A.M. BEST

METHODOLOGY OCTOBER 18, 2004

Life Settlement Securitization

A life settlement is an insurance policy sold by the owner — typically the insured or a trust — for an amount greater than the surrender value of the policy but lower than the face amount of the policy. The purchaser of the life settlement becomes the new owner and beneficiary of the life insurance policy and is responsible for making future premium payments and collecting the death benefits of the insured. Exhibit 1 lists some of the reasons to sell an insurance policy.

The life settlement market is an outgrowth of the viatical settlement market in which policies of the terminally ill — normally those insureds who are expected to die within two years — are bought and sold. In the life settlement market, however, insureds are generally 65 years or older, with medical impairments resulting in shortened life expectancies.

Life settlements typically are sold to licensed providers by insurance brokers. The price paid by providers for the life settlements depends on the life expectancies estimated by medical examiners after evaluating the medical records of the insured. The more severe the chronic illness of an insured, the lower the life expectancy and, hence, the higher the price for the life settlement.

In January 2004, A.M. Best Co. issued its first rating (an indicative debt rating) on securities issued in a bankruptcy-remote vehicle (the issuer) and collateralized by life settlements. This rating sparked further interest by the capital markets in the securitization of life settlements, and this document outlines A.M. Best's considerations in rating securities backed by life settlements. Exhibits 2 and 3 describe and illustrate the parties involved in typical life settlement securitization transactions.

For the most current versions of Guides to Best's Ratings visit *www.ambest.com/ratings/index.html*

This report was written by Emmanuel Modu, the head of the structured finance group of A.M. Best Co.

A.M. Best's Rating Policy

A.M. Best will only give a debt rating to securities backed by new life settlements after the life expectancies of the insureds have been estimated by medical examiners, the life settlements have been purchased and all legal documents have been executed. In the absence of an actual portfolio of life settlements, A.M. Best will only give an "indicative debt rating" to the securities. For an indicative debt rating, A.M. Best requires a draft of the indenture or offering memorandum from the attorneys engaged by the issuer. In addition, all essential elements of the transaction must be in place such as: the size of the securities being issued, the reserve amount, a representative portfolio of life settlements (with all the elements shown in Exhibit 7), a liquidity facility (if any), stop-loss provisions (if any), any over-collateralization or debt coverage triggers contemplated for the transaction, formation of a bankruptcy-remote vehicle, selection of medical examiners, engagement of life settlement providers, engagement of a tracking agent, designation of a collateral manager, and other significant features of the transaction. This rating is subject to immediate revision once the portfolio has been purchased.

A.M. Best generally will rate securities backed by new life settlements purchased policy by policy over a specified period of time. Occasionally, however, there are existing portfolios of life settlements made available for sale by institutional investors or providers that wish

Exhibit 1

Reasons to Sell an Insurance Policy

- Premiums paid by the policyholder have become unaffordable and the policy is in danger of lapsing;
- Estate planning needs of the insured have changed significantly;
- Funds are needed for long-term health-care;
- Beneficiary has changed because of death or divorce;
- Disposal of unneeded "key-man" insurance or other business-owned insurance;
- Fund new annuities, life insurance or investments;
- Satisfy the need for cash in a forced liquidation due to bankruptcy or financial difficulties;
- Liquidate policies donated to not-for-profits; or
- Dispose of policies that no longer are needed or wanted for a variety of other reasons.

to liquidate their holdings. Acquiring an existing portfolio eliminates the ramp-up period, which can be extensive for life settlement transactions. A.M. Best generally will rate a transaction that is collateralized by an existing life settlement portfolio under one of the following conditions:

1. New life expectancy projections for each insured in the pool have been issued by two independent medical examiners based on current medical information, with A.M. Best applying a standard mortality table such as the 2001 Valuation Basic Table (2001 VBT) in cases where obtaining two new medical examination reports is not possible; or

2. All the life settlements in the portfolio have been purchased at least five years prior to the date of A.M. Best's evaluation of the transaction and statistics are available on the original life expectancies, original prices, premiums, the pattern of maturities in the portfolio and other significant parameters.

A.M. Best may, under certain situations, make its decision on whether to rate securities collateralized by an existing portfolio based on various factors including (but not limited to): the original life settlement eligibility criteria; the medical examiners used; the ease of the legal transfer of the portfolio to the issuer; the availability of the data needed for surveillance of the transaction (as described in the last section of this document); and the mortality experience of the portfolio.

A.M. Best's Analytical Approach

Evaluating Life Settlement-Backed Securities

The A.M. Best Structured Finance Group is responsible for rating securities collateralized by life settlements. The mortality profiles of the insureds, as provided by reputable medical examiners, are used in simulating the maturities in the entire life settlement portfolio. In addition, the probabilities of impairment of the insurance companies and the assumed recoveries are applied to the transaction. These factors, along with the price of each life settlement, the premium for each policy and the projected increases in premium (if any) in the event the insureds live longer than expected, are considered in arriving at the cash flows that will service the securities. Stresses are applied to: 1) the mortality schedule (especially in the first two years of the transaction when there typically are very few deaths); 2) the recoveries upon insurance company impairment; 3) the premiums; 4) the correlation of lives (based on cure discoveries); and 5) the liquidation value of the remaining life settlement collateral (if any) at the end of the transaction. The end result of A.M. Best's analysis is a default probability of the securities that is correlated to an idealized default probability matrix. This process establishes the credit rating on the securities based on A.M. Best's credit market scale.

Rating Considerations And Requirements

1. Types of Policies Permitted/Conditions on Policies

A.M. Best will allow inclusion of life insurance policies most commonly found in life settlement transactions, such as: universal life, variable universal life, whole life, variable whole life, term life, joint survivorship and group policies. A.M. Best allows term policies that are convertible or exchangeable to permanent policies without a

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Methodology

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new medical evaluation and without a new contestability or suicide provision. The anticipated maximum increase in premiums at the time of conversion or exchange must be disclosed. Term polices that are neither convertible nor exchangeable are allowed in the transaction only if the term of the policy is at least 2.5 times the life expectancy of the insured. There is, however, a 10% limit on the number of lives covered by term policies in the pool and a 10% limit on the aggregate face value of the term policies in the pool. Since group policies are subject to the risk that the sponsoring employer, union or association will become insolvent, A.M. Best only allows convertible group policies in the collateral pool.

The general rules related to insurance policies in life settlement transactions are:

• Only policies issued by U.S. insurance companies on U.S. residents are allowed;

• Assignment of the policy to another party should not be restricted;

• Policies with decreasing death benefits are not allowed;

• Fractional shares of polices generally are not allowed;

• Confirmation is required that the policy is in force and is not within the grace period;

• No restrictions should exist on the payment of the full current net death benefits in the event of the insured's death except for nonpayment of the current premiums;

• Confirmation that nothing prevents the payment of insurance benefits in one lump sum;

• Verification that the policy is not encumbered by any other party; and

• Verification that there is no outstanding debt on the policy.

2. Medical Examiners

A. Life Expectancy Estimates, Mortality Schedules and Mortality Ratings

A.M. Best requires that two independent medical examiners provide the life expectancy estimates for the insureds in the collateral pool if the issuer is seeking a debt rating for its securities (as opposed to an indicative debt rating). A.M. Best also requires that the medical examiner provide the following: 1) a mortality (or survivorship) schedule for each insured, and 2) a mortality rating that the medical examiner applies to its base mortality table in order to derive the life expectancy for each insured.

A.M. Best will use the data from whichever medical examiner gives the longest life

Exhibit 2

Parties Involved in Life Settlement Securitizations

The Issuer — The issuer is normally a bankruptcy-remote entity established for the sole purpose of purchasing life settlements, issuing securities collateralized by life settlements and holding other assets for the sole purpose of servicing the interests of the noteholders. The responsibility of the issuer is outlined in the indenture of the transaction.

The Providers — Providers are licensed entities that purchase insurance policies directly from sellers or licensed brokers or agents authorized to act for sellers. They are responsible for making sure that all transfer-related documentation and sale documentation packages conform to applicable state or federal statutes, laws, rules and regulations relating to consumer protection, insurance and life settlement practices and procedures. Providers present policies to the issuer pursuant to an origination agreement.

Medical Examiners — Medical examiners provide comprehensive reviews of medical records and mortality profiles on the insureds looking to sell their insurance policies. The mortality profile provided by the medical examiners includes a summary of pertinent medical conditions as well as a determination of life expectancy. The issuer requires providers to engage the services of at least two independent medical examiners to evaluate the life expectancies of the insureds.

Advisor for Inconsistency — This advisor performs "Inconsistency Checks" verifying that medical records are consistent with the original insurance applications. Medical examiners sometimes can provide this service.

Collateral Manager — The collateral manager is responsible for choosing the policies that will be included in the transactions. This manager's specific responsibilities may include: confirming that the eligibility criteria for inclusion in a portfolio are satisfied; performing policy optimization to minimize premium payments and maximize death benefits; delivering the sales documentation package to the trustee; liquidating policies when necessary; determining which policies should lapse in the event of a liquidity crisis; and determining how much to reduce death benefits in order to reduce premium payments in a liquidity crisis.

Tracking Agent — The tracking agent is responsible for contacting the insureds or their representatives to verify the current life/death status of the insureds. The tracking agent normally uses methods similar to those developed for consumer loan servicing such as accessing databases for the insured's marital status, residence, physicians' visits and matching social security numbers to deaths of individuals. In addition, the tracking agent is responsible for obtaining copies of death certificates (and sometimes, filing the death claim with the insurance company) in order to facilitate the prompt collection of death benefits.

Trustee — The trustee performs all the duties it is assigned in the transaction's indenture. In general, the trustee is responsible for holding the bonds/notes for the benefit of the noteholders; for holding the security granted by the issuer over its assets; and for making payments and performing certain other obligations pursuant to the indenture. The trustee also holds all documents delivered to the issuer in connection with each life settlement. In addition, the trustee performs certain duties related to documenting life insurance policy acquisitions, fund transfers and submission of claims for payment under life insurance policies on the instructions from the collateral manager.

Actuaries — Actuaries can play an important role by helping to determine the appropriate mortality tables for the transaction, assessing the reasonability of the mortality/survivorship schedule provided by medical examiners and helping the issuer properly value life settlements.

Insurance Companies — The insurance companies that issued the life insurance policies in the transaction are critical, because they must be notified of the transfer of the policy's ownership; they can provide policy illustrations to help with policy optimization; and they are responsible for sending notices to the issuer about the policies and for sending the death benefits to the issuer.

Attorneys — Attorneys can help ensure that all documentation is complete and has been prepared in compliance with state insurance regulations. They also may provide comfort letters to verify the states in which providers are licensed and can help craft medical disclosure forms to comply with applicable privacy laws. In addition, attorneys ensure that the bankruptcy-remote entities from which the securities are issued have been created in such a way as to protect the assets of such security holders.

expectancy estimate. If one of the life expectancy estimates is more than 1.5 times the other estimate, A.M. Best will request a third medical examiner. In this case, A.M. Best will select the data from the medical examiner with the longest life expectancy estimate.

It has been A.M. Best's experience that the mortality ratings that typically are assigned by reputable medical examiners rarely exceed 500% of their base mortality tables and that assigned mortality ratings generally decrease with age. A.M. Best requires a third medical examiner to evaluate the life expectancy on any life with a mortality rating greater than 500%. In addition, a third medical examiner is required for any insureds over 80 who are assigned a mortality rating of 300% or more.

Medical examiners also should establish and indicate the primary disease category. The primary disease is the impairment for which the most debits have been assigned and that accounts for 50% or more of the total debits. If no single impairment accounts for 50% or more of the total debits, then the disease category should be classified as "Multiple." The categorization of diseases will help ensure the disease diversity required in the transaction, as described in Section 5.A.

B. Medical Examiner Underwriting Evaluation

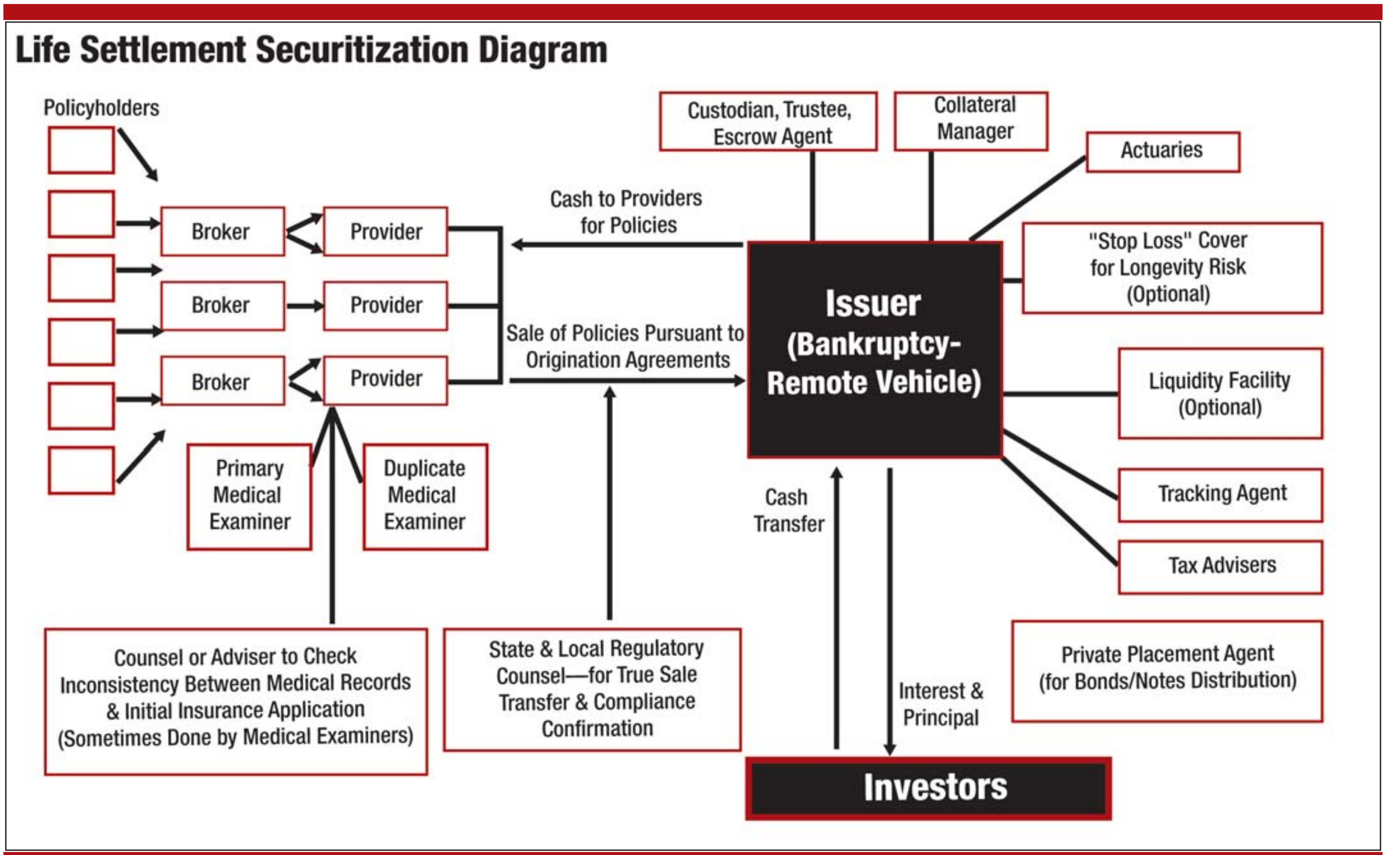
To the extent that A.M. Best does not have a copy of a recent underwriting review of the medical examiners used in the transaction, the company expects to receive a copy of such a review. The underwriting review should be performed by an actuarial firm and should cover the following: underwriting methodology and source materials, physician evaluators, mortality tables used, results of an audit of the medical examiner's files, and historical performance of the life expectancy evaluation performed by the medical examiner, if available.

3. Medical Records

A. Up-to-Date Medical Examiner Reports

As discussed earlier, all life settlements must be accompanied with two medical examiner reports based on up-to-date medical records. The initial medical examiners' reports normally are completed within a few months of the insured's last medical visit with his or her physician. A.M. Best requires fresh medical examiners' reports if more than 12 months have elapsed between the first medical examiners'

Exhibit 3



reports and the issuance of the securities backed by the life settlements.

This requirement has implications for issuers that take an extraordinary amount of time to purchase the life settlements due to the inability of their providers to supply the necessary amount of policies for the transaction. For example, if life settlements are purchased evenly over a 13-month period, the first life settlements purchased probably would have two medical examination reports that are about 13 months old by the end of the purchase period. If securities are to be issued in the 13th month after the acquisition of the first policies purchased for the issuer, A.M. Best requires two new medical examination reports on the insureds whose evaluations by medical examiners occurred more than 12 months earlier. The medical examination should be from the same medical examiners involved in the initial medical evaluations for the insureds in question.

Obtaining up-to-date medical records on the insureds poses a potential problem, as federal and state confidentiality laws restrict long-term access to such records. The federal medical-record confidentiality law, the Health Insurance Portability and Accountability Act of 1996 (HIPAA), provides minimum federal standards for obtaining authorization in order to get an insured's medical records. State confidentiality laws, which can sometimes be more restrictive than the federal law (under HIPAA), also must be observed.

B. Authorization Forms

In acquiring life settlement collateral for a securitization, it is up to the issuer to ensure that the medical records authorization forms signed by insureds are broad enough to allow for continued access (by the issuer) to up-to-date medical records over at least a 12-month period or over the longest period allowed by applicable laws. This means that the issuer would have to ensure that the medical authorization forms are compliant with HIPAA's privacy requirements. Alternatively, the issuer may have to explore other methods of receiving health records, such as using limited health-care powers of attorney or providing incentives to the insureds for providing updated medical records. A.M. Best recommends that issuers consult legal counsel for advice on any methods they choose to use to ensure that medical records can be obtained over the life of the portfolio in accordance with HIPAA's requirements.

Exhibit 4

Disease Diversity

Disease or Category	Examples	Limits
Cardiovascular	Coronary Artery Disease, Arrhythmia, Other (e.g. Heart Valve Disease)	30%
Cerebrovascular	Stroke, Carotid Artery, Transient Ischemic Attack	10%
Dementia	Alzheimer's, Multi-Infarct	15%
Cancer	Lung, Prostrate, Breast, Hematological, All Other Cancers	15%
Diabetes		10%
Respiratory Diseases	Emphysema, Asthma, Sleep Apnea, Chronic Obstructive Pulmonary Disease	10%
Neurological Disorders (Excluding Alzheimer's)	Parkinson's Disease, Lou Gehrig's Disease (ALS)	15%
Other/No Disease	Renal Failure, Peripatetic Vascular, etc.	20%
Multiple		20%
HIV/AIDS		0%

C. Consistency Check

Each policy must be checked for consistency between the original insurance application and the medical records. This consistency check often can be performed by medical examiners or others who are familiar with the review of medical records.

4. Policy In-Force Period/Proper Transfer of the Policy

Any policy contemplated for the collateral is required to have been in force for at least 36 months before being purchased by the issuer. This in-force period is 12 months beyond the 24-month contestability period. Converted policies are considered new policies if new contestability or suicide conditions are imposed on the policies. It is the issuer's responsibility to ensure that its providers keep track of the dates in which policies were acquired by the insureds.

In addition, there must be some redundant checks and balances to ensure the proper transfer of policies to the bankruptcy-remote vehicle and to ensure that the policy will be unencumbered by challenges from relatives, former spouses and others. Attorneys are best qualified to give an opinion on whether policy transfers have followed the proper protocols.

5. Diversity

A. Disease/Insurance Company

Diversity is an important factor in determining the composition of the collateral pool for life settlement transactions. In general, correlation among insureds in a life settlement portfolio occurs when a cure is discovered for a disease suffered by two or more insureds, because their life expectancies are increased simultaneously. Therefore, A.M. Best will not rate transactions based on only one specific disease such as Alzheimer's or diabetes in order to avoid the possibility that a cure will increase the life expectancies of the insureds, thereby lessening the maturities in the life settlement portfolio.

While life settlement portfolios are inherently diverse based on the statistical distribution of disease categories as determined by the medical examiners, A.M. Best nevertheless requires issuers to observe the limits shown on Exhibit 4, on the broad disease categories in the collateral pool.

Insurance company diversity is also important in life settlement transactions. A.M. Best requires that the aggregate face value of the policies issued by any one insurance company should not exceed 15%.

B. Policy Count, Policy Size

A.M. Best expects the collateral pool to consist of at least 200 lives. This number of lives can help dampen the volatility of the default probabilities associated with the securities in the transaction during A.M. Best's simulation of maturities of the life settlement collateral pool. More lives may be required if the securities issued by the life settlement bankruptcy-remote vehicle have several fixed maturity dates. No one life should comprise more than 3.33% of the face value of the entire collateral pool. Inclusion of "jumbo" policies ($10 million to $50 million in face value) is considered on a case-by-case basis and is likely to be allowed if a third medical examiner issues a life expectancy projection and the life expectancy is stressed further for modeling purposes.

6. Longevity Risk Mitigation

Exhibit 5

Typical Distribution of Available Life Expectancies

Life Expectancy (LE)	% of Insureds in LE Category
LE<= 36 months	1
36 months <LE<=72 months	12
72 months <LE<=108 months	30
108 months <LE<=144 months[1]	30
144 months <LE<=180 months	17
180 months <LE<=216 months	8
LE>=216 months	2

[1] As a practical matter, the life expectancies that are found most commonly in life settlement transactions are normally 12 years or less.

Longevity risk is the risk that the insured lives longer than was reasonably predicted by medical examiners. The longer the insured lives, the more premiums that the owner of the life settlement will have to pay and the further in the future the death benefits would be realized. Longevity risk typically is managed by "stop-loss insurance" that allows the issuer to put the insurance policies to an insurer at a price equal to the face value of the policies if the insureds live a fixed number of years beyond the predicted life expectancy. The stop-loss provider must be rated by a major rating organization. In addition, A.M. Best will review the contract that covers the stop-loss provisions to ensure that it is indeed an unconditional obligation to pay claims during the life of the transaction.

While A.M. Best does not require stop-loss insurance, such contingency insurance may enhance the transaction depending on the cost to the issuer, although it comes with the additional credit risk of the insurer.

Empirical evidence from various life settlement portfolios suggests that few deaths occur in the early years of the life settlement pools underwritten thus far. This type of longevity risk can be mitigated by the use of a liquidity facility in the early years of the transaction. This liquidity facility can provide cash flows necessary for paying the issuer's obligations. Like stop-loss insurance, maintaining and using a liquidity facility is beneficial if it is not expensive.

7. Service Providers

A. Policy Providers

The provider purchases insurance policies from a seller or a licensed broker or agent authorized to act for the seller. The purchases of life settlements are made through licensed providers approved by the collateral manager of the transaction. In the case of life settlement securitizations, the provider purchases policies for the issuer pursuant to an origination agreement between the issuer and the provider. A.M. Best requires that the purchase agreement comply with all applicable state insurance laws and regulations governing viatical or life settlement financing transactions between the issuer and the life settlement providers.

Issuers must identify the providers they intend to use for these transactions. A.M. Best's view on the providers will depend on the following considerations:

• The various states in which the providers are licensed to conduct business (in states where licensing is required);

• The partnerships between the providers and their network of policy suppliers and brokers;

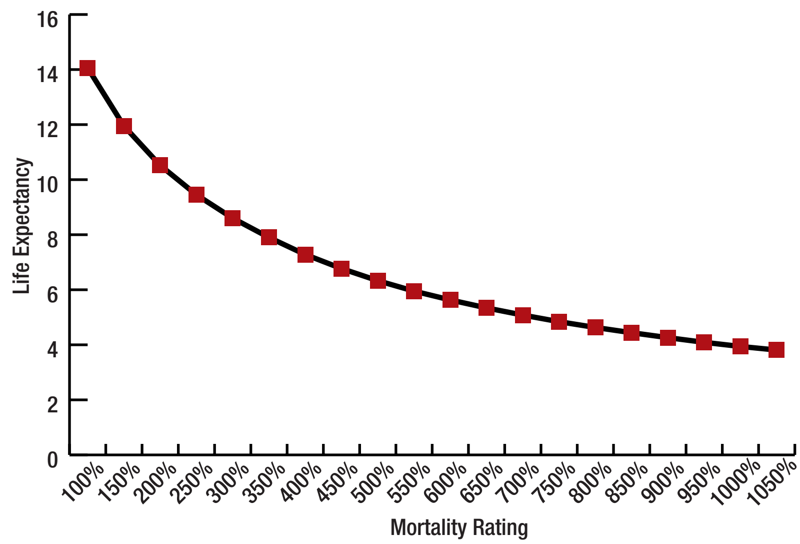
• The providers' prior policy purchasing experience for institutional investors;

• The providers' historical policy acquisition pace;

Exhibit 6

Life Expectancy as a Function of Mortality Rating*

Based on 75-Year-Old Male Nonsmokers



*Based on 2001 Valuation Basic Table. Life expectancy is defined as the time in which 50% of the people in the age category are deceased.

• The providers' infrastructure and systems for handling the administrative tasks and regulatory compliance issues associated with life settlements; and

• Other factors that may give A.M. Best confidence in the transaction.

If a provider has any ongoing financial interest in the transaction aside from its capacity as the source of policies for the issuer, A.M. Best requires full disclosure of that relationship. In addition, if this relationship requires any concessions from the provider to reduce the prices it charges the issuer for the policies it provides, A.M. Best must be made aware of how the price differs from arms-length market prices. This is accomplished by the provider demonstrating its policy pricing model to A.M. Best.

B. Attorneys for Reviewing Licensing Requirements and Sales Documentation Package

In general, after a provider makes a purchase offer to the seller of the insurance policy (normally, the insured), a sales documentation package is drafted. Through this documentation package, the issuer will contract to purchase from the seller all rights, titles and interests in the life settlement policy. The sales documentation package must be complete and must follow all applicable state insurance laws and regulations.

A.M. Best requires the following information in comfort letters written by attorneys for the transaction regarding:

• The completeness of the sales documentation package (for each insured) for compliance with established regulations for life settlement acquisitions;

• The states in which each provider in the transaction is licensed to conduct business (for states that require such licenses) and the insurance regulations related to life settlements or viaticals for those states; and

• Any outstanding legal issues surrounding the provider.

C. Tracking Agent

The cash flow to the securities depends on the payout of the death benefits (i.e. the maturity of the policies) by the insurers that have issued the policies in the collateral pool. Prompt collection of these death benefits requires the issuer to employ an independent tracking agent to track all the policies and their payouts.

The specific roles of the tracking agent, which should be outlined in an agreement between the issuer and the tracking agent, are as follows:

• Preparing reports showing the insured's whereabouts, including address and date of last contact, to be provided to the issuer on at least a quarterly basis.

• Maintaining logs of the contacts with the insureds or other individuals, records of addresses and phone numbers of those contacts, and result of contacts.

• Preparing reports, if requested by the issuer, regarding the amount of funds needed to pay premiums prospectively.

• Filing all necessary documents with each insurance company, including premium waivers, policy conversions, death certificates and documents necessary for the payment of death benefits.

A.M. Best will visit the tracking agents to be used in the transaction to determine whether they have the experience in tracking large pools of lives and whether they have the technological resources to perform such functions. Issuers who feel that they (or their providers) can track the insureds without employing a professional tracking agent must demonstrate to A.M. Best that they have experience in tracking lives, the software system set up to perform such tasks and the ability to provide the information listed above.

D. Collateral Manager

A.M. Best requires the issuer to enter a collateral management agreement with a collateral manager or to demonstrate the ability to

Exhibit 7

General Data Requirements for Life Settlements

	Representative Portfolio (For Indicative Debt Rating)	Actual Portfolio of New Life Settlements (For Debt Rating)	Actual Portfolio of Life Settlements in Existence for 5 Years or More (For Debt Rating)
Age	✔	✔	✔
Sex	✔	✔	✔
Smoking Status	✔	✔	✔
Annual Premium	✔	✔	✔
Names of Insurance Companies		✔	✔
Ratings of Insurance Companies		✔	✔
Face Value of Policy	✔	✔	✔
Assumed Life Expectancy	✔		
Two Actual Life Expectancies		✔	✔
Mortality Rating		✔	✔
Mortality/Survivorship Schedule		✔	
The Premium for Each Year	✔	✔	✔
Verified/Assumed Price of Life Settlement	✔	✔	✔
Assumed Policy Accumulation Period	✔		
Unique Identification for Insured		✔	✔
Unique Identification for Policy		✔	✔

perform the duties of a collateral manager. Some of the duties of the collateral manager in life settlement securitizations include:

• Managing the selection and acquisition (through approved providers) of the life settlements;

• Optimizing the features of the insurance policies backing the life settlements;

• Determining the appropriate amount of the premium reserve;

• Determining whether to engage a "stop-loss" insurer or obtain a liquidity facility for the transaction;

• Investing cash balances in approved, high-quality, short-term instruments;

• Developing a liquidation plan for the life settlements;

• Determining the liquidation value of the life settlements;

• Updating mortality tables used in the transaction based on new information or new medical advances;

• Determining the possible reduction in death benefits to reduce premium payments in an attempt to avert a liquidity crisis;

• Determining which policies should lapse in the event of a continued liquidity crisis; and

• Performing other duties in the interest of the transaction's security holders.

Some of the factors that A.M. Best considers when evaluating a collateral manager are as follows:

• Experience in life settlement investments and portfolio optimization;

• Knowledge of insurance policy features or access to experienced consultants;

• Actuarial experience either on staff or through consultants;

• Staffing and resources necessary to support the collateral management activities;

• The quantitative skills to create financial models to select/manage a life settlement portfolio and to determine which policies to dispose of, lapse or modify (if necessary); and

• The systems necessary to carry out its duties.

E. Backup Service Providers

Backup servicing agreements are important in life settlement transactions because the industry is in its development stage and servicers are usually small, unrated organizations. A.M. Best requires the issuer to seek out backup tracking agents and collateral managers (who presumably also perform policy administration and optimization).

A.M. Best requires an active backup tracking agent that will periodically (at least on a semi-annual basis) receive information from the primary tracking agent on the lives it is tracking and on the latest contact it has made with the insured. The backup tracking agent should have the electronic systems in place to accept the data transmitted by the primary tracking agent and should be able to prepare reports on tracking activities as requested by A.M. Best.

The backup collateral manager should meet the same requirements described in Section 7.D. that describes the expertise and experience any collateral manager should have.

F. Arrangers of the Transaction

The arrangers of the life settlement securitization transaction should clearly define their financial interest in the transaction. In addition, for arrangers that are not affiliates of large financial institutions, A.M. Best expects to be presented with their backgrounds, including their previous occupations and experience with life settlements.

8. Insurance Policy Pricing

A. Model

A.M. Best requires that a model be presented that provides the fair-market prices for the life settlements selected by the collateral manager that meet the issuer's minimum return hurdle rate for each life settlement included in the portfolio. This model should consider the mortality statistics that are representative of the impaired population comprising the policies in the portfolio. In addition, the issuer should be familiar with the supply-and-demand issues that can affect the pricing of the insurance policies. A.M. Best also requires that the prices produced by the pricing model be compared with actual prices observed in the market for reasonability. This pricing model may be used for the approximation of the liquidation value of the life settlement portfolio at the end of the transaction, after applying reasonably conservative mortality assumptions and considering any substantial insurance company downgrades.

B. Arms-Length Transaction

A.M. Best requires that all prices of polices and services reflect the prices prevalent in the market for all transactions. Therefore, A.M. Best will not consider the bargaining power of the issuer to achieve better prices on policies or services. The life settlement market is still under development, and there is no guarantee that any one policy provider or service provider will be in existence at the time the issuer is ready to acquire the policies or has completed its policy acquisition program. As discussed in an earlier section, an issuer who has entered into a financial arrangement with a provider (aside from the agreement for purchasing policies through the provider) must disclose the full nature of such an agreement.

9. Management Expertise

A qualitative aspect of the A.M. Best analysis is the assessment of the issuer's expertise in life settlements and structured securities. A small number of participants comprise the life settlement industry. Its participants have developed reputations in various areas, such as the ability to source policies, integrity in soliciting objective life expectancies and other matters related to the efficient execution of life settlement transactions. A.M. Best requires the issuer (or its representatives) to demonstrate a high degree of knowledge about policy providers, tracking agents, medical examiners and other significant service providers associated with the transaction. In addition, A.M. Best should be informed of any significant legal actions or complaints against any service provider that may be involved in the transaction.

10. Policy Optimization/Administration

A. Optimization

Issuers may choose to optimize premiums on certain types of insurance policies (such as universal life and variable universal life policies) by using the cash values in the policies to reduce premium payments. A.M. Best must be informed if the premiums on the representative policies upon which the rating is based have been altered in any way. Specifically, A.M. Best requests the following illustrations of premium schedules, which generally can be obtained from the insurance companies issuing the policies:

1. Current premium payment illustration that has not been altered in any way — i.e. the normal payment schedule of the insured;
2. Level-premium payment illustration for the entire life of the insurance policy in question (i.e. until the age at which the insured or beneficiary is entitled to the death benefits);
3. If the premium payment has been optimized in any way to lower premiums over any time period, a premium payment illustration showing premiums for both the optimization period and the remaining life of the policy; and
4. Premium payments assuming the lowest investment returns and the highest expense charges, especially for universal life and variable universal life policies.

If the collateral manager uses audited software to determine premium payments under various optimization schemes, A.M. Best requires a demonstration of such software and wants comparisons between the software's output and some illustrations produced by the insurance companies that

Exhibit 8

Summary of Policy Eligibility Criteria

- Insurance company must have a "B+" (Very Good) rating or higher.
- Confirmation from the insurance company that the policy is in force and not within the grace period.
- No restrictions prevent the payment of the current net death benefits at the insured's death, except for nonpayment of the current premiums.
- Verification from the insurance company that the policy is not encumbered by any other party.
- Confirmation from the insurance company that the policy has no outstanding debt.
- Confirmation that policy language does not prevent lump-sum payments of full insurance benefits.
- Face value of the policy or policies related to one insured does not exceed 3.33% of the total face value of the pool.
- Face value of the policy or policies in any one disease category does not exceed the percentages shown in Exhibit 4.
- Face value of the policy or policies issued by a single insurance company does not exceed 15% of the total face value of the pool.
- Projected life expectancy of the insured is certified by two licensed medical examiners.
- Purchases of fractionalized shares of policies generally are not permitted.
- Group policies are not allowed unless they are convertible.
- Confirmation that the policy has no outstanding debt.

have issued the policies.

As part of the optimization process, A.M. Best expects that the collateral manager will consider scenarios under which charges that are adjustable (such as the cost of insurance and expense charges) are increased to moderate levels in order to observe the effect on the policies in terms of premium payments.

B. Administration

A.M. Best expects that within one month of acquiring a policy, the collateral manager will submit forms to the relevant issuing insurance companies on behalf of the issuer to request that premiums be payable on an annual basis. If annual payment on a policy is not allowed, the request should be to minimize the frequency of payment to its allowable limits.

11. Portfolio of Life Settlements

A. The Portfolio and Acquisition Schedule

Issuers can only receive an indicative debt rating on their securities after providing A.M. Best with a representative life settlement portfolio. The life settlement prices in this representative portfolio must represent current prices — not just prices based on a model, but prices verified for reasonability with providers. In addition, A.M. Best expects realistic life expectancies that take into consideration the supply-and-demand issues specific to the life settlement market. Exhibit 5 shows the typical distribution of life expectancies assigned by medical examiners.

The data in Exhibit 5 show that about 13% of the evaluated policies have life expectancies of six years or less. This indicates that the supply of short life expectancies is limited, and thus the ramp-up period could be extremely long for any transaction that seeks collateral with short life expectancies, and the prices for such life settlements probably will be higher than standard pricing models will predict. The duration of the purchase period is particularly important to the extent that the issuer intends to issue securities and use the cash collected from investors to purchase the life settlement collateral in the transaction. If this ramp-up period were prolonged, the transaction would experience "negative carry" because the securities would be accruing interest while the maturities of the slowly accumulated life settlement collateral would be insufficient to cover such interest accruals.

To further illustrate why the supply of short life expectancies is limited, it is useful to observe the life expectancies of 75-year-old male nonsmokers—the typical profile of individuals likely to be in a pool of life settlements. Exhibit 6 shows the life expectancy of 75-year-olds based on various mortality ratings applied to the 2001 VBT. A 100% mortality rating applied to the 2001 VBT suggests that on the aggregate, the insureds being evaluated die based on the standard pattern established by the table. A 200% mortality rating suggests that the insureds die at twice the rate of the standard pattern established by the 2001 VBT, and so on. The mortality ratings, therefore, generally indicate the relative severity of diseases ailing the insureds. As shown in Exhibit 6, a 75-year-old male nonsmoker has a normal (unimpaired) life expectancy (based on 100% mortality rating) of about 14 years. The mortality ratings generally issued by medical examiners for the impaired lives of this age, sex and smoking status normally would range from 300% down to 150%, which translates to life expectancies between approximately 8.5 and 12 years. In order to achieve a life expectancy of about six years or less for this type of individual, the mortality rating would need to be 550% or more — rare mortality ratings for individuals with the profile under consideration.

A.M. Best will only issue an indicative debt rating for transactions that are to be ramped up in 12 months or less. In addition, the issuer must begin the acquisition program no more than three months after the indicative debt rating has been issued. A.M. Best requires that the issuer provide an acquisition schedule that outlines

Exhibit 9

Best's Cumulative Average Impairment Rates*

Years	A++/A+	A/A-	B++/B+	B/B-	C++/C+	C/C-	D
1	0.06 %	0.24 %	0.54 %	1.80 %	2.65 %	5.51 %	7.20 %
2	0.21	0.64	1.52	3.73	4.74	8.43	12.20
3	0.39	1.16	2.44	5.56	7.45	11.12	16.92
4	0.59	1.68	3.72	7.26	10.27	14.17	21.25
5	0.78	2.29	5.09	9.07	12.77	17.38	25.58
6	1.04	2.97	6.35	10.97	15.15	21.58	29.72
7	1.32	3.67	7.68	12.79	17.52	25.04	33.39
8	1.63	4.43	8.68	14.73	20.28	28.68	36.57
9	2.03	5.10	9.43	16.57	22.48	31.63	39.43
10	2.45	5.78	10.24	18.20	24.37	33.81	42.13
11	2.89	6.48	11.10	19.80	26.13	36.36	44.58
12	3.39	7.08	12.15	21.55	27.57	38.21	46.48
13	3.91	7.70	13.05	23.37	28.54	39.61	48.27
14	4.45	8.23	13.92	25.12	29.86	41.10	49.69
15	4.86	8.69	14.56	26.54	30.82	42.75	50.94

*Table is taken from the methodology report "Best's Impairment Rate and Rating Transition Study-1977 to 2002," published March 1, 2004.

the number of life settlements it realistically expects to purchase each month by life expectancy categories. The issuer also must demonstrate that its providers have the ability to supply a sufficient number of life settlements for the transaction.

The discussion in this section has centered primarily on providing an indicative debt rating to securities in transactions based on a representative portfolio of life settlements. However, debt ratings (as opposed to indicative debt ratings) are issued to securities collateralized by actual or existing portfolios that either are newly acquired or have been in existence for five years or longer. Exhibit 7 summarizes the general data requirements for a representative portfolio, a newly acquired portfolio and a portfolio that has been in existence for at least five years.

B. Portfolio Liquidation Plan

The securities issued by the bankruptcy-remote vehicle (the issuer) can mature before all of the life settlement collateral matures. Therefore, a comprehensive model for evaluating the credit risk of the securities has to consider the liquidation timing and liquidation prices.

Since the time needed to liquidate a portfolio of life settlements is difficult to determine, any liquidation plan should be put into action well in advance of the need for liquidity. A.M. Best expects liquidation of the life settlement portfolio to begin at least one year before the maturity date of the securities, after considering the life settlements that are likely to mature in that one-year period. In addition, since future life settlement prices are difficult to predict, the liquidation price calculation should use a conservative mortality table, such as the standard 2001 VBT (unadjusted for impaired lives), and also should apply stresses to this table as an extra measure of conservatism.

12. Documentation

A. Tax Opinion

Since life settlement collateral is a new asset class for securitizations, it is imperative that issuers understand its tax implications. Specifically, A.M. Best expects the issuer to engage tax advisers to provide an opinion about the recognition or amortization of expenses such as premium and administrative expenses in bankruptcy-remote vehicles in the vehicles' country of domicile. Any requirements for tax withholdings also should be determined by tax advisers.

B. General Legal Opinions/Tax Opinion/Documentation

The following are some of the required general opinions, conditions and verifications for setting up a transaction collateralized by life settlement:

- Unqualified legal opinion indicating that the transfer of life settlements from the seller to the issuer constitutes a true or absolute sale, not a pledge of collateral.
- Legal opinion stating that if the transferor becomes insolvent, neither the issuer nor its assets or liabilities would be substantively consolidated with the transferor.
- Unqualified legal opinion that the issuer will satisfy special-purpose, bankruptcy-remote criteria such as:
  - Issuer's business must be restricted to the purchase of the life settlements and the issuance of the rated debt;
  - Issuer may not incur any additional debt unless the additional debt is fully subordinated to the rated debt and the subordination is explicitly stated in the legal documents;
  - Additional debt will not impair the rating of the rated debt;
  - Issuer should have a separate corporate existence with independent officers and directors, separate books and records, and appropriate meetings of the board of directors to authorize corporate action;
  - Issuer shall not engage in any dissolution, liquidation, consolidation, merger or asset sale (other than as provided in the relevant transaction documents) or amendment of its organizational documents so long as the rated securities are outstanding;
  - All of the issuer's assets, such as the life settlements, the various proceeds accounts, the escrow accounts and all other assets that generate income for the structure, should be pledged to secure the issuer's debt;
  - Tax opinion to the effect that the issuer would not be subject to federal, state or local taxes;
  - If taxes are to be paid on the cash flow of the issuer, a tax opinion on the capitalization of certain expenses, including premium payments and fundraising costs; and
  - Written agreements with all service providers, such as tracking agent, providers and collateral managers.

Exhibit 10

Assumed Recoveries After Insurance Company Impairments

Policy Face Value	% Recovery
$300,000	100
$1,000,000	86
>$2,000,000	80

• Normal documentation associated with private placements such as: offering memorandum, trust indenture, trustee agreements, etc.

• Report on each policy detailing any contradictions between the original insurance application and the medical records of the insured.

• Disclosure of any agreements (written or unwritten) between the issuer and any other parties that outline the distribution of the residuals in the transactions after the rated debt has been fully redeemed.

• Anti money-laundering provisions in the legal documents.

Evaluating the Credit Risk of the Securities

1. Mortality Risk of the Life Settlements

Rating securities backed by life settlements is a more difficult task than rating standard collateralized debt obligation securities backed by corporate bonds. For one thing, there are many more parameters — from an analytical perspective — that can greatly affect the cash flow of a life settlement portfolio, such as: the age of the individuals behind the life settlements, their life expectancies (and the statistical distribution around the life expectancies), gender, smoking status, the premium payments and the credit risk of the companies that issued the polices. By contrast, corporate bonds often are rated individually, and their maturity dates generally are known with certainty. Therefore, credit risk is the primary risk when rating securities backed by such bonds. The ratings of life-settlement-backed securities are determined primarily by mortality risk, which is more difficult to quantify because of the various factors mentioned earlier. For example, two individuals can have the same life expectancy but different yearly probabilities of death because of a difference in age or gender.

To model the mortality pattern of life settlements, A.M. Best primarily uses the 2001 VBT for the age, gender and smoking status of each insured in the life settlement pool. This table then is modified by the mortality rating given by medical examiners. Alternatively, the mortality rating for a particular life can be derived by the life expectancy assigned by the medical examiner in order to produce a mortality pattern. Either way, the standard mortality schedule for an insured is modified to produce an expected pattern of death for a population with similar diseases that have impaired the lives of the insureds. This new mortality schedule is modified further to take into consideration the assumption that the insureds in the life settlement pools have better medical care than the general population. If a medical examiner provides a mortality schedule for each insured in the pool, A.M. Best also applies them to the transaction as an extra check of its integrity. Furthermore, if an insured lives beyond twice his or her life expectancy, A.M. Best assumes that the applicable mortality table after this time is the unadjusted 2001 VBT.

A.M. Best will consider using a mortality table derived from (non-HIV/AIDS-related) empirical data provided by medical examiners or other sources that track death patterns for impaired lives. Unfortunately, it has been A.M. Best's experience that there is insufficient historical data of life expectancy predictions vs. actual deaths in portfolios of life settlements to help with the construction of statistically significant mortality tables based solely on such empirical data.

2. Insurance Company Impairment Risk

The risk of insurance company impairments[2] is an additional factor to be considered in assessing the credit risk of securities backed by life settlements. A.M. Best maintains ratings on an overwhelming majority of U.S. insurance companies, so it is highly likely that there are A.M. Best ratings on all the companies in the pool backing the securities. A.M. Best requires that the insurance company candidates for inclusion in the transaction pool have Financial Strength

Exhibit 11

Best's One-Year Rating Transition Matrix*

	Rating One-Year Later							
	A++/A+	A/A-	B++/B+	B/B-	C++/C+	C/C-	D	Impaired
A++/A+	92.36%	7.11%	0.44%	0.02%	0.00%	0.00%	0.00%	0.06%
A/A-	4.72	90.18	3.96	0.58	0.11	0.06	0.15	0.24
B++/B+	0.41	11.69	79.77	5.87	0.72	0.34	0.65	0.54
B/B-	0.20	1.03	15.43	75.07	3.99	1.09	1.39	1.80
C++/C+	0.25	0.68	1.98	18.15	66.98	5.68	3.64	2.65
C/C-	0.00	0.66	0.26	4.59	15.62	65.09	8.27	5.51
D	0.10	0.81	1.57	3.62	3.29	3.38	80.03	7.20

	Rating One-Year Later	
	Secure	Vulnerable
Secure	97.93%	2.07%
Vulnerable	9.87%	90.13%

*Table is taken from the methodology report "Best's Impairment Rate and Rating Transition Study-1977 to 2002," published March 1, 2004.

[2] See *Best's Impairment Rate and Rating Transition Study—1977 to 2002* for a definition of insurance company impairment.

Exhibit 12

Best's Idealized Default Matrix*

Years	aaa	aa+	aa	aa-	a+	a	a-	bbb+	bbb	bbb-
1	0.03%	0.03%	0.04%	0.05%	0.06%	0.11%	0.16%	0.21%	0.23%	0.27%
2	0.08	0.11	0.13	0.23	0.32	0.44	0.56	0.67	0.74	0.89
3	0.14	0.20	0.26	0.42	0.58	0.76	0.95	1.13	1.25	1.51
4	0.22	0.31	0.41	0.62	0.84	1.08	1.33	1.58	1.76	2.13
5	0.31	0.45	0.58	0.84	1.10	1.41	1.71	2.02	2.25	2.75
6	0.42	0.60	0.79	1.08	1.37	1.73	2.09	2.46	2.74	3.37
7	0.53	0.77	1.01	1.33	1.64	2.06	2.47	2.88	3.21	3.98
8	0.66	0.96	1.25	1.58	1.92	2.38	2.84	3.31	3.68	4.58
9	0.79	1.15	1.51	1.85	2.20	2.70	3.21	3.72	4.13	5.18
10	0.94	1.36	1.79	2.13	2.48	3.03	3.58	4.13	4.58	5.76
11	1.09	1.58	2.08	2.42	2.76	3.35	3.94	4.53	5.01	6.33
12	1.24	1.81	2.38	2.72	3.05	3.68	4.30	4.92	5.43	6.88
13	1.40	2.05	2.69	3.02	3.35	4.00	4.65	5.31	5.84	7.42
14	1.57	2.29	3.01	3.33	3.64	4.32	5.01	5.69	6.25	7.93
15	1.73	2.53	3.34	3.64	3.94	4.65	5.36	6.06	6.64	8.43

*Table is taken from the methodology report "A.M. Best's Idealized Default Matrix," published Oct. 18, 2004.

Ratings (FSRs) of "B+" or higher.

A.M. Best's approach to evaluating the credit risk in life settlement transactions begins with a determination of the impairment rate of each insurance company in the collateral pool. A.M. Best has developed a proprietary impairment rate table based upon its proprietary database of more than 4,900 domestic insurance companies it has evaluated from 1977 to 2002. This data set, combined with approximately 580 incidents of impairments, forms the basis for the most comprehensive impairment statistics in the insurance industry. As a result, A.M. Best has calculated long-term, cumulative average impairment rates that can be applied to structured transactions such as life settlement securitization transactions. Please see the methodology report *Best's Impairment Rate and Rating Transition Study—1977 to 2002*, published March 1, 2004, at *www.ambest.com* for a discussion on insurance-company impairments. The cumulative impairment rate table based on FSRs for life insurance companies is shown in Exhibit 9.

3. Recoveries of Death Benefits after Insurer Impairments

Insurance company impairments may result in the diminution of death benefits. In general, guarantee funds cover nearly all death benefits in the event of an insurance company's impairment up to a limit of about $300,000 in many states. However, this $300,000 payment limit is probably smaller than the face values of the policies in most life settlement transactions, which generally range from $1 million to $2 million. The unpaid death benefits are paid out of the estate of the insolvent insurance company if the company goes into liquidation. While the anecdotal evidence is that policyholders do not lose money in life insurance company insolvencies, a rigorous life settlement model must include the possibility of losing money should such events occur. In addition, no one can be certain that as more life settlement securitizations are consummated, legislators won't impose restrictions on the payments to the bankruptcy-remote vehicles that own life settlements in the event of insurance company impairments. A.M. Best assumes the recovery rates on Exhibit 10 for the proceeds of impaired insurance companies. The recoveries are assumed to be achievable in three months.

4. Life Settlement Liquidation Value During Impairment

If there are life settlements that have not yet matured at the end of a transaction, the issuer would have to liquidate policies and use the proceeds to pay any outstanding obligations to security holders. A.M. Best assumes no liquidation value for life settlements that have not matured by the end of the transaction and that have been issued by insurance companies that have ratings below "B+" (i.e. ratings from "B" to impaired). This is particularly important for transactions in which the legal maturity of the securities issued by a bankruptcy-remote vehicle is shorter than the maturity of the last life settlements in the transaction.

Exhibit 11, Best's One-Year Rating Transition Matrix, shows the movement of ratings over a one-year period. Such a matrix can be helpful in estimating the probability of company ratings moving below "B+." For example, the exhibit shows that a company originally rated in the "A/A-" (Excellent) category has a probability of 1.14%[3] of being downgraded below "B+" over a one-year period. A.M. Best applies the appropriate transition matrix to its analysis depending on the legal term of the transaction being evaluated.

5. Cash Flow Model/Use of Issuer Credit Rating Default Table

A.M. Best has developed its own proprietary Monte Carlo simulation model for evaluating life settlement transactions, but the company expects to receive a copy of a model created by the issuer (or its representatives) that takes into consideration prices and face values of the life settlements, the statistical distribution of deaths, insurance company impairments, recoveries associated with such impairments, premiums,

[3] The probability of a downgrade is calculated as follows: 0.58% + 0.11% + 0.06% + 0.15% + 0.24% = 1.14%.

liquidation value, payments on the securities collateralized by the life settlements, and other significant modeling parameters. A.M. Best will model the transaction and compare its results with the output from the issuer's model. The ultimate output of A.M. Best's cash-flow model is the default probability of the securities in the transaction. This default rate is then tied to Best's Idealized Default Matrix (Exhibit 12), which shows the default rates associated with Issuer Credit Ratings (ICRs). The securities are assigned ICRs, not FSRs.

Surveillance Requirements

If the issuer is seeking an indicative debt rating, A.M. Best requires monthly updates on the pace of acquisition of the life settlements and on revised plans for ramping up of the transaction. Any planned changes for the structure of the transaction during the policy acquisition period also must be communicated immediately to A.M. Best, since such a restructuring may affect the indicative debt rating, and hence the final debt rating.

As the life settlement policies are being acquired, A.M. Best will require the following information about each insurance policy in the transaction within two weeks of the acquisition:

- A unique policy identification number;
- A unique identification number for each life;
- Insurance company that issued the policy;
- Classification of the types of policies in the following categories: universal life, whole life, variable life, variable universal life, survivorship universal life, and term;
- In-force date of the policy;
- Rating of the insurance company at the time of policy's purchase;
- Policy face value;
- Date policy was acquired for the transaction;
- Acquisition cost for each policy;
- Medical examiners used;
- Insured's date of birth;
- Life expectancies by the two medical examiners;
- An indication of policies that required a third medical examiner;
- Date of life expectancy evaluation;
- Date of latest medical records used in the life expectancy evaluation;
- Current premium payment;
- Date of change in premium payment (if policy is optimized);
- Name of tracking agent;
- Primary disease;
- State where insured lived at the time the sale documentation package was executed; and
- Name of policy provider.

After life settlements have been acquired by the issuer, A.M. Best would like immediate notification of:

- The date of death of any insured;
- The date the death was reported to the issuer;
- The date the death benefit was collected;
- The liquidation price of the policy (if policy is sold);
- The cumulative premium payment for each deceased insured;
- Any changes in premium payments, death benefits, crediting rates, expense charges, borrowings against policies, or other features that could affect the net cash flow of the life settlement;
- Any planned changes in the calculation methodologies by the insurers issuing the policies in the pool that can affect premium payments, death benefits, crediting rates, expense charges or other features that could affect the net cash flow of the life settlement; and
- Any lapses.

On a quarterly basis, A.M. Best would like the following information for any insured:

- Cumulative dividends received on each policy;
- Cumulative premium payment for each policy;
- The policies that had a change in premium or net death benefits; and
- Policies with debt.

Every six months, A.M. Best expects a projection of the maturities in the life settlement portfolios from that point to the end of the transaction. If the projected maturities result in a shortfall of the cash flow necessary to pay the premiums or any principal or interest due on the securities, A.M. Best expects to see a plan from the issuer for averting a liquidity crisis. A.M. Best also will periodically request information from the backup tracking agent to make sure it has up-to-date records of the insureds being tracked.

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