?** How is this expected to benefit investor returns and risks? Various methods for hedging investment risks in life insurance policies have been structured and tried, but because most are expensive and result in reduced investment returns, most investment offerings rely on management skills to manage risks. Typical hedging arrangements to look for include: insured payments or buyouts at certain future dates, e.g. the LE date; indemnity and parametric swaps where risk of extended longevity is swapped with another party betting on shorter longevity; and, mortality indexes where a counter risk of longevity can be purchased pursuant to a mortality index based on a large portfolio of cohort lives.

IX – EVALUATION OF RISK FACTORS AND CONFLICTS OF INTEREST

SUMMARY NOTES FOR RISKS AND CONFLICTS:

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There are a number of general risk factors applicable to investments in life insurance policies including, but not limited to, a lack of liquidity and an immature resale market, uncertainty of life expectancy estimates, life expectancy extensions, insurer default, tracking insureds, fraudulent policy issuance, and former beneficiaries contesting the legality of the settlement. The sponsor should provide a comprehensive disclosure of all potential risks and conflicts of interests, regardless of how remote any risk may be perceived. In addition consider the following:

1. *Financial Stability of the Sponsor.* What is its operating history? Has it achieved stable net income? What is its equity? To what extent will these fluctuate in the future and how do these variables impact risks to investment?
2. *Condition of the Life Insurance Secondary Market.* To what extent is the sponsor's business dependent on the life insurance secondary market? The development of the secondary market will be impacted by a variety of factors such as the interpretation of existing laws and regulations, the passage of new legislation and regulations, mortality improvement rates, and actuarial understandings and methodologies, all of which are out of the sponsor's control.
3. *Actuarial Stability.* Rating agencies generally suggest that portfolios of life insurance policies be diversified enough to achieve actuarial stability in receiving expected cash flows from underlying mortality. For instance, in a study published in 2009, A.M. Best concluded that at least 300 lives are necessary to achieve actuarial stability.
4. *Continuity.* Can the sponsor maintain the investment structure and service all obligations to investors?
5. *Dependency on Credit Facilities.* If the sponsor or investment relies on a credit facility, will such facility be continued, renewable, and at what cost? If such facility is not maintained, what happens to the assets and to investor returns?
6. *Impact of Increasing Interest Rates.* Similar to bonds, life insurance policies are fixed-income assets. As interest rates rise, the value of policies held will decline because investors can purchase different assets with higher rates of return. Should the sponsor be forced to sell its policies in an environment of increasing interest rates, the policies would likely be sold at a discount. In addition, if the sponsor's business or the investment uses leverage, increasing interest rates may increase the cost of such debt and decrease proceeds available for operations and for investment returns.
7. *Exposure to Longevity Volatility.* Most life insurance policies are acquired based upon life expectancy predictions made by third-party life expectancy providers, which typically are not guaranteed. Life expectancy estimates are subject to the risk that the medical information is inaccurate, or that an unanticipated medical breakthrough will improve treatment of a condition or disease and result in lower mortality rates than previously expected. In either case, if an insured lives longer than anticipated, the policy will have to be supported for a longer period of time before the related death benefit is paid, resulting in lower yields if the investment has direct ownership in the policy, or higher risk the fewer cash flows will be available to pay returns to investors.
8. *Stability of Mortality Tables*. In 2009, the Society of Actuaries published a 2008 Valuation Basic Table with substantially revised information concerning the longevity of American citizens. As a result, several of the leading life expectancy providers revised their mortality tables to reflect the increase in life expectancies. If mortality tables were to be revised again in the future, such increase might indicate that all existing life expectancies are understated and that the insured should be expected

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to live longer, resulting in lower investment returns and even risk of investment failure if extended payment of premiums could exhaust the sponsor's ability to keep policies in good standing.

9. *To What Extent is the Sponsor Reliant on Third Party Services and Systems*? Changes in such arrangements, services and systems can be disruptive to the sponsor's operations.
10. *Are There Any Known Exposures to Litigation Risks*? Undertake an entity/management litigation search.
11. *Reliance on Key Personnel.* What is the vulnerability of key personnel to leave and what may be the impact of such terminations?

Additional risks considerations that may or may not be applicable.

1. Material changes in the life insurance secondary market, a relatively new and evolving market, may adversely affect future performances, business prospects and ability to repay obligations.
2. Operating history of the Sponsor or the investment structure may be unproven.
3. The valuation of the life insurance assets may involve material assumptions that may ultimately prove to be incorrect.
4. If actual portfolio results do not match expected results, the Sponsor and/or the investment structure may be adversely affected, servicing may be disrupted and growth stymied.
5. If debt financing is required by the Sponsor or the investment structure, the inability to borrow could adversely affect performances.
6. Investments in life insurance policies have inherent risks, including fraud and legal challenges to the validity of the policies.
7. Purchasing of life insurance policies necessarily requires material reliance on information provided or obtained by third parties. Misinformation or negligence can materially and adversely affect the value of the policies purchased.
8. The LISM is subject to laws and regulation in most states. Changes in state laws and regulations governing the LISM, or changes in the interpretation of such laws and regulations, could negatively affect investment performances.
9. If federal or state regulators or courts conclude that the purchase of a life insurance policy from a seller in the secondary market constitutes a transaction in securities, availability of policies could decrease, costs of purchases could increase and operating costs could increase. The materialization of such risks could adversely affect investment performances.
10. Fundamental changes, lack of growth or increased competition in the life insurance secondary market may adversely affect the ability to purchase policies, increased the prices paid for policies and decrease liquidity of portfolios, all resulting in reduced investment yields and performance.
11. Changes in general economic conditions, including, for example, interest rates, investor sentiment, changes specifically affecting insurance industry, competition, technological developments, political and diplomatic events, tax laws, and other factors not known today, could substantially and adversely investment performances.
12. If hedging activities are utilized, market changes and interest costs could adversely affect the ability to put hedging contracts in place, resulting in material increases in investment risks.
13. If actuarial assumptions and estimates, whether obtained from third-party providers or created by the Sponsor, used to establish investment projections and expectations prove to be incorrect, investment performances could be materially adversely affected.
14. If the actuarial assumptions used when valuing life insurance policies and forecasting the performance of the policies, including estimates derived from statistical methodologies for projecting future cash flows, prove to be incorrect, it could materially and adversely affect the investment results.
15. If the investment offering is unable to raise the capital planned for the business undertaking, the Sponsor may be unable to meet its overall business objectives.

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16. Success or failure of the Sponsor's parent company and/or subsidiaries, and contractual restrictions on distributions or adverse events at a related company could materially and adversely affect the Sponsor's financial viability and solvency.
17. Provisions contained in financing arrangements may limit access to needed funds, prevent distributions to investors and/or create illiquidity in the investment structure. For example, if the value of a life insurance policy portfolio decreases below a threshold in the financing terms, the financing entity could usurp priority of assets otherwise securing or planned for servicing of the investment.
18. If a significant number of investors concurrently demand liquidity, assuming such demands are allowed, repayment of those demands may be limited by funds available at the moment, and/or may require liquidation of life insurance assets at distressed values, thus reducing the value of the investment.
19. If the Sponsor intends to hold its life insurance policies to their maturity and therefore relies on the accuracy of its cash flow projections, delays in policy maturities can materially adversely affect cash flows resulting in the need to prematurely liquidate the policies at distressed values.
20. If the Sponsor intends to purchase and resell life insurance policies in the tertiary market at a profit, its business model can be materially adversely affected by availability of other investor capital, mark-to-market valuations, cost of such trades and cost of holding such policies until sold.
21. If the investment is in a Sponsor that intends to fractionalize individual policies into multiple ownerships and sell those fractionalized interests to individual investors, its business model can be materially adversely affected by: a) availability of policies in the market to purchase at attractive prices, b) the ability to re-price the policies for individual investors such that the Sponsor realizes its target profit margins, c) the ability to find individual investors to purchase the fractionalized interests, and d) its compliance with securities laws.
22. If the investment is in fractional policy ownership the investor is exposed to several major risks, including: a) holding only a few such interests and thus being materially exposed to longevity risks, b) availability of money to continue premiums and servicing costs if the insured lives longer than the projected investment return period, c) separation of money such that investor funds are used only for the investor's policies, and d) what happens if more money is needed and investors of the other fractional ownerships in the policy refuse to contribute their share of assessments.
23. Fraudulent transfer statutes may limit the investor's rights in the event the Sponsor is found to be insolvent.
24. If an investor seeks to sell its investment, there may not be an market available for such a sale.
25. Changes in tax laws, even if the life insurance policies are held in a tax treaty country, can adversely the tax on policy maturities and on distributions to the investors.

GLOSSARY OF TERMS FOR LIFE SETTLEMENTS AND LIFE INSURANCE INVESTMENTS

Accelerated Death Benefit: If the insured has a terminal illness, the policy advances a specified part of the death benefit to pay medical bills or other expenses, which the amount is subtracted from the ultimate paid death benefit.
Accidental Death Benefit: A provision or rider that promises to pay more (usually double) if death occurs by accident. Also known as double indemnity.
Accumulation Value: (See Cash Value)
Actuary: A mathematics expert who applies probability theory to the business and risks of life insurance and is responsible for calculating premiums, policy reserves and other values.
Administrative Fee: Charges by insurers for the administration of policies, generally is deducted from policy cash values.
Age at Issue: Policies are approved and issued on a specific date. Insurers generally use the nearest age or last age of the insured to determine the insured's age as of the issuance date.
Agent: (See Life Insurance Agent and Life Settlement Agent)
Annual Renewable Term Insurance: A type of term life insurance that offers a guaranteed rate for one year. Each subsequent year, the policy renews at a higher rate based on the insured's next age. At older ages the price of annually renewable term can become cost prohibitive.
Application: A form provided by the insurer to obtain an individual's declaration of personal, occupation, financial, and avocation information. The information provided by the insured (and typically completed by the agent) forms the basis on which an insurance company will make an offer to provide a life insurance policy. The application becomes a part of the legal contract of insurance, and the insurer is generally allowed to challenge the validity of the policy based on misstatements if death occurs within 2 years of policy issue.
Assignment: Giving rights under the insurance policy to someone else. You can assign beneficiary rights or policy ownership.
Automatic Premium Loan: A provision in a policy that authorizes the insurance company to use money from the policy cash value to pay premiums.
Assignment: Life insurance is considered property. Therefore insurance policies are legally assignable to another party in part or in full including all rights.
Assignee: An individual or entity that receives the rights in a life insurance policy assigned by the policy owner.
Attained Age: The current age of the insured as measured from the age at the time the policy was issued.
Beneficiary: The person designated to be paid a death benefit when upon the insured's death. A policy may have one or more beneficiaries, which may be a person, trust, corporation or other entity.
Bid (Appraisal): Offer to purchase a policy
BOLI: Bank Owned Life Insurance
Broker: This is a person who, on behalf of a policy owner and for a fee, commission or other valuable consideration, represents the owner in an effort to obtain the best price and terms for a sale of the owner's life insurance policy to the Life Insurance Secondary Market through licensed Providers. Most states with life settlement regulations require brokers to be licensed. A broker generally excludes an attorney, certified public accountant or financial planner retained in the type of practice customarily performed in their professional capacity to represent the Owner whose compensation is not paid directly or indirectly by the Provider.
Broker-dealer - An individual or company whose primary business activity is the buying, selling or management of securities. Broker-dealers are required to be registered with the NASD and comply with certain SEC regulations.
Carrier - An insurance company or issuer of insurance products. (See also Insurer, Insurance Company)
Cash Value: The excess of premium payments over cost of insurance, accumulated in a cash value account for the policy owner and which earns interest and/or dividends. Typically this amount is available for loans or distribution to the policy owner, but sometimes subject to reductions for fees and obligations due to the insurance company.
Cash Value Policy: A policy that provides a build-up of a cash value, e.g., universal life policy or whole life policy. A cash value policy is a permanent policy versus a term policy.
Cash Value Withdrawal: The amount of a policy cash value that can be withdrawn by the policy owner. The policy death benefit is reduced by amount withdrawn.
Collateral Assignment: Certain rights in a life insurance policy can be assigned to a third party, typically as security for a loan or other transaction. Collateral assignments are generally not made for a specified amount, rather are defined "to the extent that his interest may appear." The assignment is registered with the insurer, and typically the assignee must prove to the insurer the amounts that are owed to it if and when the assignment collection criteria are met.
COLI: Life insurance that is purchased and owned by a company on the life of an employee, typically on executives.
Contestable Period: The period of time, typically two years, during which an insurance company can challenge information on an application for an issued life insurance policy during the first two years after issue, and if found in error, may rescind the policy.
Conversion: Changing a term life policy to some other form of policy, typically a permanent universal life policy. This can be done only when the policy contains a convertible provision.
Convertible Term - A type of term life insurance policy that includes a provision allowing the policy owner to exchange the policy for another type of life insurance policy issued by the same company.
Covered Life - The individual upon whose life is insured under a life insurance policy. The age, gender, smoking and other personal habits, income and medical history of the insured may all be considered in the decision made by the life insurance company as to whether or not to issue a policy. (See also Insured)
Cost of Insurance (COI): An accounting amount an insurer charges a life insurance policy based on the actuarial probability of the insured having died when the charge is made. This is regarded as the real cost of insuring the insured and the excess amount of premium paid above the COI to the insurance company covers the insurer's fees, profits and build-up of the policy account value.
Credit Life: A policy issued to pay off a specific debt (loan for car, furniture, appliances, etc.) upon death of the debtor.
Date of Issue: The effective date of the policy as issued by the insurer.
Death Claim: When an insured dies, the policy owner or beneficiary will provide the insurer with poof of death (including a death certificate) and other information to cause the proceeds of the policy to be paid to the beneficiary.
Disability Waiver: A feature in some life insurance policies that keeps the policy in force and forgives the payment of premiums if the insured is totally disabled.
Death Benefit: The face value, i.e., lump sum of money, that a life insurance policy is obligated to pay beneficiaries upon death of the insured.
Decreasing Term: Life policy for which the death benefit decreases each year.
Dividends: Distributions from life insurance company earnings to policyholders. Typically this is paid into cash value accounts.
Endowment Policy: A cash value policy for which the cash value will equal the death benefit after a specific number of premium payments, and at that time the policy owners may collect the death benefit prior to death. It is like a savings account.
Escrow: Funds held by a third party until the conditions of a contract are met. In a life settlement the amount payable to the policy seller is held in escrow until the transfer of ownership and change in beneficiary are recorded with the insurance company.
Escrow Agent: A state or federally regulated financial institution whose responsibilities typically include accepting investor funds, transferring funds to policy sellers, paying premiums and collecting death benefits for policies where investors are not the beneficiaries.
Endow: A policy will endow when the policy's cash value is equal to the death benefit of the policy. Not all policies are "endowment" policies.
Evidence of Insurability: When purchasing a life insurance policy, the applicant seeking to be insured must provide evidence of their health. The insurer evaluates the information and determines if the risk of

death is insurable. Once a life insurance policy is in force, no further evidence of insurability is required to maintain the policy.

Exclusions: Exclusions are specific events or circumstances where the insurance company has the right to deny an insurance claim. They are always listed in the policy. Common exclusions include suicide within the first 2 years and fraud.

Expense Charge: A monthly charge paid to an insurance company based on various elements of the policy such as insured's attained age, original rate class, etc. Allowable charges are specified in the policy, but at its discretion, the insurer may charge less than the contractual amount as circumstances allow.

Face Amount: (See Death Benefit)

Face Value: (See Death Benefit)

Financing Entity: An entity whose principal business in a life settlement is to provide funds to effect the transaction, and/or who has an agreement in writing with one or more life settlement Providers to finance the acquisition of policies. Non-accredited investors or purchasers may not be financing entity.

Flat Extra Rating: A flat extra rating is an extra charge that is applied to some policies where the insured has very adverse health conditions such as cancer or does hazardous sports or hobbies such as skydiving.

Flexible Premium Adjustable Life: A type of life insurance policy that allows the policy owner to vary the amount of premiums payable, the death benefits and some other components of the policy without having to exchange the policy for a different policy.

Funder: A financing entity, other business entity or person that provides capital to a life settlement provider for the purpose of purchasing a portfolio of life insurance policies as an investment. The term generally does not refer to an investor who invests in life insurance funds, portfolios, partnerships, stock life insurance investment firms or any other such investment.

Financing Transaction: A transaction in which a life settlement Provider obtains financing from a Financing Entity to facilitate the purchase of life insurance policies and investing therein.

First to Die: Provision in a policy that insures both husband and wife, and when the first spouse dies, the surviving spouse collects the full death benefit.

Fractional Interest: This results from the practice of dividing a life insurance policy into multiple ownership units which units are sold to investors.

Fraud: Any knowingly false or incomplete information on an application for an insurance policy, policy claim or sale of the policy. Also, any misrepresentation of a material fact regarding risks in a life insurance investment, such as misrepresentation of what a life expectancy means (see Life Expectancy).

Free Look: A time after receipt of a new policy to review and consider whether to keep it or return it to the insurer.

Grace Period: The time period after an insurance premium is due during which the premium can still be paid with no interest charged, and coverage remains in force. This period is usually 30 to 31 days.

Group Life: A policy issued to an employer, association, or other organization that provides life insurance to employees or members.

Guaranteed Issue: A policy that is sold to all applicants without regard to their health.

Guaranteed Rate: The minimum interest amount that the insurance company promises to pay on any cash value in the policy.

Guaranteed Return: A promise to pay a certain return to an investor.

HIPAA: An acronym for the Health Insurance Portability and Accountability Act of 1996 (public law 104-
191) that governs the treatment of medical files by companies.

In Force: A policy is in force when all conditions have been met to establish or maintain the company's obligation to pay the death benefit upon the insured's death.

Insurable Interest: In order to be both the owner and beneficiary of a life insurance policy, there must be some relationship to the insured person that shows a reason for the policy owner to keep the insured alive.

Insurance Company Rating: A rating of the insurance company's financial strength. The major rating firms include: A.M. Best Company, Standard & Poor's, Wiess Research, Duff & Phelps, and Moody's Investor Services.

Institutional Investor: An entity with large amounts to invest such as mutual funds, pension funds, investment banks, etc.

Insurable Capacity: Every person has a capacity for life insurance, which capacity is measured by net worth, income, obligations, and other financial measures. One's actual capacity is not precise, but for example, a person with only $20,000 income and no assets would not have capacity for a $10,000,000 policy, but someone with an income of $300,000, assets of several million, major obligations and substantial business interests would have a capacity for a $10 million policy.

Insurability: Insurability refers to an individual's ability to obtain life insurance based on their health. If an individual is unable to obtain life insurance due to bad health, the individual is considered to be uninsurable.

Issue Date: The specific date when the insurance company issues an insurance policy. The issue date is shown in the policy**.** Note that the Policy Date and Issue Date are different. (See Policy Date)

Insurer: An insurance company or issuer of insurance products.

Investor: A financing entity or other business entity or person that provides capital to a life settlement provider for the purpose of purchasing a portfolio of life insurance policies as an investment. (See also Funder, Financing Entity)

Insured: This is the person whose life is covered by the policy. (See Covered Life)

Lapse: The termination of an insurance policy as a result of failure to pay the premium.

Legal Competency: An opinion provided by an insured's and/or policy owner's doctor that assures the insured and/or policy owner is of sound mind.

LE: Life expectancy, an estimate of the period of time a person has left to live

LE Provider: (See Life Expectancy Underwriter and Underwriter)

Level Term: A type of term life insurance policy that provides a fixed death benefit for a period of time during which the premiums payable do not rise (i.e., 5, 10 or 15 years) and the death benefit remains constant over the same period.

Life Insurance Agent: Individuals or businesses that are licensed to sell life insurance by the State Departments of Insurance. The agent or insurance sales person or entity has primary duties to the insurance company and not to the applicant. Agents may represent just one or many insurance companies, and are generally paid commissions by the insurer with whom the policy has been written.

Life Insurance Policy: A legal contract entered into between a life insurance company and a policy owner. The agreement provides for the payment by the company of a sum of money (the death benefit) to the beneficiary when the covered life (the insured) dies.

Life Insurance Settlement: See "Life Settlement."

Life Expectancy: The number of months the insured is expected to live. Typically a life expectancy such as 48, 60, 96, 120, etc. months, means the number of months at which 50% of the cohort group of people are expected to have died. A life expectancy is typically estimated by experts who evaluate the insured's personal and medical records.

Life Expectancy Underwriter: An individual or company that reviews personal and medical information for the purpose of issuing mortality reports and related life expectancy estimates for use in life settlement transactions. Other terms used to describe this service include LE Provider, Life Expectancy Estimator or Life Expectancy Evaluator)

Life Insurance Investment: This may include any of the following:

- The purchase of entire or fractional portions of life insurance policies from within the Life Insurance Secondary Market or Tertiary Life Insurance Market for the purpose of achieving an investment return.
- Investment in special purpose entities that own portfolios of life insurance policies.
- Investment in debt instruments issued by entities which assets are primarily made up of life insurance policies.
- Purchase of stock in corporations which assets are primarily made up of life insurance policies.

Life Insurance Secondary Market: This is all of the businesses and individuals who provide the resources, systems, pricing, bidding, handling, safe keeping, legal compliance, transferring, financing, i.e., all services that enable original owners of life insurance policies to sell policies via life settlements. This is not the reselling of policies among life insurance policy investors as done in the Life Insurance Tertiary Market (See Tertiary Market).

Life Settlement: A financial transaction or process, in which a policy owner sells a life insurance policy to a third party for more than the cash value offered by the policy insurer. The purchaser is responsible to pay all subsequent premiums and typically becomes the new beneficiary of the policy. Investors do not invest in life settlements.
Life Settlement Agent: Typically this is a Life Insurance Agent (see Life Insurance Agent) that helps an owner get a life insurance policy to a life settlement broker or life settlement provider. Such agent represents the policy owner and is paid for such services from sale proceeds paid to the policy owner/seller.
Life Settlement Broker: (See Broker)
Life Settlement Company: (See Life Settlement Provider)
Life Settlement Provider: (See Provider)
Life Settlor: The seller of a life insurance policy that is the subject of a life settlement.
Life Settlement Investment: There is no such thing as a viatical or life settlement investment. A life settlement is a legal process, not an asset. (See Life Insurance Investment and Life Settlement)
Living Benefit (Accelerated Benefit): Death benefits paid to a policy owner while the insured is still alive using strict guidelines dictated by the insurance policy and the insurer.
Loan: If a policy has an accumulated cash value, the policy owner may borrow part of it. The amount borrowed will be subject to an interest charge. Any unpaid loan and unpaid interest will deductable from the death benefit until paid.
Medical Records: Records provided by an insured's doctor(s) and other medical care providers or facilities (hospitals, etc.) reflecting the insured's medical history
Medical Underwriter: See (Life Expectancy Underwriter and Underwriter)
Misstatement of Age: If the age of the insured is misstated and is not discovered until death of the insured, the insurance company generally has the contractual right to adjust the death benefit to reflect the face amount that would have been paid with the corrected age and actual premiums paid.
Modal Premium: This is a payment method selected by the insured to pay policy premiums. There are generally four premium mode options including annual, semiannual, quarterly, and monthly. There is usually a higher incremental cost for all modal premium options other than annual.
Mortality Charge: The cost of insuring you at your current age. (See Cost of Insurance.)
Net Death Benefit: The policy death benefit (face amount or in-force amount) less any outstanding policy debts or liens.
Non-forfeiture: The minimum amount that an insurer must pay if a cash value policy is surrendered.
Option A-Level Death Benefit: Universal life policyholders may elect a level death benefit (Option A) that is fixed and doesn't increase unless required to maintain a policy's status as life insurance under IRS rules. With a level death benefit option, the net amount of insurance at risk with not decrease over time assuming proper premiums are paid.
Option B Increasing Death Benefits: Universal life policyholders may elect an increasing death benefit (Option B) that increases as a policy's cash values increase. With an increasing death benefit option, the net amount of insurance at risk never decreases over time as all cash values are added to the initial face amount to determine the actual death benefit.
Owner: A person who contracts with an insurance company to purchase a life insurance policy and is recorded as the owner with the insurer. The owner of the policy has the right to designate beneficiaries.
The term "Owner" does not include a life settlement Provider, escrow agent, transfer agent, financing entity, or any other such firm or individual who facilitates a life settlement, except it does include the ultimate purchaser of a life insurance policy in a life settlement transaction to whom the ownership of the policy is recorded with the insurer.
Paid-Up: A policy on which all premium obligations have been paid and no further premiums are due.
Participating Policy: A policy that earns dividends based on the earnings of the insurance company.
Permanent Policy: A life insurance policy that typically has a level premium, i.e. it is a universal or whole life policy and is not a term, group policy or variable life policy.
Policy Anniversary: The policy anniversary occurs yearly on the day and month of the policy date.
Policy Date: The actual day month and year on which coverage becomes effective. Note that the Policy Date and Issue Date are different. (See Issue Date)
Policy Exchange: Usually the result of a policy replacement. Any potential taxable gain associated with terminating a policy can be deferred by qualifying the purchase of a new policy as an exchange under the provisions of Internal Revenue Code 1035.
Policy Loan Amount: (See Loan)
Policy Owner: (See Owner.)
Preferred Risk or Rate: The cost of insurance rate the company charges people who have the lowest risks, i.e. they are expected to live longer than most other people.
Premium: The payment amount required to maintain the insurance policy. Premiums can generally be paid annually, semiannually, quarterly, or monthly.
Provider: Any person or entity that is licensed to process the purchase of a life insurance policy from a policy owner in accordance with applicable state laws and regulations. Most states with life settlement laws prevent anyone from performing the "provider" functions without being licensed by the state. A provider may purchase policies for its own portfolio or represent investors seeking to purchase life insurance policies for investment. Providers are paid by the investors they represent. A natural person generally may bypass Providers and/or Brokers and enter into no more than one life settlement agreement in a calendar year.
Purchase/Sale Contract: (See Sale/Purchase Contract)
Reinstatement Period: Reinstatement is the restoration of a policy that has lapsed due to non-payment of premium after the grace period has ended. Typically the reinstatement period is 3 years from the premium due date. Reinstatement may be conditional based on the insured health and other factors.
Related Provider Trust: A trust established by a licensed Provider or a financing Entity for the sole purpose of holding ownership or beneficial interest in purchased policies in connection with a life settlement or financing transaction. In order to qualify as a Related Provider Trust, the trust must have a written agreement under which the licensed Provider is responsible for ensuring compliance with all life settlement laws and under which the Related Provider Trust is obligated to make all records and files relating to life settlement transactions available to regulators for review as if those records and files were maintained directly by the licensed Provider.
Renewable Term: A term life policy that guarantees the owner the right to renew the policy at the end of its term.
Rescission Period: This the period of time, typically 30-60 days, during which the seller of a life insurance policy may rescind the sale providing the seller returns all monies received for the sale to the Provider.
Rider: An amendment to an insurance policy that provides additional benefits or otherwise modifies the policy.
Risk: The probability of the insured dying at any point in time.
Risk Factor: Things about the insured that affect risk, such as age, smoking, hazardous occupation, a family history of heart disease, etc.
Sale/Purchase Contract: This is a written agreement between a Provider and a policy owner, the subject of which is a Life Settlement. Sale/Purchase contracts can include numerous sub-parts that stipulate terms and conditions applicable to the owner's and insured's family members, beneficiaries, trustees, lenders, spouses, etc, i.e. any persons or entity that might have some interest in the policy that is being sold.
Secondary Markets: (See Life Insurance Secondary Market)
Senior Settlement: A life settlement that where the insured is a "senior," i.e., age 65 or older.
Settlement Option: Choices available to a beneficiary for payment of a death benefit.
Special Purpose Entity: A corporation, limited liability company, trust, partnership or other similar entity formed solely to provide access and/or to hold capital or assets for the purpose of facilitating financing and investment arrangements.

Split-Dollar Policy: A life insurance policy that includes an arrangement between two parties where life insurance is written on the life of one party who also names the beneficiary of the net death benefits (death benefits less cash value) and the other party is assigned the cash value of the policy. The two parties share the responsibility for making premium payments.

Standard Risk: Standard risk is an underwriting classification that refers to the overall health of the individual applying for life insurance. A standard risk is an individual that is in average health with an average life expectancy.

Sub-Standard Risk: Sub-Standard risk is an underwriting classification for individuals that have significant health concerns. Generally, sub-standard risks have a shorter than average life expectancy due to a health impairment and will therefore pay higher premiums for their insurance than preferred or standard risk individuals.

Suicide Clause: A provision that voids a life insurance policy if death occurs by suicide within the contestability period.

Surrender: The policy owner may terminate a policy by surrendering it to the insurer in exchange for the policy's cash surrender value or other non-forfeiture values.

Surrender Charge: Typically applicable to adjustable life, indexed universal life, and variable universal policies. This is generally a declining schedule of charges that may be imposed on the policy. If the policy is surrendered the death benefit is reduced. In some instances the surrender charge is taken into account in the monthly calculation to determine if the policy is still in force.

Surrender Value: (See Cash Value)

Term Life: A policy that is provides a death benefit for a specific period of time, e. g, one year, 10 years, 20 years. This is the simplest form of life insurance. It offers no cash value feature.

Terminally Ill: Having an illness or sickness that can reasonably be expected to result in death in twenty-four (24) months or less.

Underwriting: The process of evaluating the risks and associated costs involved in issuing a life insurance policy, estimating a life expectancy, or deciding whether or not to enter into a life settlement.

Universal Life: A flexible-premium non-cancelable life insurance contract that accumulates cash values and pays a death benefit. The owner can choose policy premium amounts over the life of the insured, providing the amount paid never is less than the cost of insurance plus minimum fees the insurer charges.

Variable Life: A type of universal or whole life insurance in which the face amount and cash value rely on the investment performance of a special fund, such as a designated stock mutual fund.

Verification of Coverage (or VOC): A statement provided by an insurance company defining the current status of a life insurance policy, including relevant policy values, premium payments, and ownership status.

Viatical Market Place: (See Life Insurance Secondary Market)

Viatical Settlement Investment: There is no such thing as a viatical or life settlement investment. (See Life Insurance Investment and Life Settlement)

Viatical Settlement: Same as Life Settlement (See Life Settlement). Some states use the term "viatical" to describe a life settlement.

Viatical: A term referring to a life settlement. (See Life Settlement)

Viator: A terminally ill person who sells his/her life insurance policy. (See Terminally Ill)

Waiver of Premium: A life insurance policy provision that suspends the obligation to pay premiums while the insured is disabled or meets some other policy requirement. This benefit typically ends when the insured reached age 65.

Whole Life: This is a life insurance policy that remains in force for the insured's entire life and requires (in most cases) premiums to be paid every year into the policy. Typically whole life insurance has a savings feature and build up of cash value. Unlike universal life, whole life generally has fixed level premiums that are not subject to change by investment yields or interest rates.