

THE LIFE SETTLEMENTS REPORT

NEWS, INFORMATION, & ANALYSIS OF THE SECONDARY MARKET FOR LIFE INSURANCE

Volume IV, No. 19

lifeselements.dealfow.com

November 4, 2010

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NEWS IN BRIEF

Fortress won KBC's portfolio; CSSF wanted currency hedging, liquidity for ARM; AXA will pay Peachtree \$5M; Phoenix can't rescind a policy and keep the premiums; CarVal loaned Lifemark \$7.5M; Vida Capital is buying A&O policies; a firm botched an announcement about AVS's sale; Integrity Life received small-face funding; Equus Financial can settle variables; Regal Settlement got two new licenses; Wilmington Trust is merging with M&T Bank; Tranen Capital is opening a Colombia office; and hirings & firings 3

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LIFE EXPECTANCY DISPUTE HURTS MARKET, KEY PLAYERS SAY

by Donna Horowitz

Infighting among life expectancy providers doesn't bode well for bringing confidence back to the life settlement market, according to key market players.

Four life expectancy underwriters – **AVS Underwriting, 21st Services, Examination Management Services and ISC Services** – broke away from the Life Insurance Settlement Association (LISA) last month to form a group to further refine best practices and develop a mortality table. **Fasano Associates**, a fifth large LE provider, has declined to join the group.

The new group, calling itself Major Life Expectancy Providers (LEPr), plans to present its proposal to investors at a meeting in New York on Dec. 7. The group's members said they weren't satisfied with a similar LISA-led effort by Mike Fasano,

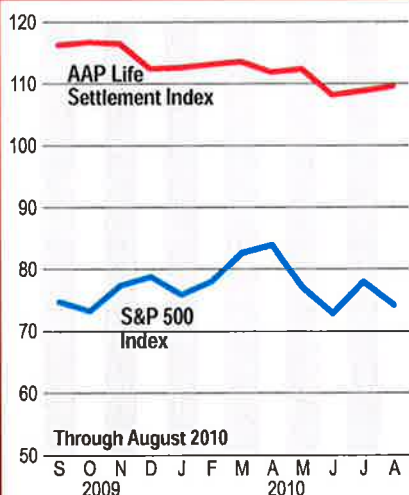
president of Washington-based Fasano Associates, who also sits on the LISA board.

The key point of contention centers on what entails actual-to-expected results. Fasano wants to use results given to clients at the time life expectancies are calculated while the rest of the underwriters prefer to give clients restated results arrived at by using their updated methodologies.

The issue first erupted in April, just before LISA released its mortality table intended to help investors compare each underwriter's accuracy. Only then it was a dispute between two underwriters – 21st Services and Fasano Associates. 21st Services issued a press release saying its actual-to-expected results using its latest methodology were 98.1% accurate between 2001 and 2008, and that it was the

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LIFE SETTLEMENTS VS. S&P 500



Source: AA-Partners; indexes at 100 in December 2006

BUYERS HUNT FOR VALUE IN DISTRESSED DEALS

by Maria Brosnan Liebel

Despite a growing number of distressed assets on the tertiary market that can be had for a discount, not all buyers want to invest the costs for due diligence and take on the risk of policies with insurable interest issues.

But those willing to take the time and expense to forensically investigate portfolios can get some good policies without cutting deep into anticipated rates of return, according to buyers who have been completing deals.

"I think a lot of people want to buy distressed portfolios, but they don't have enough intellectual property to know what they have without involving a lawyer," which can increase costs, said Elliot Bertram, a portfolio manager at **Madison Strategic Partners**, an asset manager in New York.

A survey of attendees of DealFlow Media's Life Settlements Conference

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2010 in Las Vegas last month bore out that perception. Fifty-eight percent of respondents said they have looked at distressed deals, but only 10% have bought any.

Market professionals say sources of new market capital are trying to ramp up their portfolios by acquiring large groups of policies at a higher internal rate of return (IRR). When asked where the dominant amount of capital has been played in 2010, 66% of conference audience members responding to the survey said it was on the tertiary market, rather than the newly settled secondary market.

"Today, the buyers looking at the space are more distressed focused," said one executive from a provider firm who declined to be named. There are a "lot of toes in the water."

The \$6.2 billion **KBC Financial**

Products portfolio, which *The Life Settlements Report* reported will be sold to **Fortress Investment Group**, is a prime example of a deal that would take a great deal of work to investigate, particularly for a new life settlements investor. Market players say they heard that the portfolio contained a mixture of low- and high-risk policies. The **Oregon Investment Council**, which committed capital in a bid by competing buyer **Apollo Global Management**, expected a 15% to 22% leveraged IRR.

Because there is so little capital in the market, most portfolio owners are reluctant to put up their best policies for sale because they don't believe they will get the best price. Providers and advisers expect more deals to come to the tertiary market through the court system because of bankruptcy and

receivership liquidation, as well as lender foreclosures. As a result, any tertiary deal these days is assumed to be distressed, they say.

"People are assuming if it is being sold in tertiary, someone needs the money," said Steven Shapiro, chief executive of **Q Capital Strategies**, a New York-based provider.

This has led to tertiary IRRs ranging from the upper teens to upper 20% range, depending on the quality of the portfolio and the financial situation of the seller.

Costs of Due Diligence

There are different types of distressed portfolios. Ones that have outdated life expectancy estimates have the least risk and most potential for value creation, market players say. Those with insurable interest issues, such as portfolios taken over by premium finance investors, or with documentation problems are considered higher risk because they could be contested or are costlier to fix. These portfolios are separate from distressed sellers, who are in a desperate cash-flow situation and may be trying to unload a block of better-quality paper quickly to make premium payments on the remaining portfolio.

Although the high returns sound attractive, compared to low- to mid-teens on the secondary market, the costs of due diligence can run into several hundreds of thousands of dollars and the buying process can be lengthy. Any buyer would have to decide how deep to dig into a portfolio to measure that risk and determine how many policies may be better to let lapse.

"What is the right level of due diligence, and what is the cost associated with performing it?" said Boris Ziser, a partner in the New York law office of **Stroock & Stroock & Lavan**.

For example, premium financed policies that are carrier approved have a different profile than those that are not approved, Ziser said. Also, if the seller is an institution with good credit and offers a full panoply of warranties, buyers can spend less up front.

Some buyers, such as providers **The Lifeline Program** and **FairMarket Life Settlements Corp.**, and fund manager **Managing Partners Ltd.**, are not buying distressed portfolios because of the additional cost and questionable quality.

It is unlikely that all the policies in a portfolio would meet the purchase criteria of **Managing Partners' Traded**

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Policies Fund, said managing director Jeremy Leach, who estimated that costs could exceed \$1,000 per policy.

"If all policies did meet the criteria of our fund there would not be a need to sell them in a portfolio as their individual value would be considerably higher if offered to the market individually with all of the available information to price them," he said in an email.

Other investors and providers disagree. The costs of updating the life expectancies and the legal costs of reviewing paperwork for lower-risk portfolios does not "move the needle," on returns, said one provider executive.

On a portfolio of roughly 100 policies and an approximate \$30 million purchase price, updated medicals and two new life expectancies per policy could cost about \$82,500, according to the executive.

Additional costs for diligence would run approximately \$75,000 for legal review and potentially another \$100,000 for sale documentation, depending upon ease of negotiations.

"All of these diligence costs total in the range of \$250,000 to \$300,000, which does not have a major affect on yield for a portfolio of this size," he said.

Thomas Hanley, president of **Clayton Advisory Group** in Warrenton, Ill., agreed that the cost of reviewing portfolios is minimal. He said he has four people who can review 350 policies a day. His firm has purchased \$2 billion in face since 1999. Based upon portfolios he is aware of, Hanley estimates there is \$35 billion of distressed face value on the market.

Provider **Lotus Life**, an affiliate of **Silver Point Capital**, purchases distressed portfolios for multiple funding sources. Greenwich, Conn.-based Lotus Life stayed away from "manufactured paper" in the past, said sales director Jason Jacobs at The Life Settlements Conference 2010, but now evaluates policies based on their origination.

One way Lotus Life creates value is from portfolios with outdated life expectancies.

However, that is getting harder to do as sellers recognize this and are willing to obtain new medical records and life estimates themselves to get more competitive bids. Such was the case when **Maple Bank** postponed the auction of 100 policies this summer. It has not been rescheduled yet.

Value can even be found in policies typically shunned by buyers such as contestables or those with B-rated carriers, said a representative for a fund in the market for distressed assets.

"A lot of people buy what's cool and popular. It doesn't necessarily mean it has economic value," he said.

Bringing Work In-House

Experienced firms such as Madison, **Legacy Benefits** and Q Capital can reduce costs by keeping much of the work in-house, while new players in the market will require more legal and advisory work.

Nick Williams, partner at New York law firm **Clifford Chance**, said new investors are sophisticated, experienced financial players who recognize the importance of comprehensive due diligence.

"I think the subterranean, bargain-basement prices that you are getting within the more suspect paper have put a damper on the good paper," Williams said. He said buyers can take advantage of the depressed market and get a good asset. "I think that is why you have the Apollos and Fortresses coming to the market."

He said Clifford Chance has reduced costs by one-third or more compared to other law firms by assembling a "knowledge center" of common-law lawyers in India who are trained in life settlements. They can do all aspects of due diligence, including forward policy applications, life expectancy reviews, and closing documentation.

"In the distressed market, it's all over the map," said Nemo Perera, managing director of **Risk Capital Partners** in New York. "If you are thinking of securitizing right now, much of the stuff out there just won't work."

The New York specialty insurance and consultancy firm, in partnership with **Freeman & Co.**, is currently marketing the sale of a portfolio of more than \$500 million in face as part of hedge fund **SageCrest's** bankruptcy. Perera said the 106-policy portfolio is not distressed because it has updated life expectancies and is diversified. He said there are some premium-financed policies that are seasoned at about four or five years.

Perera said his firm has advised on four bankruptcy situations and can determine which policies should be allowed to lapse because they are not worth the premiums. He said that in the end, it depends on the risk appetite of the investor. He said he has one client that is a "bottom fisher" that wants to be the buyer of last resort and doesn't spend more than \$50,000 on due diligence.

"If you can get it at 25% IRR, you're willing to take your lumps if you are wrong," Perera said.

LSR

Maria Brosnan Liebel may be reached at maria@dealflow.com.

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