



# Life Solutions International Newsletter

## September 2009

### *Simon Says*

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Almost a year after the financial crisis began, Congress will open hearings to examine recent innovations in securitization – with a particular emphasis on those related to life settlements. In a release published on September 15, 2009, Congressman Paul E. Kanjorski, Chair of the House Financial Services Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises, stated: “As we work to reform the rules by which the financial industry operates, let us remain cognizant of the dangers of excess that securitization can cause.” Chairman Kanjorski’s statement admits that he has great difficulty in understanding how securitization of life settlements could contribute to economic growth, but also states that securitization can play an important role in our financial system and that he looks forward to learning more about how settlements can provide a benefit to people. This comes at a time when the capital markets are finally starting to stabilize but the impacts of the crisis continue to have a restrictive impact on capital availability in the settlement marketplace.

Like all of you, we will be happy to put this year behind us but we are making sure that lessons learned will get carried forward. One constant has stayed the same and is gaining attention from institutional investors worldwide – life settlements are a viable alternative asset class that is not going away and offers key benefits that are strongly desired nowadays. Namely, life settlements offer attractive returns in a non-correlated asset with

highly rated receivables. Many investors learned that assets believed to be non-correlated turned out to have significantly higher correlation to the major markets. As such, increasing attention is being paid by various financial institutions as they are seeking assets that are not correlated to traditional stock and bond markets, and assets with high credit quality – both of which are key characteristics of life settlements.

The restrictive capital environment continues to provide attractive buying opportunities for investors in both the individual case (secondary) market as well as the portfolio (tertiary) market. As is the case with all financial markets, capital supply decreased significantly in the life settlement market and is beginning to improve. Life Solutions International has been active with portfolios working with exclusive buyers which have helped the tertiary market’s activity. We’ve also seen more activity in recent months in <\$2,000,000 FV individual case market we expect that this trend will continue until more new money comes into the market and liquidity facilities return. The current market conditions have enabled investors to increase their IRR requirements in this market segment and increase even further in less active segments like larger face value cases as well as premium financed cases. We expect these conditions to remain until the capital supply increases and the market achieves more balance between buyers and sellers.



The first quarter of 2010 is when I believe we will see substantial upticks in the market, catapulted by the rise in interest to securitize portfolios of life settlements, which will likely come to fruition late in the fourth quarter of 2009. The elongation and decreased variability of the life expectancy underwriting from the various LE providers has also fostered greater confidence from investors and enabled them to account for longevity risk more effectively in their asset evaluations. After the significant changes in 2008, we do not foresee any major life expectancy underwriting changes in the near future.

High quality portfolios are a treasured commodity in today's buyer's market and are closing quickly if they have had excellent origination and servicing quality throughout the asset's existence. Rating agencies are focusing more attention on the origination of the life settlement asset and its servicing quality as key aspects of the rating evaluation as carriers and regulators focus more attention on the insurable interest issue for the underlying life insurance policies. Quality origination and servicing are strong indicators that the life insurance policies possessed proper insurable interest at time of issue and that these assets are in compliance with carrier and regulatory requirements.

Another trend that has emerged is related to investors attempting to securitize asset pools contingent upon their taking ownership. It is obviously important that portfolios should not be securitized without current, verified ownership of the policies. Most investors are refusing to tie up funds without the seller's prov-

en ability to close the pools. Especially in market conditions like we have currently, it is critical that portfolio buyers and sellers work with experienced and capable firms like Life Solutions International to meet your transactional goals in the tertiary life settlement market.

In May the IRS issued tax rulings 2009-13 and 14. While the industry has long awaited a more clear definition on the taxation of life settlements, these rulings verified some long standing treatment of gains but also added a few new wrinkles that both policy sellers and buyers need to address. We believe that the rulings will have a somewhat minor impact on policy sellers in secondary market transactions as gains are still likely to be treated as capital gains, but there is an adjustment that reduces cost basis by the cost of insurance of the policy. This adjustment, we believe, will have a much larger impact though on sellers whose policies were financed as the increased amount of taxable gains further offsets any potential gain for the client that also have loan balances to satisfy. This aspect of the ruling is anti-consumer by treating basis differently depending upon whether a client sells their policy back to the issuing insurance carrier (where no cost of insurance adjustment is made to basis) or an independent buyer in the life settlement market. The Life Insurance Settlement Association is working with regulators and the IRS to develop more balanced practices.

While many states are enacting regulations that are fair and balanced to consumers and the life settlement market, there are also a few states that have enacted regulations that have driven the



majority of life settlement business out of the state and have significantly harmed their state's consumer rights. Read on in our legislative and regulatory updates below for more detailed information on these rulings.

One of the most important recommendations that we can offer based on what we're seeing in the current market relates to proper servicing of life settlement portfolios to ensure that the policies remain in force at the lowest possible cost to the investor and that revenues are obtained as efficiently as possible. Life Solutions International and its affiliates have an industry-renowned servicing entity that has expanded to provide servicing to portfolios that were not originated by our firm. This capability is a one-stop-shop for policy servicing, life tracking, and premium optimization and payments. A lapsed policy could mean significant losses. It is important that your servicer has proper state-specific licensing in all states represented in the portfolio and experience in the insurance and life settlement industry. Various firms have come to us for help in this key area because they were either handling servicing themselves without any experience or had contracted with one of the firms that have recently formed as a servicer. Our affiliates have been able to find significant savings in premium payments as well as prevent a number of policy lapses saving the investors millions of dollars in both expenses and investment losses.

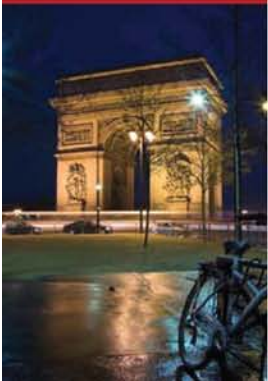
In addition, we have successfully established tracking relationships with insureds for portfolios that were previously not monitoring the health status of insureds,

or who were relying solely on passive monitoring of death records through internet database services without cross-checking that information against the much more accurate, up-to-date and detailed information that can be obtained through an active tracking program.

This past February and June we held the first Insurance Linked Investments Awareness Month™ (ILIAM) and the fourth annual Life Settlement Awareness Month (LSAM)®, respectively. Collectively the two month-long educational awareness events garnered more than 2,000 attendees. We are already in the planning stages for the 2010 events and would welcome your input on topics and feedback from previous events.

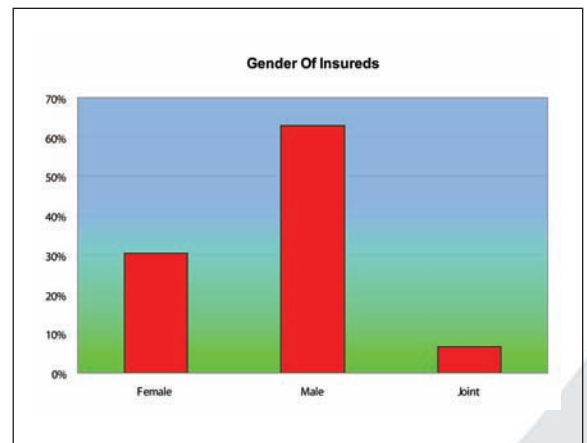
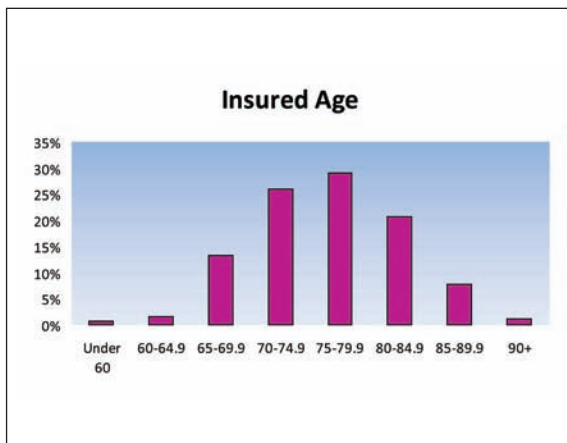
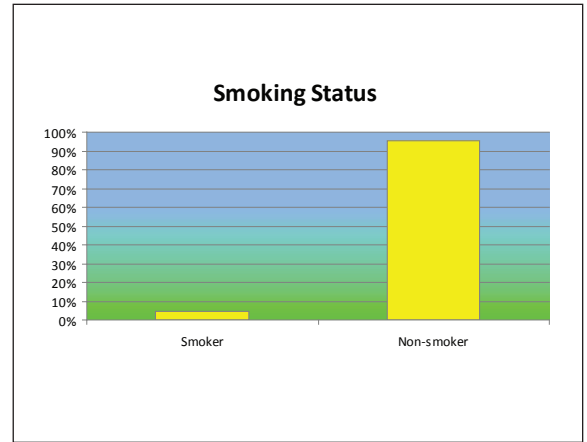
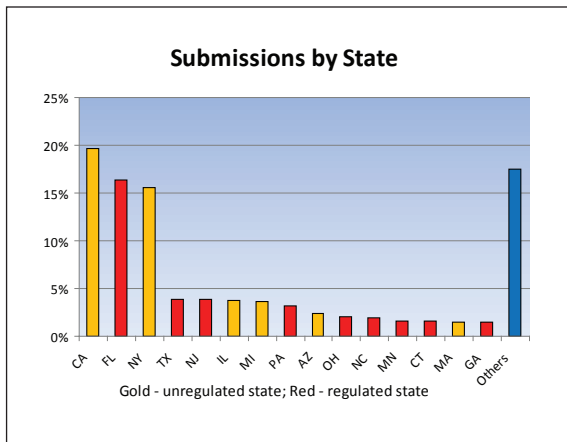
In connection with its recent announcement of extending life settlement portfolio servicing beyond its existing client base, Life Settlement Solutions is presenting a free webinar to explain the details and importance of servicing a portfolio of life settlements. The free-of-charge event is open to qualified purchasers, life settlement portfolio owners and their advisors, and will be held online Thursday, Sept. 24 at 1:30 p.m. Eastern time. To register, contact Angie Robert at [arobert@lifefirms.com](mailto:arobert@lifefirms.com).

As always, we appreciate your business and look forward to a prosperous year to come. If you have any questions or suggestions, feel free to contact me at [info@lifesolutionsint.com](mailto:info@lifesolutionsint.com).

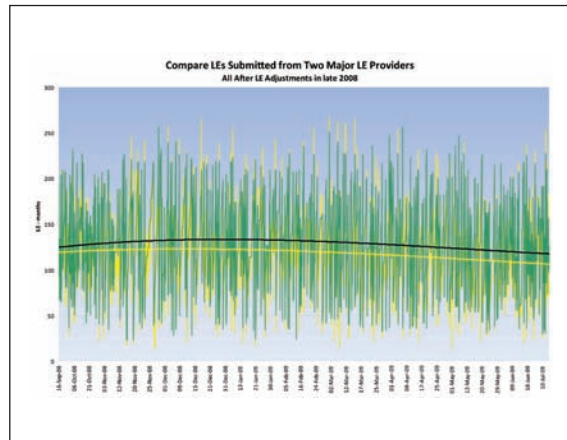
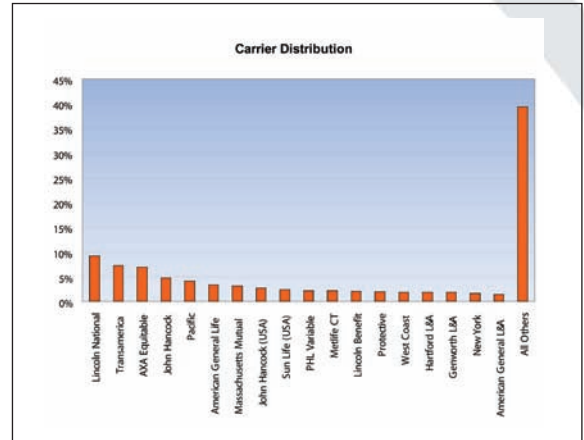
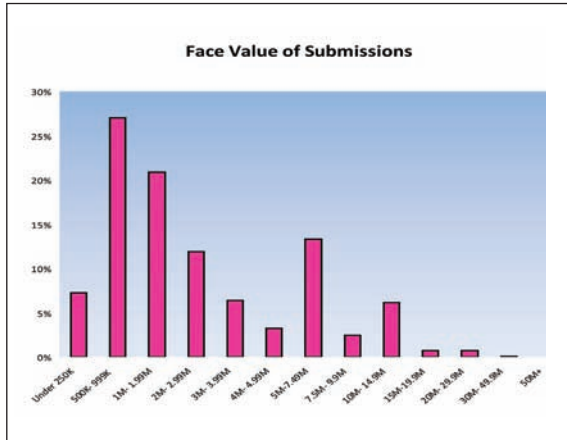


## Industry Analytics

The following charts provide an overview of life settlement assets. For more detailed analytics, contact us at [info@lifefirms.com](mailto:info@lifefirms.com).



Source: Life Settlement Solutions Year End 2008



Source: Life Settlement Solutions Year End 2008

## Legal Briefs

### Legal Updates - August 2009

#### Taxation of Settled Policies

In May 2009, the IRS released two rulings that provide some guidance as to when proceeds may be taxable as capital gains or ordinary income, or a combination of both:

- Revenue Ruling 2009-13 discusses the amount and characterization of recognized income, from the standpoint of a

policy owner (other than an investor-owner) resulting from either a surrender of the policy for cash value or sale of a policy through a settlement. The full text of the Revenue Ruling 2009-13 can be downloaded from the IRS website at <http://www.irs.gov/pub/irs-drop/rr-09-13.pdf>.



### *Legal Briefs Continued*

- Revenue Ruling 2009-14 addresses tax treatment from a secondary or tertiary market perspective. This ruling is focused on the buyer's receipt of the death benefits from a previously settled policy or proceeds from re-sale of the policy on the tertiary market, including discussion of calculation of the amount and characterization of income recognized in certain circumstances. The full text of the Revenue Ruling 2009-14 can be downloaded from the IRS website at <http://www.irs.gov/pub/irs-drop/rr-09-14.pdf>.

Proposed tax changes affecting life insurance are also under discussion in Washington, including changes eliminating the deductibility of expenses associated with certain employer-owned policies. Other proposals would require informational returns to be filed by settlement providers and other purchasers of settlement policies in connection with the purchase of any policy, as well as by insurance carriers upon payment of death benefits. As proposed by the IRS, these informational returns would be required to include the name and address of each party receiving any proceeds from sale of a policy or payment of death benefits, the amount of each payment, the policy number and the name of the issuing insurance carrier.

### **Proposals for Federal Regulation of the Insurance Industry**

Early this year, the U.S. Treasury Department issued its report, Financial Regulatory Reform, A New Foundation: Rebuilding Financial Supervision and Regulation, which, while espousing a commitment to the continued regulation of insurance at the state level, also recognized concerns

with respect to the lack of uniformity from state-to-state and "patchwork" approach to regulation at the state level. Accordingly, the Treasury Department recommended establishment of a federal Office of National Insurance, within Treasury, to "gather information, develop expertise, negotiate international agreements, and coordinate policy in the insurance sector". The Treasury Department also proposes to assume greater oversight with respect to insurance holding companies, as well as bank holding companies and other financial institutions.

Following release of the Treasury report, HR 1880, the National Insurance Consumer Protection Act, was introduced in Congress. This bill proposes to establish the federal Office of National Insurance as recommended in the Treasury report. As introduced, however, it goes much further to appoint a National Insurance Commissioner as head of the Office, whose primary duties would be to (1) oversee the organization, incorporation, operation, regulation, and supervision of national insurers and national insurance agencies and shall issue charters therefore; and (2) license, regulate, and supervise national insurance producers. HR 1880 proposes the establishment of an optional national charter for insurance companies, as well as national licensing for producers. If adopted and subject to a few exceptions, HR 1880 would provide that any nationally chartered insurer, insurance agency or insurance producer would be regulated at the federal level only, and would not be subject to licensing, examination, reporting, regulation, or supervision by any State as related to the insurance operations of such insurer, agency or producer.



### *Legal Briefs Continued*

As an alternative to a national charter structure, HR 2554 was introduced to effect the reestablishment of the National Association of Registered Agents and Brokers "to provide a mechanism through which licensing, continuing education, and other nonresident insurance producer qualification requirements and conditions can be adopted and applied on a multi-state basis (without affecting the laws, rules, and regulations pertaining to resident insurance producers or appointments or producing a net loss of producer licensing revenues to States), while preserving the right of States to license, supervise, discipline, and establish licensing fees for insurance producers, and to prescribe and enforce laws and regulations with regard to insurance-related consumer protection and unfair trade practices".

HB 2609 seeks to establish an Office of Insurance Information, the Director of which would report to the Secretary of the Treasury, serving information gathering and advisory purposes similar to the description previously set out in the Treasury Department's report. Specifically, HB 2609 provides that the Director of the Office of Insurance Information would be responsible to (1) collect, analyze and disseminate data and information from state insurance departments and from other sources, (2) coordinate federal efforts and establish policy on international insurance matters, (3) determine whether State insurance measures are consistent with federal policy, (4) serve as a liaison between the federal government and the states regarding insurance matters of national or international importance, (5) serve as the primary advisor to the Treasury represen-

tative on the Trade Promotion Coordinating Committee with regard to promoting the export of U.S. insurance products, and (6) advise the Secretary of the Treasury on major domestic and international insurance policy issues.

All bills pending in the U.S. House of Representatives may be accessed through the following website: <http://thomas.loc.gov/home/c111bills.html>

### *Legislative Activities at the State Level*

Heading into the third quarter, the 2009 legislative calendar has shown significant interest in the life settlement industry in a majority of states. From January through July 2009, six states have passed new life settlement laws, while ten other states have amended existing life settlement acts.

A minority of jurisdictions, 16, have still not enacted any laws regulating life settlements, but legislation is pending in 7 of them with a likelihood of adoption in at least a few of them before the end of the year. The trend still favors legislation based on the NCOIL Model Act as amended in 2007, although proponents of the NAIC Act and its 5-year rule have had some success in certain states.

A quick summary of the current landscape as of August 2009:

- States, to-date, that have adopted life settlement acts: AK, AR, CO, CT, FL, GA, HI, ID (eff. Jul-09), IA, IL (eff. Jul-2010), IN, KY, KS, LA, MA, MD, ME, MN (eff. May-09 & Aug-09), MS, MT, NC, ND, NE, NJ, NV, OH, OK, OR (eff. Jan-2010), PA, TN, TX, UT, VT (eff. Jul-09 & Jan-2010), VA, WA (eff. Jul-09) & W.VA



### *Legal Briefs Continued*

- States that have recently amended previously adopted life settlement acts: AR, GA, IA, ME, MT, ND, NV, TN, UT & W.Va
- States that currently regulate only viaticals: CA\*, DE, MA\*, MI\*, NM, NY\*, & WI\*
- States that have not adopted any settlement act: AL, AZ, D.C.\*, MO, NH, RI\*, SC, SD & WY
- States with proposed legislation currently under review: CA (passed & pending the governor's signature, D.C., MA, MI, NJ, NY, RI, TN, TX, & WI
- States where administrative rule-making processes are ongoing or expected in near future: AR, GA, HI, ID, LA, MT, NV, OH, OR, VT, WA, W.Va
- States that have recently amended previously adopted life settlement acts: AR, GA, IA, ME, MT, ND, NV, TN, UT & W.Va
- States that, separately from any settlement act, have recently adopted or amended other laws of interest: AZ (prohibits stranger originated life insurance), FL (investor protection), KS (securities), MN (insurable interest).

### *Issues of Continuing Concern at State Level*

Stranger Originated Life Insurance, or "STOLI," and the insurable interest issues raised by STOLI practices, continue to be the number one topic of conversation in legislative and regulatory activities. Broker compensation issues and consumer disclosures also remain high on the list of topics being addressed by lawmakers throughout the country.

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Differing approaches in efforts to combat STOLI practices include:

- Extended waiting periods following issuance of a policy before it may become the subject of a settlement transaction: Two years still remains the rule in the vast majority of life settlement laws, although a few have followed the NAIC five-year rule applicable primarily to premium-financed policies. There are certain exceptions stated under both 2-year and 5-year statutes, generally designed to protect consumers that suffer a material change in circumstances after a policy is issued.
- Insurable interest laws: A number of states have enacted statutes that attempt to define STOLI and declare such programs to be illegal insurance practices and violations of insurable interest laws. Often, these laws are part of or enacted in tandem with new or amended settlement laws, although in 2008 Arizona elected to adopt a stand-alone anti-STOLI statute without adopting any settlement laws. Minnesota recently adopted a new insurable interest law, applicable to policies issued after the May 2009 effective date of the law, which essentially says that any settlement within four years after the policy was issued is presumed to be part of an illegal STOLI transaction. However, that presumption may be rebutted and a settlement can be lawfully conducted if it can be proven that the policy was not a STOLI product. This places the burden on the policy owner (and the producing agent) to document details about pro-



### *Legal Briefs Continued*

curement of the policy through the date of the proposed settlement. Ultimately, this law will compel settlement brokers and providers to obtain copies of such documentation prior to entering into any settlement transaction.

- Non-recourse premium financing: In nearly all settlement legislation adopted in 2008 and 2009, non-recourse premium finance transactions are identified as either falling within the definition of a "settlement contract," or as a primary element of consideration under anti-STOLI provisions, or both. Exceptions are often provided, such as for policy loans from the carrier, loans from banks or licensed lending companies, loans that are fully recourse to the policy owner or insured, loans that are secured by assets other than the policy that are owned by the policy owner, or loans for which the lender's collateral interest in the policy does not exceed its cash surrender value.

- Beneficial interest transfers: In a few states, newly enacted or amended settlement laws expressly include within the definition of a "settlement contract" any transfer of beneficial interests in an insurance trust or other vehicle established for the primary purpose of owning one or more life insurance policies. Even in states that have not adopted express statutory language that specifically addresses transfers of beneficial interests in the policy-owning entity or vehicle, an argument might be made that such transfers could be covered by more generic provisions that include "indirect" transfers of a policy

or transfers of the beneficial interest in a policy.

Disclosure requirements continue to hold the attention of lawmakers, as more states adopt new or more specific requirements for consumer-protection disclosures to be given to policy owners. These include, in particular, specifications for detailed disclosure of the amount and method of calculating broker commissions, and additional disclosures related to risks that should be considered by a policy owner prior to selling a policy. A few states have also been willing to address the topic of disclosures that carriers may be required to provide to policy owners alerting them to the possibility of settlement as an alternative to letting a policy lapse or surrendering it for cash value.

### ***Burdensome Laws Threaten to Leave Consumers Without Options in Some States***

There seems to be a consensus that the life settlement market has a legitimate place in business and provides valuable financial options for our nation's growing senior population. Unfortunately, all of the positive economic impacts of the settlement industry are sometimes overlooked in crafting legislation or administrative rules. In their zeal to fight what everyone agrees are bad practices, such as STOLI, and to assure that consumers are treated fairly and given enough information to enable them to make intelligent decisions, lawmakers may sometimes shortchange the public by failing to carefully draft laws that will also protect the financial viability of the business of life settlements.



### ***Legal Briefs Continued***

In a recent survey sponsored by the Life Insurance Settlement Association (LISA) and published in the August issue of the Life Settlement Review, it was revealed that some settlement firms have already discontinued doing business in certain states due to overly burdensome or ambiguous laws that have been enacted over the past two years. The survey found that 43% of participants state that they have discontinued transacting business in one or more states, with North Dakota, Vermont and West Virginia being named most frequently. At the same time, while lack of capital was most often identified as the biggest challenge facing settlement companies today, a significant majority of respondents identified regulatory controls and other legal issues as the largest challenge that will fact the settlement industry as it grows.

#### ***Carrier Litigation***

Although we have not seen widespread regulatory enforcement actions aimed at STOLI practices, no doubt due at least in

part to budgetary constraints, various insurance carriers are pursuing civil lawsuits challenging the procurement of policies alleged to be the product of STOLI programs or fraud. In cases alleging misrepresentation in the original policy application, such as in responses to questions asking if the applicant intends to settle the policy or if premiums are being financed through a third party, the results will most often depend upon whether the action was filed prior to expiration of the contestability clause in the policy. The law is well established in virtually every state that, once the contestability period has passed, a carrier cannot deny liability based on alleged misrepresentations or failure to disclose material information when completing a policy application.

It remains to be seen as to when, or based on what set of facts, any jury or court of record will uphold a carrier's defense to liability based on STOLI allegations if first raised after expiration of the contestability period.

### ***About LSI***

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LSI and its affiliates work with investors with varying needs including major institutional investors who need to deploy large amounts of capital via custom managed life settlement investment accounts. These portfolios are tailored to meet the investor's risk and return parameters as well as timelines for capital deployment. LSI and its affiliates also work with investors whose risk/return and portfolio allocation needs are better fulfilled by other investment vehicles available in the marketplace including structured notes, leverage, fund investments and derivatives.

For more information, visit [www.lifesolutionsint.com](http://www.lifesolutionsint.com)



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