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# Life Settlement Investment Strategies for Pension Plans

February 23, 2010

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# Panelists

- Andrew Plevin, BroadRiver Capital
- Randall Johnson, Locke Lord Bissell & Liddell
- Moderator:
  - Kurt Gillhaus,  
Life Solutions International

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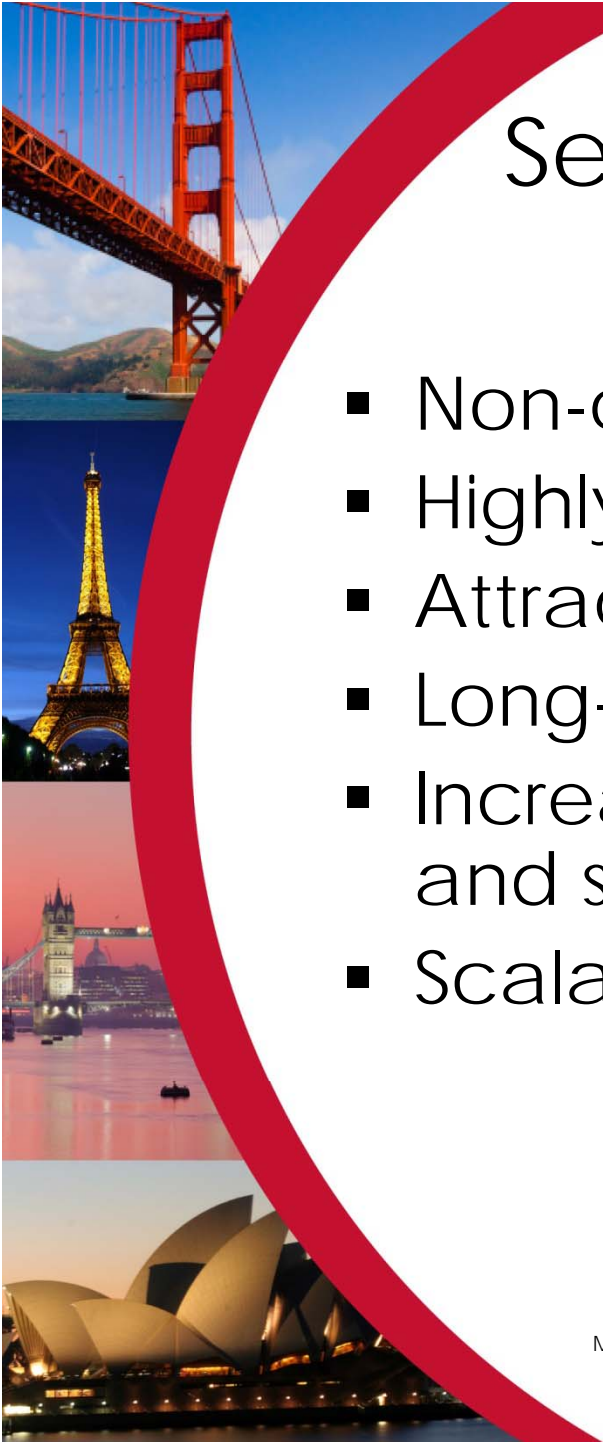


Kurt Gillhaus

Life Solutions International

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# Settlements as an Asset Class

- Non-correlated returns
- Highly rated receivables
- Attractive risk/return characteristics
- Long-term Industry Growth Trends
- Increasing regulation adding to strength and stability of industry
- Scalability

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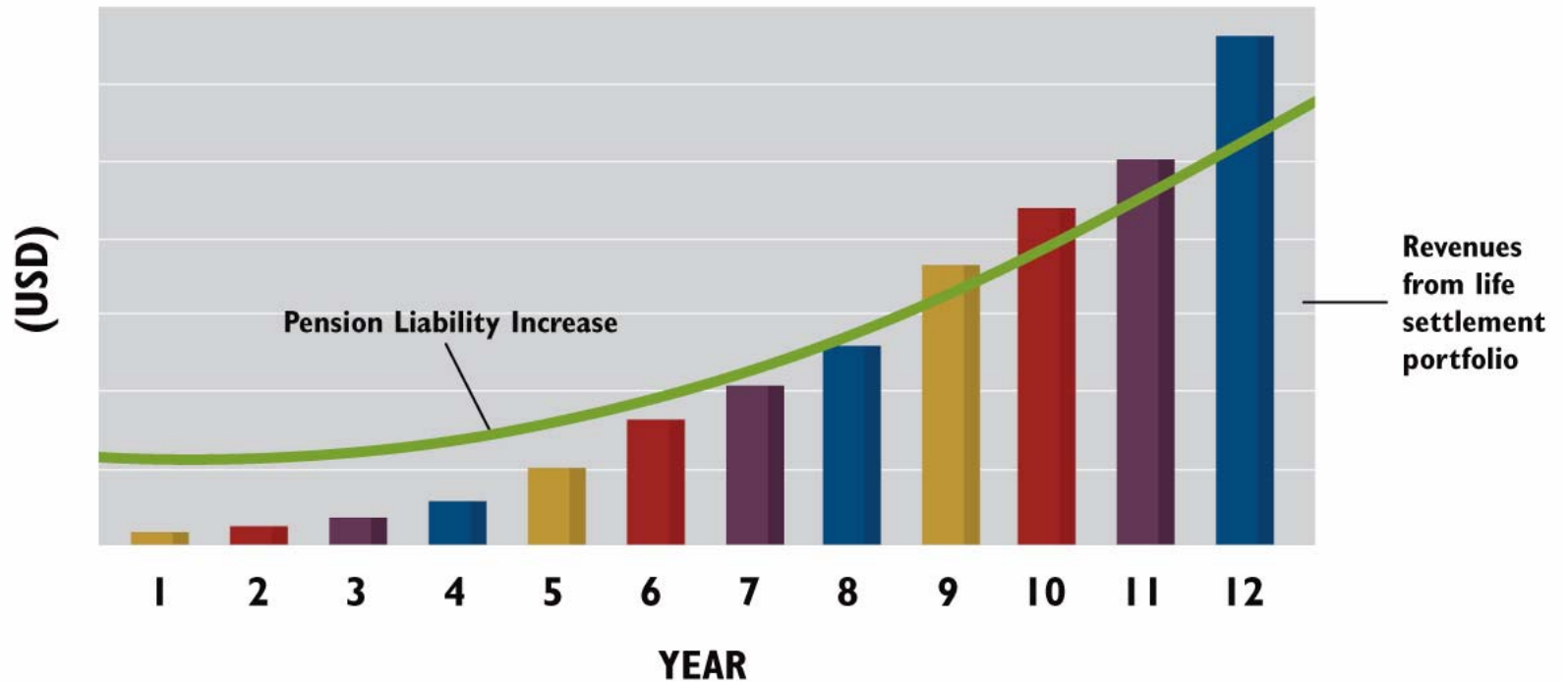
# Opportunities in Market

- Traditional life settlements - higher IRR's - longer LE's
- Jumbo policies – few buyers
- Financed assets
- Portfolios

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# Liability Driven Investing



Life settlement portfolios can be tailored to meet liability-driven investing needs of pension funds.

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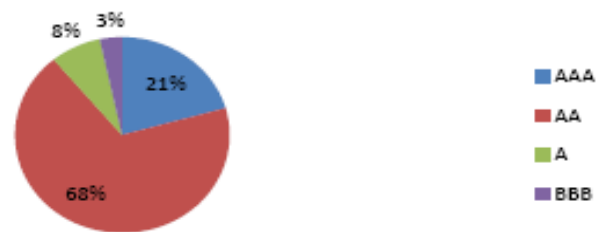


# Highly Rated Receivables – Post Financial Crisis

Carrier Rating on Submitted Policies - When Submitted



Carrier Rating on Submitted Policies - Current



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# Demographics

- Growing senior population
- Capital crisis reduced senior retirement assets and increasing their liquidity needs
- Devaluation of estates
- Financial advisor and consumer awareness increasing, leading to increased market penetration

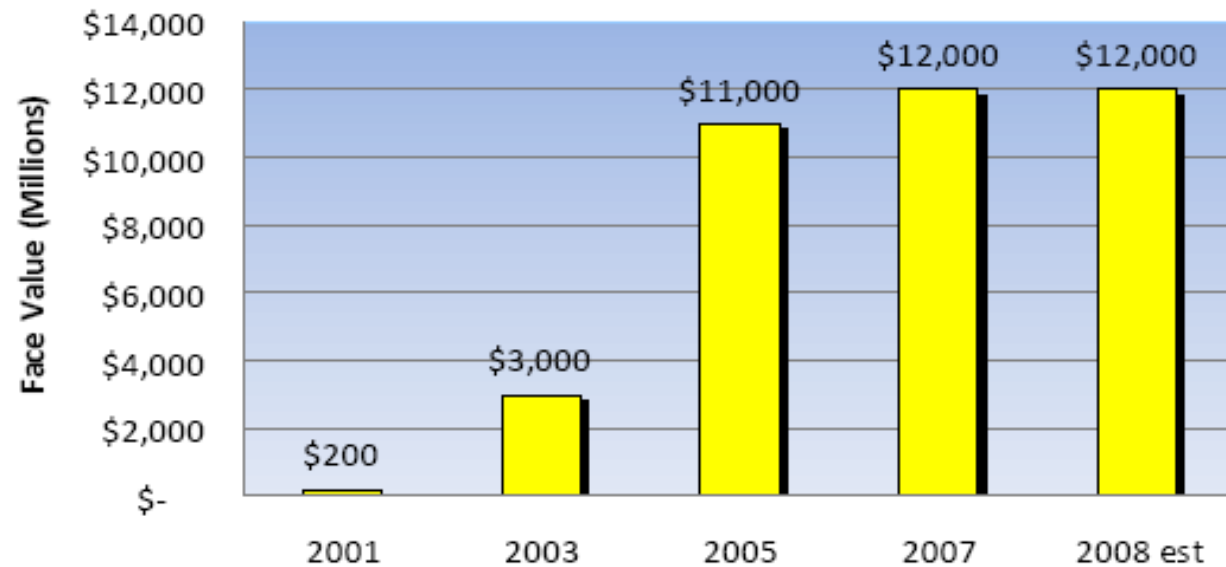
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# Growth in the US Life Settlement Market

## Industry Growth



Source: Bernstein Research

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# Methods of Participation

- Custom Managed Accounts
- Fund Investments
- Structured Notes
- Portfolio Acquisitions

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# Managed Accounts

- Custom tailored portfolio construction
  - IRR, risk, LE , carrier ratings, age, gender,
  - Diversification of carriers, geography, policy size
- Start-to-finish: structure to servicing
- Development of portfolio criteria – pricing model
- Custom reporting and analysis of portfolio
- Post-acquisition servicing & mortality tracking

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# Portfolios

- Several billions of dollars of FV available in the marketplace
- Varying composition and quality of assets
- Billions of dollars of assets available from distressed sellers
- Can acquire large blocks in a few transactions
- Lots of duplicative and unauthorized intermediaries operating in marketplace
- Requires experienced team to effectively complete transactions

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# Risks

- Longevity
  - Updated LE's
  - Multiple providers
- Counter-party
  - Highly rated carriers
- Regulatory
- Insurable interest
- Liquidity





# A Look Ahead

- Securitization
- Capital availability
- Education of potential investors

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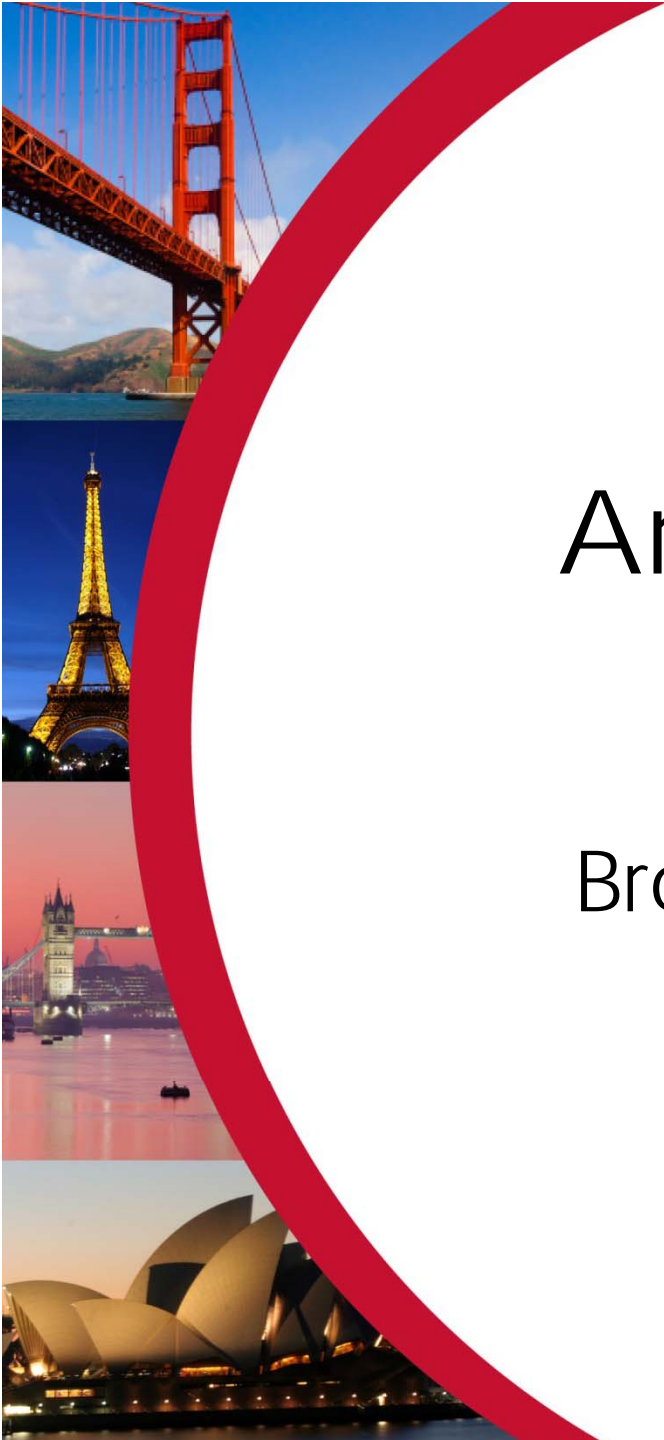
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Andrew Plevin

BroadRiver Capital



# Return Profile

- Life contingent assets ("LCAs") are assets whose return primarily depends on the mortality pattern of an individual or groups of individual lives (the "reference lives"). LCAs give an investor exposure to longevity risk or to mortality risk.

## LCA Return Profile

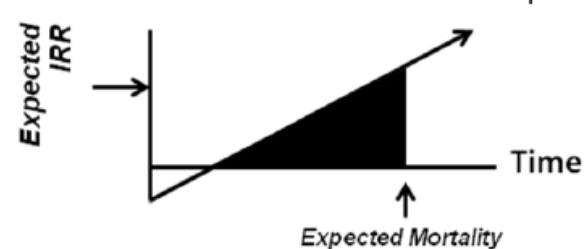
### Longevity Risk

Investor returns fall as individuals live **longer** than expected



### Mortality Risk

Investor returns fall as individuals die **earlier** than expected



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# Return Profile

- Examples of assets that give exposure to either longevity or mortality risk:

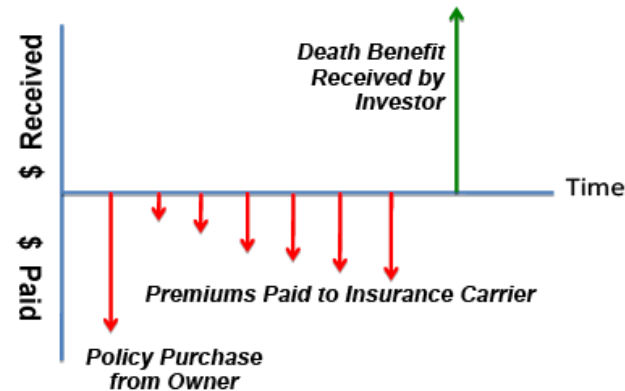
Asset Type	Risk Profile	Asset Type	Risk Profile
Life settlements	Longevity risk	Life insurance policies (issuer)	Mortality risk
Life annuities (issuer)	Longevity risk	Life reinsurance	Mortality risk
Premium financing	Longevity risk	Pandemic insurance	Mortality risk
Life contingent notes on reference lives	Longevity risk	Life contingent structured settlements	Mortality risk
Swaps on reference lives	Either	Regulation XXX reserve relief	Mortality risk

The logo for BroadRiver, featuring the word "BROADRIVER" in a white, serif font inside a blue rectangular box with a white border. The box is set against a dark blue background.

# “Buying Mortality” Taking Longevity Risks

- Within LCAs, BroadRiver can buy “expected mortality” and take longevity risk -- i.e. a position where the return declines if longevity **increases** and the reference lives live **longer** than expected. Longevity risk is found in physical assets such as life settlements and synthetically in swaps and notes that contain reference lives. BroadRiver will strategically manage its investment allocation between physical and synthetic exposure.
- In a life settlement policy, an investor, in return for paying an upfront purchase price and the ongoing cost of premiums, will ultimately receive the death benefit associated with that policy.

## Sample Cash Flow for Life Settlement



- This payment diagram is the opposite of the direction of cash flows for an issuing life insurance carrier. In a cash life settlement, the insurance carrier pays the death benefit to the investor. The later the individual dies, the lower the return to the investor.

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# Size of Markets

The U.S. life insurance market is the largest in the world.

US Life Insurance Segments, December 2007			
\$Billions	U.S. Life Insurance: Total In Force	Annuity Reserves	Reinsurance: Amount Assumed
Individual	\$10,231	\$1,633	\$1,028
Group	\$9,157	\$843	\$9
Total	\$19,388	\$2,476	\$1,037

Source: American Council of Life Insurers, U.S. Life Insurers Fact Book, 2008

- **Life Insurance:** At the end of 2007, of the \$10.2 trillion of life insurance in-force held in individual policies in 158 million policies, it is conventionally estimated that approximately \$1 trillion of individual life insurance policies are held by insureds aged 65 and over. These policies represent the aggregate target market of policies for purchase in the secondary market. As the number of U.S. residents over the age of 65 increases, the target market should increase commensurately. BroadRiver estimates that approximately \$30 billion (face value) in policies were shown into the life settlement market in 2008.
- **Annuities:** In 2007, Americans paid \$192 billion in annuity premiums and carriers hold in reserves nearly \$2.5 trillion in assets for annuity claims. While no third party data has been collected, BroadRiver estimates that 1%-2% of outstanding annuities are available annually in the secondary market.
- **Reinsurance:** Approximately \$1 trillion of life insurance risk is assumed in the reinsurance market each year. There has been an active movement of this risk to the capital markets through Regulation XXX offerings and, more recently, through the issuance of letters of credit associated with assuming excess mortality risk.

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# Historical Changes in Overall US Mortality

- While it is not possible to predict the exact date when any individual person may die, it is highly predictable to estimate how long groups of people may survive. This seeming divide has been bridged by actuarial science using laws of large numbers and historical experience and constitutes the founding principle of the entire life insurance industry and private and public pension plans.
  - For the period of 1900 – 1999, the annual mortality rate for the entire U.S. population has **declined on average by 1.19% per year.**
  - According to the Social Security Administration (the “SSA”), this decline has been driven by access to primary medical care for the general population, improved healthcare provided to mothers and babies, availability of immunizations, improvements in motor vehicle safety, clean water supply and waste removal, safer and more nutritious foods, rapid rate of growth in the general standard of living.
  - The SSA states that each of these developments is expected to make a substantially smaller contribution to annual rates of mortality improvement in the future.

1900 - 1999, Change in U.S. Mortality Rates Per 100,000*			
	Total U.S. Population	Male, 65 and Over	Female, 65 and Over
Average Percentage Change	-1.19%	-0.49%	-0.79%
Max Percentage Gain	12.69%	8.48%	9.37%
Max Percentage Drop	-17.07%	-8.19%	-9.43%
Annual Std Deviation	3.72%	3.38%	3.66%

\* Social Security Administration, Actuarial Study No. 116, August 2002

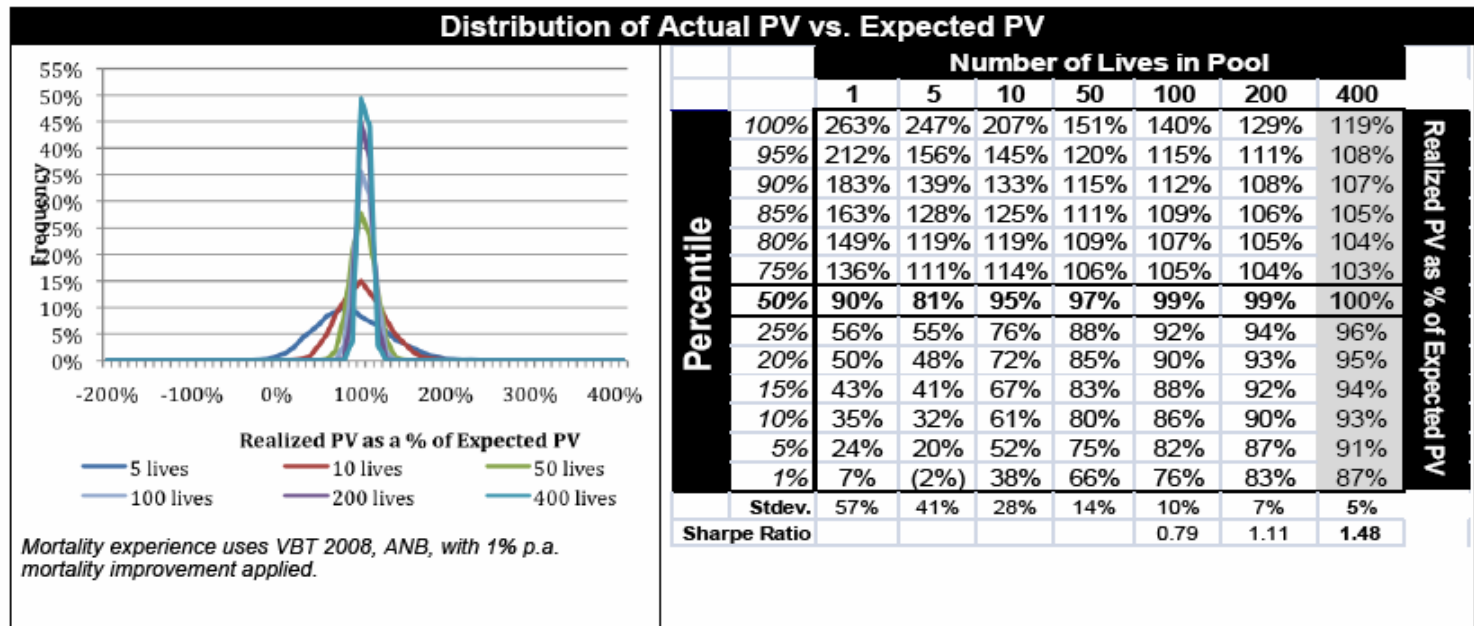
#### Highlights:

- The largest annual rise in the total U.S. mortality rate occurred in 1918, caused by the “Spanish Flu” epidemic.*
- Its impact was not uniform across age ranges and timing, with peak rise in mortality for older individuals not occurring until 1920.*
- The largest annual drop in total mortality rate occurred in 1919, as the epidemic ran its course for most of the population, except the elderly.*
- The largest annual declines in mortality rates for older females occurred in 1901 and for older men in 1908.*
- The overall mortality rate fell in 69 years of the last century.*
- The annual standard deviation in the annual mortality rate has been less than 4%.*



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# Volatility in Mortality vs. Returns on LCAs – Larger Pools Deliver Stability



## Key results:

- The distribution of returns is more stable as the number of assets increases.
- At >400 assets, the standard deviation is 5%. At 100 assets, it is 10%.
- At >50 assets, the likelihood of negative returns is negligible.
- At 400 lives, a Sharpe ratio of 1.48 on realized returns, assuming a risk-free rate of 3.65%.

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# Longevity Risk – Returns Are Attractive Despite Risk of Systematic Under-estimation of Mortality

Mis-estimation of mortality may come in several forms: mortality ratings shifts (by underwriters); mortality improvement in the general population (beyond model assumption); errors in baseline mortality curve shape; and unexpected disease elimination. BroadRiver rigorously stress tests its positions and models for potential mis-estimation of longevity risk. From the same 400 life pool, we show the impact on expected PV and IRR of a systematic error in the prediction of life expectancy, by calculating returns if mortality occurs at a rate of only 90%, 80%, and 67% of predicted mortality in a long-only position.

	Mortality Multiplier Shock				Mortality Multiplier Shock			
	Base MM	90%	80%	67%	Base MM	90%	80%	67%
Percentile	100%	119%	120%	103%	90%	15%	12%	10%
	95%	108%	108%	93%	80%	13%	11%	9%
	90%	107%	107%	91%	78%	13%	10%	8%
	85%	105%	105%	89%	77%	13%	10%	8%
	80%	104%	104%	88%	75%	13%	10%	8%
	75%	103%	103%	87%	75%	13%	10%	8%
	50%	100%	100%	83%	71%	12%	9%	7%
	25%	96%	96%	80%	67%	11%	9%	7%
	20%	95%	95%	79%	66%	11%	9%	7%
	15%	94%	94%	78%	65%	11%	9%	7%
	10%	93%	93%	76%	64%	11%	8%	6%
5%	91%	91%	75%	62%	11%	8%	6%	
1%	87%	87%	71%	58%	10%	8%	6%	
LE (PP Weighted)	104	109	116	126	<u>Sharpe Ratio</u>			
		<u>LE Extension (mos)</u>			1.48	1.48	1.03	0.67
		5	12	22				

## Key results:

- When mortality is reduced to 90%, 80%, and 67% of predicted life expectancies are extended by 5, 12, and 22 months, respectively (i.e. 5%, 11% and 21%).
- At the 50% percentile distribution, the IRR remains the same for 90% of predicted life expectancy and the IRRs fall from 12% to 9% and 7%, respectively, for LE haircuts of 80% and 67%.
- Even when mortality is only 67% of predicted, the worst 1% draw is a 6% IRR.

## Other take-aways:

- In a synthetic structure with different tranches the impact of lower returns is not equally distributed.
- BroadRiver's Long/Short positions help mitigate impact of systematic mis-estimation of mortality.



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# Mortality Is Very Weakly Correlated to Capital Markets

- It is conventionally assumed that there is a zero correlation between mortality rates and the capital markets. This is generally supported by historic data across OECD countries, since mortality rates have steadily and fairly smoothly decreased, while equity markets have behaved erratically in the short term, grown exponentially in the long term, and interest rates have tended to revert to the mean. So there seems little prospect of identifying a meaningful connection between mortality across the general population and financial risk drivers. BroadRiver's analysis of data from 1928 - 1999 largely confirms this, although it does show a small cyclical correlation between stock market returns and changes in the mortality rate.

<b>Correlation of Change in Mortality Rates to Changes in Capital Markets, 1928 - 1999<sup>1</sup></b>				
	<b>Mortality vs. S&amp;P500</b>	<b>Mortality vs. T-Bills</b>	<b>Mortality vs. T-Bonds</b>	<b>Mortality vs. Real GDP<sup>2</sup></b>
<b>Total US Population</b>				
Same Year	0.23	0.06	0.07	-0.26
+1 Year	0.37	0.09	0.06	-0.12
<b>Male, 65 and over</b>				
Same Year	0.17	-0.08	0.01	-0.15
+1 Year	0.25	-0.05	0.01	-0.04
<b>Female, 65 and over</b>				
Same Year	0.24	0.03	0.09	-0.20
+1 Year	0.27	0.08	0.08	-0.11

<sup>1</sup> Data on mortality from Social Security Administration. Returns for 3-month T-Bills, 10yr T-Bonds and S&P500 from the Federal Reserve of St. Louis (FRED) for years 1928 - 1999

<sup>2</sup> Data on Real GDP from the Federal Reserve of St. Louis (ALFRED) for years 1934 - 1999

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# Limited Exposure to Credit Risk

The counterparties in LCAs are primarily U.S. insurance companies and, to a much smaller extent, large commercial banks such as Barclays, Credit Suisse, JPMorgan Chase and Goldman Sachs, who take positions in LCAs. At the end of 2007, there were 1,009 life insurance companies active in the United States, although two thirds of all life insurance was issued by the twenty largest firms.<sup>3</sup>

## Key Credit Issues:

- Insurance carriers are regulated at the state level
- To maintain credit rating and regulatory standing, larger carriers keep statutory levels of capital reserves at 300% - 400% of true economic risk reserves
- Carriers themselves often utilize the largest reinsurance firms in the world (Swiss Re and Munich Re) to cede risk, so counterparty strength is even stronger
- Policy claims are generally senior to corporate senior debt
- Despite liquidity crisis in the fall of 2008, no major life insurance company lost its investment grade rating, including the life insurance subsidiaries of AIG.

## BroadRiver's Controls:

- Generally takes exposure to only investment grade carriers
- Diversifies exposure amongst firms
- Can purchase hedges on larger firms if CDS market pricing attractive

<sup>3</sup> American Council of Life Insurers, *Life Insurance Fact Book, 2008*.

Largest Life Insurers, by Total Assets, 2007 <sup>5</sup>		\$Billions	S&P Rating
1	MetLife, Inc.	456.7	AA
2	Prudential Financial	386.6	AA-
3	AIG Life Insurance Company*	364.1	A+
4	Hartford Life Insurance Company	263.6	A
5	Manulife Financial	217.9	AA+
6	TIAA-CREF	199.2	AA+
7	AEGON USA, Inc.	197.5	AA-
8	New York Life Insurance Company	192.9	AA+
9	ING North America	191.0	A+
10	AXA Financial	159.4	AA-
11	Northwestern Mutual	156.6	AA
12	Lincoln Financial	154.7	AA
13	Principal Life Insurance Company	135.7	A+
14	Massachusetts Mutual	131.6	AA+
15	Nationwide	111.2	A+
16	Pacific Life Insurance Company	98.6	AA
17	Allstate Life Insurance Company	89.2	AA-
18	RiverSource Insurance	84.6	AA
19	Jackson National	77.0	A+
20	Allianz Life Insurance Company of N.A.	69.5	A+

\* American General subsidiary rated AA+      S&P data as of Sep. 30, 2009



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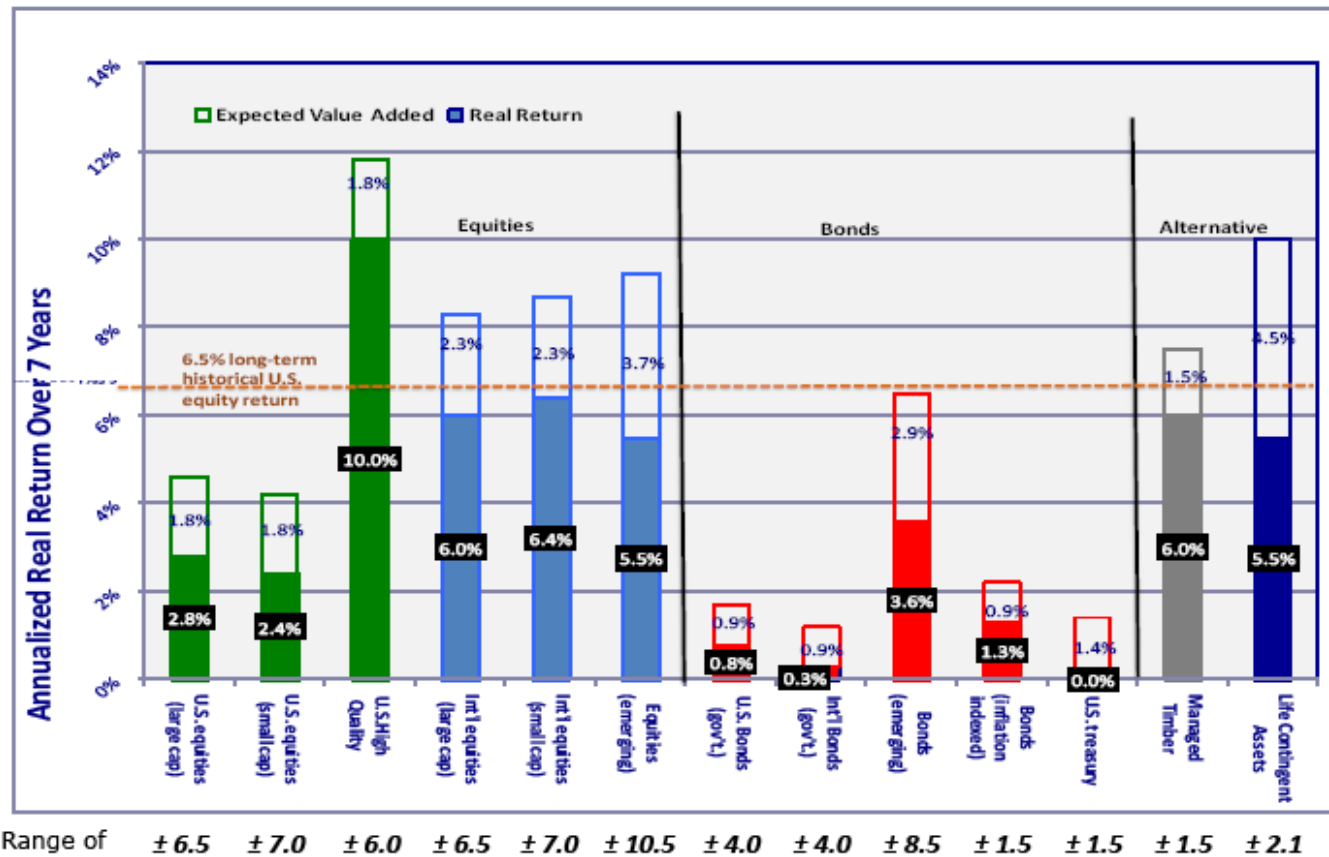
# Comparison of Expected Returns Across Asset Classes

## LCA vs. Traditional Asset Categories

- We have presented below the 7 - Year Asset Return Forecast of Grantham, Mayo, Van Otterloo & Co. GMO releases this forecast annually, most recently on August 31, 2009.
- We have added BroadRiver's calculations for life contingent assets, following the strategies outlined above.
- All forecasts in the chart are by GMO LLC, August 31, 2009, with the exception of life contingent assets (which are BroadRiver's). According to GMO, the chart represents real return forecasts for the indicated asset classes and an estimate of the value added that GMO estimates comes from active management of the asset class. GMO assumes a long-term inflation assumption of 2.5% per year and its return forecasts for international equities are ex-Japan.
- BroadRiver has presented its forecasts for life contingent assets on the same basis and assumes GMO's long-term inflation assumption of 2.5% per year. The estimated range of seven-year annualized returns has been calculated to a 95% confidence interval. (See "*Volatility in Mortality vs. Returns on LCAs – Larger Pools Deliver Stability*" at Page 16, above.)

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# Comparison of Expected Returns Across Asset Classes



Estimated Range of Annualized Returns

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# Comparison of Expected Returns to Private Equity and Other Alternative Assets

We compare LCA to private equity and other alternative asset categories and their management by top quartile managers. For this purpose, we compare LCA held to maturity to return forecasts released by the Yale University Investments Office for fiscal 2008, its last publicly released statement of its forecasts. Yale is a useful proxy in two respects: (a) it has access to and will continue to access top-quartile managers in all categories; and (b) its estimates avail themselves of standard deviations and return forecasts in alternative asset categories, hard-to-obtain data which is rarely available outside the GP/LP universe.

Asset Category	Expected Real Return	Std Dev	Sharpe-Ratio
Absolute Return	6.00%	12.50%	0.188
Domestic Equity	6.00%	20.00%	0.118
Fixed Income	2.00%	10.00%	0.063
Foreign Equity	6.67%	21.67%	0.139
Private Equity	11.20%	27.70%	0.273
Real Assets	6.00%	13.60%	0.173
<b>Life Contingent Assets</b>	<b>10.00%</b>	<b>5.00%</b>	<b>1.270</b>

*Risk-free rate 3.65% for all categories, except Fixed Income  
Fixed Income risk-free rate 1.375%; Annual inflation 2.5%*

**Life contingent assets held to maturity compare favorably when placed in a mean-variance optimization framework across asset classes, notwithstanding Yale's access to the best managers of Absolute Return, Private Equity and Real Assets.** In particular, the predicted return on private equity -- the similarly illiquid alternative asset class -- is not sufficiently greater than that of life contingent assets, once volatility is taken into account.

The Yale forecasts are as of 2008 and therefore stale; we can presume that their estimates of standard deviation have probably increased in all categories. Moreover, if we are in the "new normal" world as described by Bill Gross, expected returns have probably dampened, at least for developed economies. So, **the relative benefits and advantage of life contingent assets have only grown during the past year.**



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# Key Investment Characteristics

- **Life Contingent Assets generate extremely stable returns with attractive yields for institutions with a long-term investment horizon and substantial resources.**
  - Investment *returns are stable* in a sufficiently large pool of reference lives
  - LCAs are generally *long-duration assets*, with 8 – 15 year typical duration
  - Mortality is *highly uncorrelated* to equity, bond, commodity, and other capital markets and virtually impervious to market sentiment
  - **Major risk factors:** diversification, life expectancy assessment; illiquidity; provenance
  - **Volatility** of LCAs will increase if
- the pool of reference lives is smaller
- there is a systematic error in assessing life expectancies
- the size of payouts are unevenly distributed
- there is not sufficient diversification among insurance carriers/counterparties
  - Individual mortality and *life expectancy assessment are highly specialized* and medical-impairment specific
  - Many types of LCAs are *regulated* by state insurance and securities regulations
  - The market for LCAs is currently *fragmented and inefficient* with limited pools of dedicated institutional capital and inefficient means of originating and aggregating the assets
- **Life Contingent Assets require specialized asset management for acquisition, ongoing management and realization.**

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# Broad River Asset Management

## BroadRiver Asset Management, LLC

- BroadRiver Asset Management LLC (“BroadRiver”) is a Delaware limited liability company established in 2009 to provide **best-of-class investment management** for life contingent assets to pension plans and other institutional investors. Its head office is in New York City and it employs, directly and indirectly, a staff of eight.
- The principals of BroadRiver, Andrew Plevin and Philip Siller, have been engaged in the life contingent asset space since 2002, as investors, institutional advisors, and industry leaders. **They have been responsible for the investment of over \$400 million in life contingent assets** and have directed the review of over \$40 billion of face value of these assets since 2002. In 2006, they sold their life contingent asset management business to Goldman, Sachs & Co., Inc. and joined Goldman Sachs as Co-CEOs of its life settlements investment arm in Goldman Sachs’s Longevity Markets Group, deploying a wide range of investment strategies involving life contingent assets. In 2009, they left Goldman Sachs to start BroadRiver.
- BroadRiver’s principals have direct **experience in all aspects of LCA investment**, including origination, compliance, IT systems, modeling, pricing, acquisition, tax structuring, trading, servicing and fund management.
- BroadRiver relies on **in-house modeling, valuation and stress-testing tools**, with access to specialized physician teams for medical-records review.

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Randall Johnson

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Locke Lord Bissell & Liddell<sup>LLP</sup>



# Life Settlement Funds Are:

- Pools of in-force, non-variable, whole life policies, on U.S. residents, typically age 65 or older and without life threatening health conditions.
- Typically, the originators and brokers of life settlements have made the most money in this industry.
- Origination of LS is regulated by state LS laws.
- Creation and funding LS pools is regulated by federal and state securities laws.
- States have begun regulating life settlements as “securities”.
- If LS are properly originated and transferred, LS investment value is generally a function of:
  - --Purchase Price
  - --Premium Payments
  - --Carrier Risk
  - --Longevity
  - --Other fees (to a lesser extent)



# Investment Structures

- Private (Single Owner) Account (Pool)
- Private Investment Fund (to acquire new policies)
- Public Securitization of Existing Pool
- Publicly Registered Fund
- Non-U.S. Based Fund
- All typically use a special purpose entity to own LS pool, and are managed by a third party “servicer”
- All typically are pass-through entities for tax purposes



# Typical Investor Hurdles

- Track Record of Promoter/Originator/Servicer
- Proper Origination and Documentation
- Diversified: Number and Type of Policies
- Trustworthy Life Expectancies
- Effective Premium Program
- Effective Servicing
- Backup Liquidity Plan
- Transparency of Economics



# A Model Investment

- Benchmark: A.M.Best 2009 Ratings Methodology
  - 300 lives; 3% single life limit
  - Premium liquidity facility
  - Backup LS sale plan
- Use teams with a track record
- Require economic transparency throughout supply chain
- Require economic incentives for all service providers



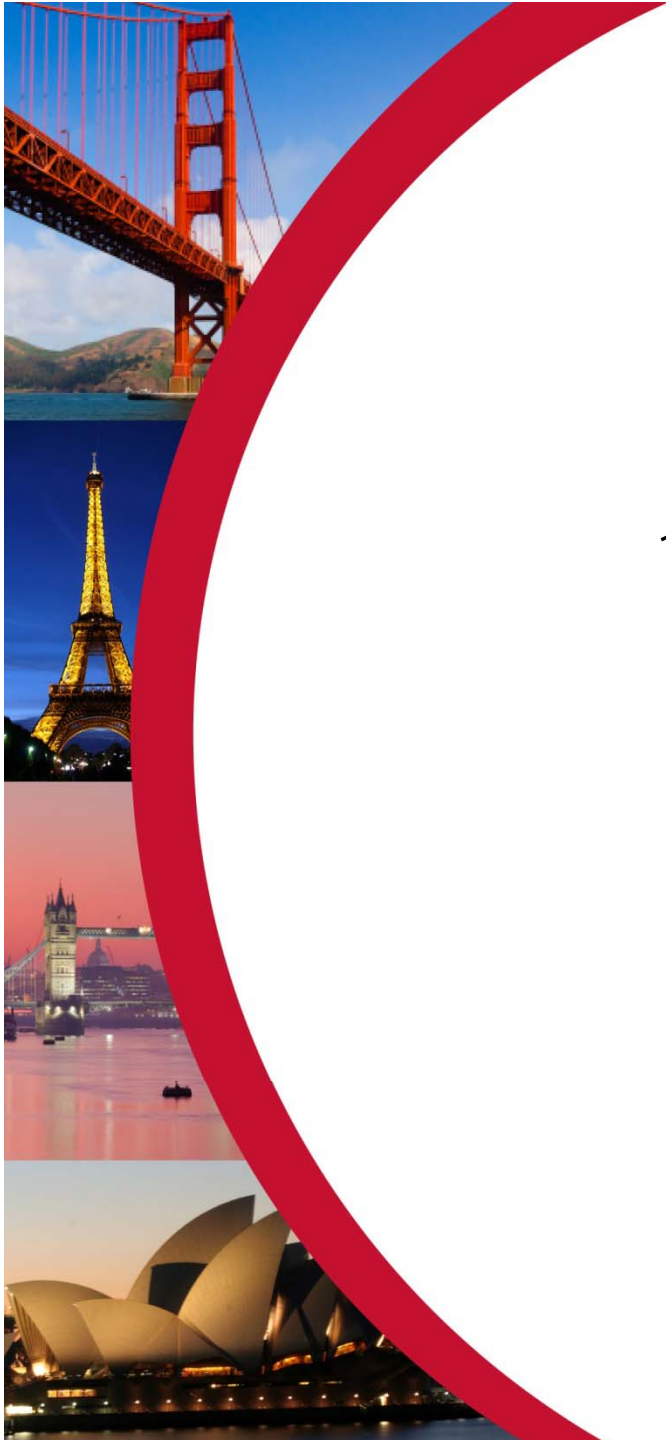
# ERISA Issues

- Within Plan Investment Policies
  - Liquidity Issues
  - Additional Funding Issues
- 25% Investment Limitation
  - All Plan Investments
  - Plan Fiduciary Issues
- Investment Valuation and Reporting



# Additional Pension Issues

- Confirm accounting and valuation methodologies
- Confirm Investment Company Act and Investment Advisors Act compliance
- Confirm pass-through tax implications
- Assess rights to replace “manager”



# Contact

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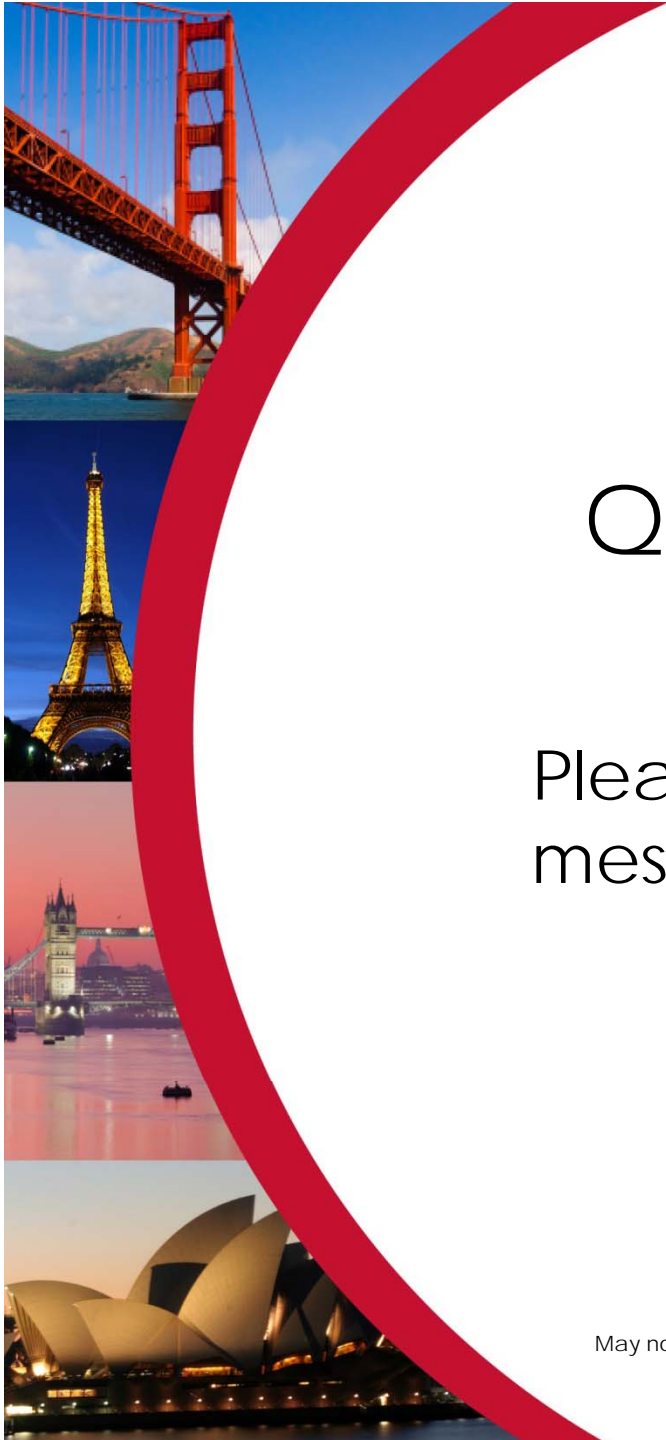
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# Questions & Answers

Please send all questions in via the message function on the right side of your webinar screen.

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# ILIAM

- Feb. 3, 2010, 10:30 a.m. PT/1:30 p.m. ET - Investing in Distressed Life Settlement Portfolios
- Feb. 9, 2010, 10:30 a.m. PT/1:30 p.m. ET - Life Settlement Investors Market: Yesterday's Distress is Tomorrow's Success
- Feb. 16, 2010, 10:30 a.m. PT/ 1:30 p.m. ET - Life Settlement Securitization
- Feb. 18, 2010, 3:00 p.m. Western Europe Time (UTC) (GMT)/7:00 a.m. PT - Life Settlement Investments: Yesterday's Distress. Tomorrow's Success (Special event for European time zones)
- Feb. 23, 2010, 10:30 a.m. PT/1:30 p.m. ET - Life Settlement Investment Strategies for Pension Plans
- Mar. 4, 2010, 9:00 a.m. China Standard Time (UTC+8)/5 p.m. PT on March 3 - Life Settlement Investments: Yesterday's Distress. Tomorrow's Success (Special event for Asian time zones)

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