

The logo for Alternative Asset Management Limited (A²ML) features the letters 'A²ML' in a bold, blue, sans-serif font. The '2' is a superscript. The text is centered within a dark blue oval shape.

Alternative Asset Management Limited

New Broad Street House, 35 New Broad Street, London EC2M 1NH
Tel: +44 (0) 800 0612 556
admin@altasset.com
www.altasset.com

16th March 2009

Innovative approach to matching liabilities

There is an asset class on offer today that can help institutions to match their longer term liabilities by securing a fully collateralised underlying portfolio of investments with characteristics that ensures an accretion in value over time. The asset class is not new and has not been designed by clever structuring wizards with a view to creating a product with such complexity that only the designers themselves really understand what is involved – a familiar trail of modern day investment through which many a professional investor and even the issuing banks themselves have come unstuck. The asset class is the US Life Settlements sector.

A US life settlement is the sale of an existing life insurance policy for more than its cash surrender value but less than its net death benefit. The vendor voluntarily sells his/her policy through the regulated broker market to investors who take on the obligations and rights of owning these policies. Prior to purchase there is a medical review undertaken. The result of this review forms the basis of the amount offered and is based on a number of facts such as how long the individual is expected to live (Life Expectancy or “LE”), the amount paid as premiums under the policy, the rating of the insurance company and the terms of the policy (e.g. premium waivers, etc). This is an emerging asset class which is not well understood in relation to either the risk and return or portfolio construction. As such life settlements offer investors the potential for attractive risk-adjusted returns. Life settlements can be created as a form of fixed-income arbitrage with a 10-year investment horizon and an average annual significantly beyond current bond yields.

In today's volatile and nervous global markets a portfolio of US Life Settlements can be acquired at a deep discount to its current net asset value which tends to be expressed as a ‘mark to market’ price. The market is inefficient and little understood by most but the astute and experienced professional. Many banks have acquired the asset class through takeover or asset swaps and have little understanding of how the asset can be used to great effect in times of low interest rates. Life settlements assets must be actively managed to maximise the returns potential but the returns are proving to be hugely attractive for some.

One innovative boutique asset manager has grasped the concept and assembled an experienced team of professionals to provide investors access to this the asset class. *Alternative Asset Management Ltd (A²ML)*, run by the ex funds specialist, Nicholas Edwards, has structured a range of hybrid funds and bond offerings using US life settlements as the underlying collateral to protect 100% of investment capital over time by using merely circa 50% of the capital. The balance is used to invest in what Edwards calls “active alpha” so that investors effectively de-risk investment opportunity in any asset class they choose. Edwards comments “our hybrid structures will not improve a poor alpha model but it will offer the investor a high degree of protection by providing 100% capital protection over time. Essentially we use life settlement portfolios to allow investors access to higher risk opportunity at a very attractive price”.

Given the inherent capital protection, with above-market return opportunities and the low-volatile, uncorrelated nature of life settlement investments, a growing number of fund-of-funds, multi-strategy funds, investment banks, asset managers and family offices are requesting advice regarding available life settlement products best suited for their portfolios and asset allocation needs. However Edwards warns “there are many sellers of poor quality life settlement portfolios and investors need to be wary of buying a miss matched asset that may not suit their longer term needs.” Edwards stresses that the asset class is not necessarily suited to

those who want a buy and hold investment. Careful detailed research and due diligence is required to sift the wheat from the chaff and the skills sets required are rare but for those who do their homework well it is possible to invest substantial sums into this sector. The possibilities are there to strip future portfolio maturities (essentially cash flow from maturing policies upon death of the life insured) in much the same way as a conventional zero coupon bond uses Bonds (Gilts).

A²ML is currently structuring a number of instruments where it employs a qualified life settlements portfolio as the collateral protection behind the issuance of a zero coupon bond offering investors a substantial uplift in yield to maturity. They are currently offering a 10 year zero coupon bond fully insured by AIG and enhanced AAA rated by one of the USA's largest investment houses carrying a yield of 7.2% per annum to maturity.

Such an innovative approach might surely find favour among those investors who seek yield through the Gilt markets. Is UK Government 'risk' any more highly rated than AAA? Liquidity is surely an issue for some investors but for those seeking longer term guaranteed returns to match future liabilities the US life settlements asset class may offer a practical and low risk solution. "After all" say Edwards, "No one has found a cure for death as yet and this asset class, if researched and purchased correctly, can provide a useful alternative to buying gilts at only 3% or so – a yield that surely won't be sustainable for long!"

More information on the US Life Settlements asset class can be found by visiting *A²ML's* web site www.altasset.com.