



Life Solutions International Newsletter

May 2009

Simon Says

The instability in the financial markets continued through the first quarter of 2009 and had a restrictive impact on the capital supply in the life settlement marketplace. However, there are signs that capital is getting ready to re-enter this important marketplace due to the key benefits it offers to institutional investors. Investor interest increased so significantly that Life Solutions International hosted a month-long series of educational events and launched a portfolio service designed to meet the needs of the emerging tertiary market for life settlement assets.

In February, we hosted the first-ever Insurance-Linked Investments Awareness Month™ (ILIAM) in February 2009, which garnered the participation of more than 1100 investment professionals across the globe. We provided information on the opportunistic buying opportunities in the current marketplace, quality assets selling at distressed prices, important industry trends on the regulatory, capital and medical underwriting fronts, portfolio transacting and servicing as well as premium financing lending programs.

The number and diversity of participants was significant covering financial professionals in Asia, Europe and the Americas from a wide variety of institutions including banks, insurance and re-insurance carriers, investment banks, family offices, hedge funds, pension plans and private equity firms. Based on the detailed discussions with these participants, the asset class ap-

peals to these firms because of the potential for key benefits including competitive returns on receivables that continue to be highly rated in an asset that is not correlated to the major financial markets. As investors learned during the market meltdown, many assets did not offer sufficient diversification and non-correlation with major markets, therefore attention has turned to assets like life settlements where longevity risk is not tied to the performance of equity or debt markets.

Other changes during the past year have contributed to the increased interest in this asset class. States are enacting life settlement regulations across the country adding stability to the industry and many new types of firms have begun analysis and due diligence on life settlement investment programs. The financial market conditions have also resulted in many settlement portfolio sellers coming to market due to capital and liquidity crunches. These distressed sellers have placed a large volume of assets in the marketplace providing an opportunity for buyers to acquire large blocks of these assets at favorable prices. The revised VBT mortality tables released last year and the elongated life expectancy results have reduced the acquisition prices of these assets going forward. Elongated life expectancies incorporated into valuation models provides some mitigation of the longevity risk of the asset class and has reduced a potential barrier to entry for many institutional investors.



More recently, the IRS issued two revenue rulings dealing with the taxation of life settlements from both the investor and policy seller perspectives. These rulings have been long awaited and clarify many, but not all areas of the tax treatment of life settlement transactions.

In ruling 2009-13, the IRS issued guidance to original policy owners who either sell their policy in the secondary market or surrender their policies to the insurance carrier, however, the ruling creates a disparity in the tax treatment between the two transactions.. It states that if a seller surrenders their policy, the taxable gain is reduced by the full amount of premiums paid and any gain is treated as ordinary income. However, if the original policy owner sells the policy to a third-party, the IRS stated that the basis is not equal to the full amount of premiums paid because the basis must be reduced by the portion of premiums that were paid to cover the cost of insurance. This reduction in basis increases the portion of settlement proceeds that is treated as "profit", however, those profits are treated as capital gains instead of ordinary income. Since the ruling referenced only examples of term insurance, there are some unresolved details involving how the seller obtains/calculates their cost of insurance for permanent policies, like UL, and what requirements the insurance carriers have to provide that information.

Ruling 2009-14 outlines the tax treatment to life settlement investors/providers regarding policies they acquire and either hold to maturity or resell to another buyer. If a policy is held to maturity by a provider/funder/purchaser, the ruling confirms a long standing practice that any profit constitutes ordinary income. However, if the investor resells the policy, the ruling states that the sale is treated as a capital gain/loss and that the seller's basis con-

sists of their acquisition cost plus premiums paid without reduction for any cost of insurance.

The IRS also stated that any revenues (policy benefits) paid to non-US settlement market investors/purchasers are considered "US source income " and are subject to a 30% withholding tax. Further guidance is still needed in certain areas such as the specific impact of tax treaties and whether non-US investors are subject to this US tax if the investor resells the policies to another investor. Much more will be written on this topic and, as always, we strongly advise all investors to consult qualified professional tax advice.

Throughout all of the changes in the financial marketplace and the life settlement industry, the fundamental benefits of investments in remain the same. Life settlements offer attractive returns in a non-correlated alternative asset on highly rated receivables. Despite the financial market turbulence, the collapses of major investment banks, and the downgrades in many insurance carrier ratings, the insurance carriers' financial claims-paying ability and ratings remain very strong. As depicted by the following charts, life settlements still offer an average AA-rated receivable.

Carrier Rating on Submitted Policies - When Submitted



Carrier Rating on Submitted Policies - Current





Life Solutions International also launched a life settlement portfolio matching service called Life Portfolio Advantage™ filling a key need in the emerging tertiary market for life settlements. This service will provide a variety of services for settlement portfolio buyers and sellers wishing to evaluate and transact entire portfolios or portions of portfolios that meet their investment criteria. Several billions of dollars of face value in portfolios are available from a variety of sellers covering a wide range of asset characteristics in terms of size, lives, life expectancy and pricing requirements. For more information, please contact us.

Whether new to the asset class or considering an investment for the first time, it is more important than ever before to work with only the most reputable, capable and properly licensed settlement firms to optimize your life settlement program during the portfolio acquisition stage as well

as during the servicing and/or portfolio transaction stages. Life Solutions International and its affiliates ensure that investors receive a significant and steady flow of policy assets that meet investor criteria; proper licensing as opposed to “renting” licenses from other licensed organizations; have the capabilities to source, negotiate, transact, close and service life settlement portfolios in a timely and efficient manner; and possess qualified in-house legal counsel to efficiently review and evaluate cases with complex ownership structures or premium finance arrangements as well as stay on top of the rapidly evolving legislative landscape and state-specific regulatory requirements that can impact case transactions.

Please feel free to contact us with questions or for more information at info@life-solutionsint.com.

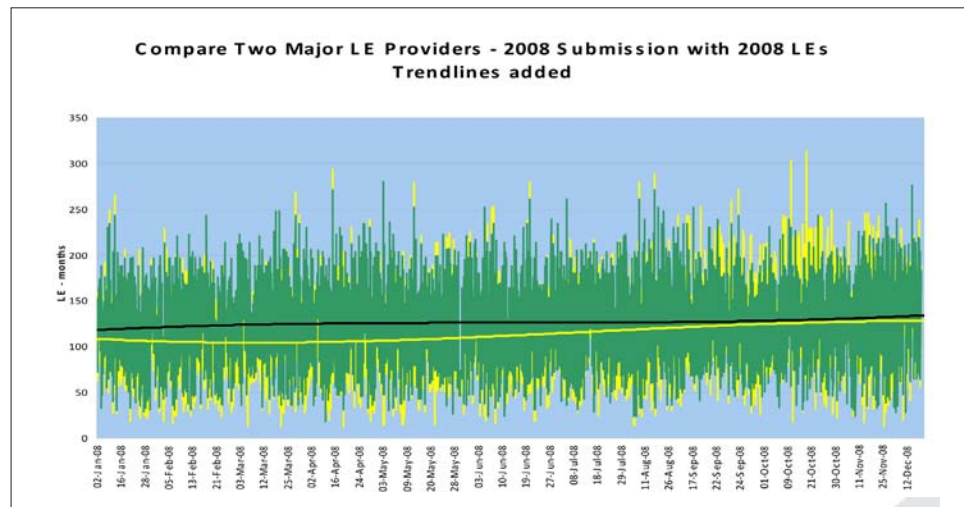
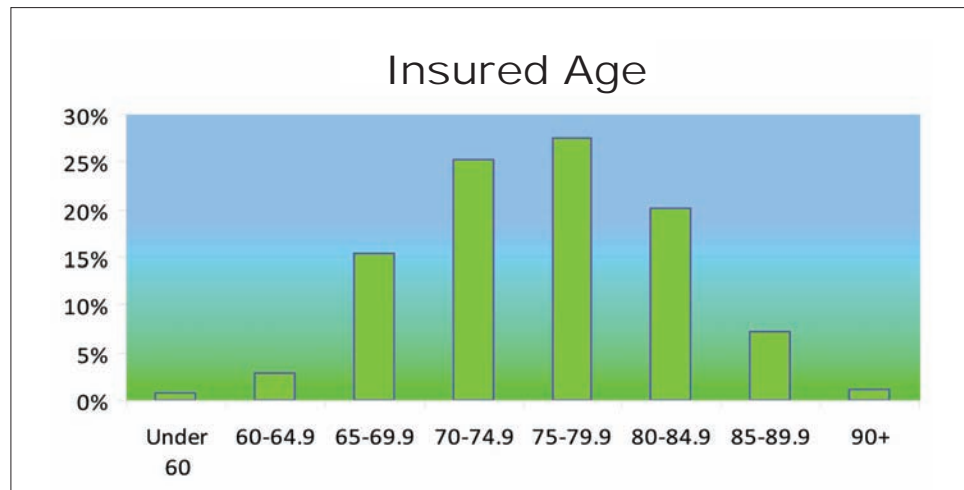




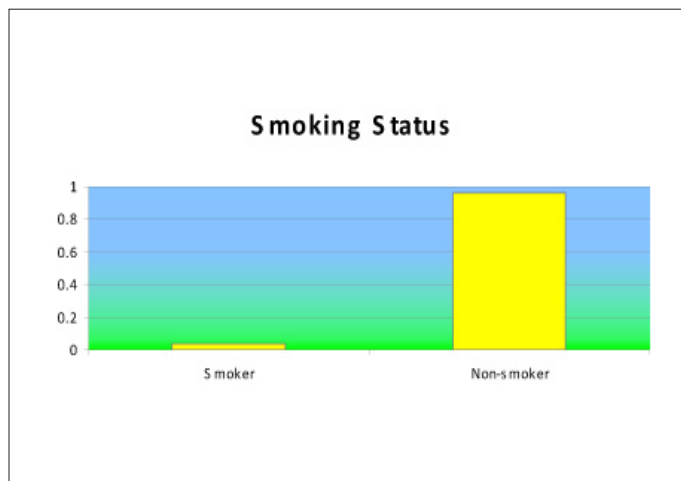
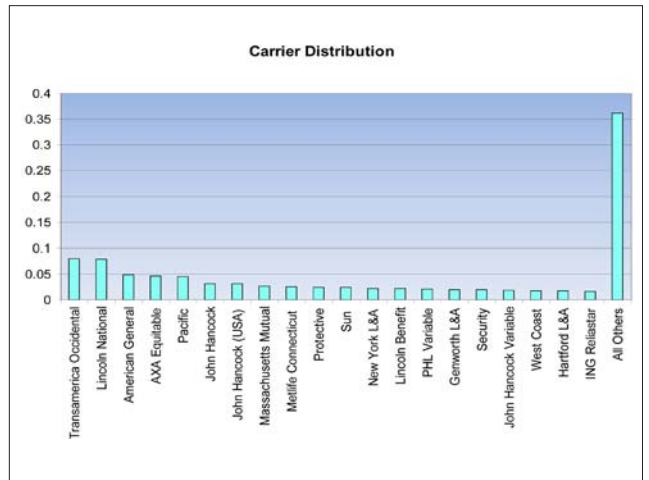
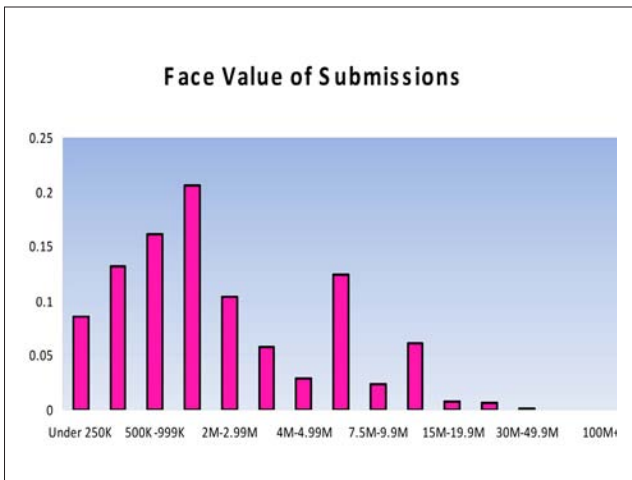
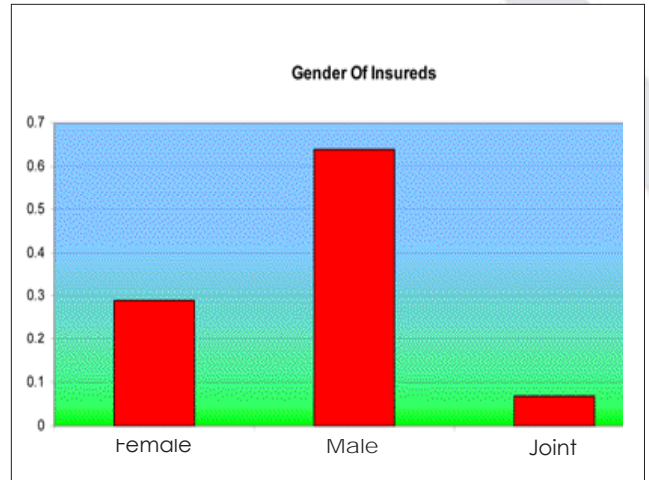
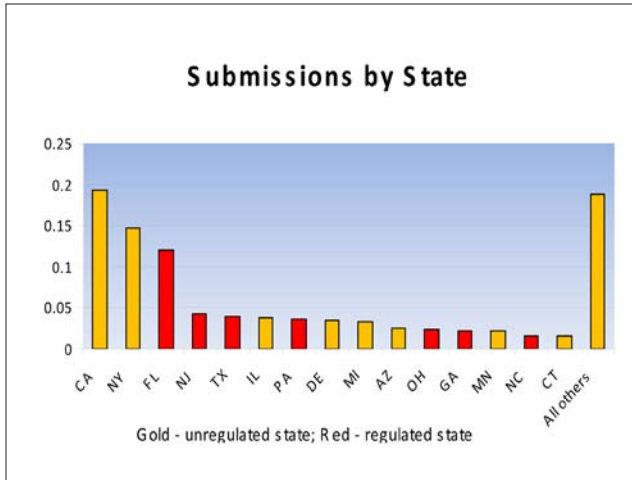
Industry Analytics

The following charts provide representative samplings of life settlement assets.

For more detailed analytics and questions about these charts, contact us at info@lifesolutionsint.com.



Source: Life Settlement Solutions Year End 2008





Legal, Regulatory & Compliance Update

Legislative Activities

As the first quarter of 2009 drew to a close, the 2009-2010 legislative season was already ramping up. We expect this year to be busy with legislative and administrative rule-making activities. At least 28 states have bills pending or committees working on draft legislation directly governing life settlements.

Another 10 bills are in play that may impact life settlements, and other financial assets that are secured by or derive their value from life insurance policies, in other ways. The debate over which model act is a better template for life settlement laws – the NAIC vs. NCOIL – continues. Various parties are also promoting bills that they claim to be hybrid versions. Differing views may see any given hybrid as combining the either the best or the very worst features of both model acts.

One version – the California bill that passed that state's legislature on a nearly unanimous vote in 2008 (but was vetoed by the governor) – is a good example of legislation that can be agreed upon among all players in the industry. In addition to the California Senate and Assembly members and staff that worked that bill, the final result was supported by consumer advocates, life insurance carriers, regulators, and the Life Insurance Settlement Association (LISA). With such a consensus of support, other states should pay attention to the California version as demonstrative of where settlement laws should be going.

Utah Amended Life Settlement Act Goes Into Effect May 12, 2009: HB 170 quickly passed both houses of the legislature and has now been signed by the Governor of Utah, with

an effective date of May 12, 2009. In addition to eliminating references to "viatical" transactions and adopting life settlement terminology, this new law includes several anti-STOLI provisions. STOLI is defined under the Act as "an act, practice, or arrangement to initiate a policy for the benefit of a third party investor or other person who has no insurable interest in the insured..." Expressly included within this definition is any situation in which, and the time of origination of a policy, there is an oral or written agreement to directly or indirectly transfer the policy and/or policy benefits to a third party, and the policy is purchased with resources or guarantees from a party that could not lawfully initiate the policy on its own.

Among other things, the amendments expressly state that all beneficiaries of a trust must have an insurable interest in the life of the insured if the trust is the original applicant for a policy. Even if all named beneficiaries satisfy the insurable interest test, the trust may still be held to violate Utah's insurable interest laws if the trust was created to give an appearance of insurable interest but it is in reality used to initiate a policy for another person who has no insurable interest.

The definition of a "life settlement" under the new version of the Utah law expressly includes: (i) transfers of beneficial interests in trusts or other entities formed or operated for the principal purpose of acquiring one or more policies, (ii) premium financing transactions if, at the time of the loan, the policy owner either receives a guarantee of future settlement value or agrees to sell the policy or any portion of the death benefit on some future date.



Legal, Regulatory & Compliance Update Continued

Carrier Financial Ratings & Regulations

As the first quarter of 2009 drew to a close, Carrier Financial Ratings and Regulations: Capital market sources are understandably taking a hard look at the impact of Wall Street troubles on the financial strength of life insurers and the potential solvency risk that could impair collection of death benefits. No doubt, it is always a prudent approach to consider financial ratings when evaluating any life-linked asset.

A decline in any carrier's financial strength rating merits monitoring, but policyholders need not panic at the first sign of a dip in any carrier's rating scores. Undeniably, the market dynamics of the past year have resulted in some carrier ratings slipping from AAA to AA+ or from AA to AA-, etc. However, these carriers are still considered to have excellent ratings. In addition, all states in the U.S. have adopted extensive requirements governing life insurer's financial management and frequent reviews and examinations by regulatory financial analysts.

Life insurers are typically assigned financial strength rates, which differ from credit ratings. Financial strength ratings are indications of a rating agency's assessment of the probability of a carrier being able to pay claims, whereas credit ratings refer to a company's ability meet debt obligations other than policy claims. Different factors are used to assess credit ratings than those used in arriving at a financial strength rating. When an agency downgrades an insurer's financial strength rating, it means that some change has occurred that, in the opinion of the rating agency, increases the likelihood that the carrier may not be able to pay all expected claims. On the other hand, a decline in a particular insurer's rating does not necessarily mean that the insurer will have difficulty paying claims.

In a recent release, "The Life Insurance Industry: Withstanding the Financial Crisis" (March 2009), the American Council of Life Insurers [ACLI] observed that life insurers are in the business of long-term financial management, and manage their assets in accordance with the long-term nature of their contractual obligations. According to ACLI, life insurers invest "primarily in high-grade corporate bonds and in government bonds. Conditions in the financial markets may change many times during the period life insurers hold their assets. Because of their long-term outlook, life insurers can choose the appropriate time to sell their holdings and need not sell in a depressed market. At the same time, premium income helps provide liquidity to insurers regardless of market conditions."

Over the past two decades, state regulatory framework has continually increased financial security standards applicable to life insurance carriers. Because of the reserve and liquidity requirements, among other restrictions, life insurers in the U.S. on the whole are financially sound and well positioned to be able to pay future claims. According to ACLI, as of March 2009, "the life insurance industry remains well-positioned to withstand the [financial] crisis and continue its proud tradition of honoring its obligations to policy holders. The life insurance industry holds about three times the minimum capital required by law to remain solvent and operational." ACLI estimates that "life insurers hold more than \$3 trillion in their General Accounts. These funds back the promises made to policyholders. Additionally, life insurers enjoyed a surplus of \$256 billion at the end of 2008. This surplus represents assets above and beyond what is required to pay expected claims."



Legal, Regulatory & Compliance Update Continued

The traditionally healthy condition of life insurers as an industry is due in no small part to the strict requirements of financial regulations and the constant regulatory reporting and examination regimen intended to assure compliance with such regulations. Every state has adopted legislation designed to protect policyholders from the possibility of carrier insolvency, and most recognized carriers are licensed in and subject to multiple sets of such laws in the many states in which they do business. Among the factors that are subject to regulation are requirements that life insurers must maintain certain reserve requirements, which include minimum standards dictating that assets be no less than the present value of the life insurance in force at any particular time. There are also a number of restrictions on the types of asset classifications that life insurers may hold as investments, with the emphasis being placed on assuring that life insurers are restricted or prohibited from investing in speculative assets.

Furthermore, assets are valued in accordance with "standard" or "statutory" accounting principles, which are viewed as more conservative than generally accepted accounting principles. Consequently, a carrier must use lower values in statement of assets on its balance sheet even though those assets might have substantially greater value if valued in accordance with GAAP standards that would be used by other types of businesses.

As a general rule, for each state in which it is licensed, a life insurer is required to file financial statements on a quarterly basis, audited financial statements on an annual basis, and additional annual reports as designed by each state. Those statements and reports are reviewed by regulators on an ongoing basis, so the insurance commissioner's office has significant information from which

it can confirm compliance with applicable financial security standards. In addition, life insurers are subject to market conduct examinations that delve even deeper into the insurers' financial affairs, and multiple regulators from all of the states in which each carrier is licensed are empowered to conduct such examinations. All such requirements apply separately to each licensed entity, so life insurer subsidiaries may remain in very sound financial condition despite difficulties encountered by a parent company, which is often a non-licensed holding company that is not subject to the same financial standards that apply to its subsidiaries.

In order to maintain accreditation with the NAIC, insurance departments in the various states must provide for detailed regulatory authority, capital and surplus requirements, utilization of standard accounting practices that are more conservative than the GAAP standards used by most businesses and CPAs, specified and conservative methods of asset valuation, investment diversification requirements, liquidity requirements, liability restrictions and various types of reserve requirements. (Financial Regulation Standards and Accreditation Program, NAIC, March 2009)

Under the NAIC's accreditation program, state departments are also required to provide for sufficient resources and implement appropriate procedures to assure that carriers comply with the applicable financial standards. Each state department's financial analysis and market conduct examination processes are designed to ensure that potential problem companies are reviewed promptly and any adverse findings are dealt with appropriately. If problems are identified, the department generally follows the procedures set forth in the NAIC Troubled Insurance Company Handbook.



Legal, Regulatory & Compliance Update Continued

Because of the tight financial requirements imposed on life insurance companies, material risk of non-payment of policy benefits is relatively small. The requirements applicable to regulation of life insurers' financial affairs are generally considered to be stronger than the requirements applicable in the property and casualty field. In addition, as compared to property and casualty insurance, life insurers' contractual obligations to policyholders are viewed as longer term obligations that are more susceptible to forecasting on an actuarial basis, and are less subject to the possibility of catastrophic losses of the type that have plagued the P&C business.

Among the broad powers afforded to state insurance regulators is the ability to step in and exert control over a life insurer upon identifying a financial "hazard" even though the insurer is not "insolvent." Moreover, the commissioner's office need not perform a complete financial audit of the carrier prior to taking action to prevent a carrier that is in a hazardous situation from further deterioration.

In those instances where a life insurer has run into trouble, the regulatory process of the carrier's home state kicks in to make every attempt to rehabilitate the company as quickly as possible. If necessary, a rehabilitator or receiver may be appointed, but even a receiver's first priority is to help the company get its operations back on track for a successful rehabilitation. In some cases, this process may lead to liquidation of some of the carrier's assets or the company may be bought out by a larger, stronger insurer. In either event, policy assets have usually been taken over by another financially sound insurer that is fully capable of paying claims as they arise.

Finally, although rarely needed in connection with life insurance, all carriers must participate in a guarantee association in each state where they are licensed to do business. Carriers are assessed fees that are contributed to each state's fund to protect policyholders in the event of a carrier's financial inability to pay a claim. Guarantee funds for life insurance purposes are separate from property & casualty guaranty associations, so a major natural disaster precipitating a P&C crisis in a particular state would not deplete the guaranty fund for life insurance.

When a commissioner identifies a life insurer as "troubled" or a "hazard", or appoints a rehabilitator or receiver, that state's guaranty association cooperates with the commissioner's office in determining whether the insurer can be rehabilitated. The state's guaranty association, or a national task force of guaranty associations if multiple states are involved, will work with the commissioner's office and the carrier even prior to the carrier reaching a state of actual insolvency. If it is determined that assets should be liquidated, the guaranty associations will also work with the commissioner's office to assure that in force policies are transferred to other, financially sound insurance companies. Shortfalls, if any, as to both death benefits and loss of cash surrender or withdrawal values, are covered by each guaranty fund for each state, subject to statutory limits. If a policyholder resides in a state where the carrier is not licensed, the guaranty fund for the state in which the carrier is domiciled typically provides coverage.

As important as the guaranty fund's availability to cover shortfalls, perhaps more important in many ways, is the fact that guaranty associations place a priority on efforts



Legal, Regulatory & Compliance Update Continued

to keep continuing coverage in place, usually by placing existing policies issued by an insolvent carrier with another healthier life insurer. Guaranty associations also have the option of taking over the insurer's obligations in exchange for receiving future premium payments. Consequently, according to National Organization of Life & Health Insurance Guaranty Associations

(NOLHGA), "thanks to the guaranty associations, every eligible policyholder has been given the opportunity to have their policy assumed by another healthy carrier or had the covered portions of their policies fulfilled by their guaranty association." Additional information and links to particular state guaranty laws and provisions can be obtained through the, www.holhga.com.

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