



Aurora Defined Benefits Fund

Prudent Life Settlement Investing



Introduction

No wonder life settlements are misunderstood

- Life insurance protects you from “premature” death but isn’t called “death insurance”
- Health insurance protects you from sickness but isn’t called “sickness insurance”
- Most insurance protect you from things you try very hard to avoid while life insurance protects you from something you cannot
- Yet, most consumers lapse their life insurance before they die
- Insurance contracts are called “policies” but reinsurance contracts are called “treaties”
- The life settlement market’s performance is tied to “mortality” but we only hold “longevity” conferences
- Payments for other contracts are called “consideration” but payments for insurance are called “premiums”



Introduction

Life settlements basics:

- Life settlements, “traded life policies” or “TLP”s are life insurance policies which have been sold to an investor
- Life insurance and life settlements are poorly understood
- Not all things referred to as being “life settlements” are true life settlements
- Before you can understand life settlements, you must understand life insurance
- Life settlements **are** life insurance policies
- A properly managed life settlement investment is a financial tool which can help investors achieve their financial goals
- Improper use of any tool can be risky
- Education is the key to understanding life settlement investing



The good

Life settlements are an attractive alternative asset

- 7 to 9 % net returns
- No correlation to stock, bond, commodity or property markets
- Long-term, growth-oriented asset
- Death benefits are obligations of large, highly-rated financial institutions
- Death benefits are “first-priority” obligations
- Supply tied to rapidly aging population
- Demand tied to need to grow wealth for the future
- Demand is fragmented
- Alternative investments are catching on
- Pension funds are seeking to “catch-up”
- Market conditions are ideal for the intelligent investor



The (not so) bad

Life settlements are an attractive alternative asset

- Highly specialized market
- The details and processes required are labor intensive and complex
- Experiential knowledge and expertise is required but scarce
- Qualitative and quantitative exercises must be conducted
- The market is dynamic and challenging
- Shake out of mark-to-model structures is not yet complete
- Some intermediaries still trying to be all things to all people
- Post-purchase management is critical but not common
- Tertiary market is developing slowly and is crowded with “vulture” investors
- Market is under new forms of duress



The ugly

Life settlements are an attractive alternative asset

- FSA has described life settlement investments as being “toxic” for retail investors
- Us regulators said the same thing about mortgage investments for institutions
- Several large life settlement funds have suspended trading
- The asset class was abused by institutional players & “structuring”
- Headlines are often negative
- Misinformation and “hype” abound
- Many mark-to-model valuations have been exposed but its not over
- Overemphasis on the quantitative remains entrenched
- Regulators are ill-informed, reactive and intentionally hard of hearing
- Investors are upset and confused
- Alternatives are still new to most investors and very new to “retail” investors
- Staying the course is difficult in uncertain times



Back to basics

What is life insurance?

- Life insurance protects a consumer's beneficiaries from the risk of their "premature" death
 - Capital at work replaces income earned by the consumer at work
- Life insurance is a legally binding contract between a consumer and an insurer
 - The contract or policy is the asset
- This contract cannot be changed except by mutual consent of both parties
- To the insurer, a policy is a long term liability
- To the consumer, a policy is a long term asset
- The consumer pays premiums and the institution promises to pay the "death benefit" when the consumer dies



Back to basics

What is life insurance?

- Life insurance provides protection against an **ABSOLUTE CERTAINTY**
- There are three (3) major categories of life insurance sold in the US:
 - Term Life
 - Whole Life
 - Flexible Premium Adjustable Life or “Universal” Life
- There are many, many variations within each category
 - Products change constantly
- Most life settlements involve *universal life* insurance policies



Back to basics

Flexible Premium Adjustable Life Insurance (aka Universal Life)

- A form of permanent insurance
- Certain features and benefits of the policy can be changed (“Flexible”)
- Premiums are not fixed and can be varied (“Adjustable”)
- Premiums consist of three elements:
 - Interest expense charges
 - Overhead expense charges
 - Mortality expense charges (COIs)
- Death benefits can be fixed or variable within limits (“Death Benefit Options”)
- Term insurance with a “side fund” or “investment feature”
- Universal Life is the most common type of life settlement policy
- Premiums are a key component of life settlement investing



The asset

A life insurance contract involves:

- An insurance company
- An agent or broker
- A policy owner
- An insured
- A beneficiary

A life settlement involves:

- An Insurance company
- An agent or broker
- A policy owner
- An insured
- A beneficiary

What's the difference?

The policy owner and beneficiary change but, all other parties do not change. The asset is still a life insurance contract!



The asset

So what makes a life insurance policy a life settlement?

- The original policy owner **sells** the contract to an investor
- The investor **buys** the contract at a deep discount (%-age of the death benefit)
- The original owner is **replaced** by the investor
- The original beneficiary is **replaced** by the investor
- The agent or broker continues to receive residual commissions
- Premiums are paid by the new owner
- The new beneficiary will still receive the death benefit



Longevity risk

Longevity risk is the risk associated with living too long
The primary risk associated with life settlements is longevity risk

Life insurance companies take longevity risk by selling annuities

- The insurer receives cash “up front”
- The insurer agrees to pay periodic income to the annuitant (the insured)

If the insured dies:

- **EARLY** - the insurance company keeps the excess premium paid and earns a higher return
- **WHEN EXPECTED** - the insurance company earns its expected return
- **LATE** - the insurance company earns less than its expected return

Life settlement investments are tied to longevity risk

- Life expectancy determines outcomes
- A combination of quantitative and qualitative work must be done

If the insured dies:

- **EARLY** - the life settlement earns a higher return
- **WHEN EXPECTED** - the life settlement earns an expected rate of return
- **LATE** - the life settlement earns less than its expected return



Longevity risk

What can happen?

- If a life settlement has a purchase LE of 48 months, and the insured lives 12 months longer than expected
 - the “extension risk” is 25% greater
 - The purchase LE is no longer valid as the basis for valuing the policy
- The impact on IRR is a decrease of 5%
- The impact is caused by:
 - Having to pay premiums 12 months longer than expected
 - Not receiving the death benefit when expected
- The death benefit will be paid

What it could mean?

- The insured has moved off the path they were on
- A decision needs to be made
- Data is needed
- Mark-to-model funds have an incentive not to acknowledge this risk
- If a large portion of the fund is close to its LE, it stands to reason not all will die on time and most will extend
- Unplanned premium payment will be required
- Liquidity will be affected
- Valuation will be affected



Market participants

Sell-Side

- **Policy Owners/Insureds**
 - Consumers
 - Trusts
 - Companies
 - Charities
- **Insureds**
- **Beneficiaries**
- Policyowner Advisors
 - Insurance Agents
 - Distribution platforms
 - Financial planners
 - Accountants
 - Attorneys
 - Securities brokers
- Brokers
 - Policy brokers

Service Providers

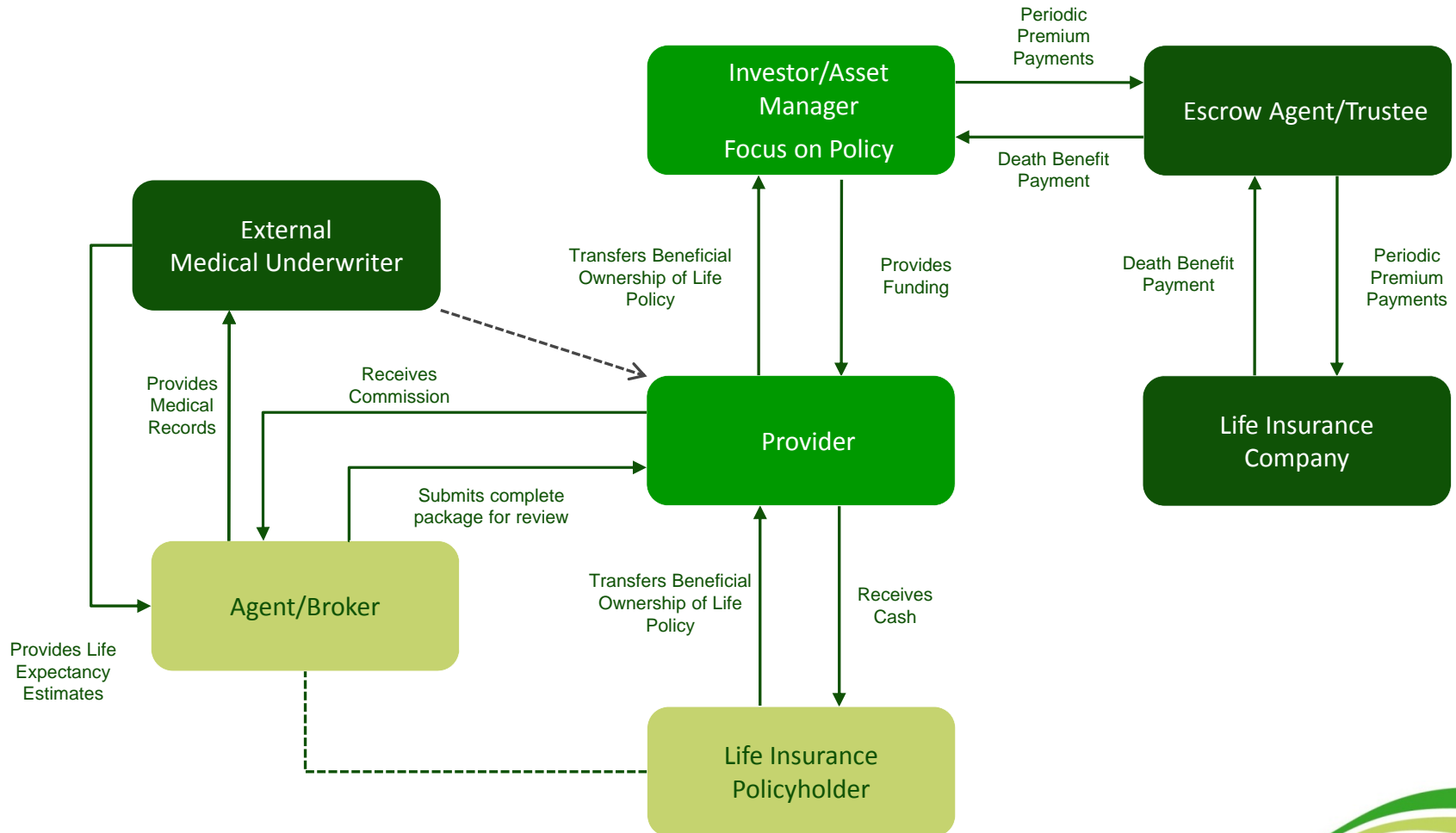
- Medical Underwriters
 - AVS, 21st Services & Fasano
 - Make money selling reports
 - Take NO investment risk
 - Consultants
- Servicers
 - Tracking insureds
 - Premium payment calculation, direction & verification
 - Claim processing
- Banks, Trust Companies, etc.
 - Escrow Agents
 - Securities Intermediaries
 - Verification Agents
 - Cash Managers
 - Premium Paying Agents

Buy-Side

- Providers
 - **Non-fiduciary role**
 - Licensed & regulated
 - Secondary market orders
 - Paid per transaction
- Asset Managers
 - Decision-makers
 - Fiduciaries
 - Passive & active models
- Financing Entities
 - Special purpose vehicles
 - Funds
 - Trusts
 - Partnerships & Other Structures
- Investors
 - Retail
 - Institutional



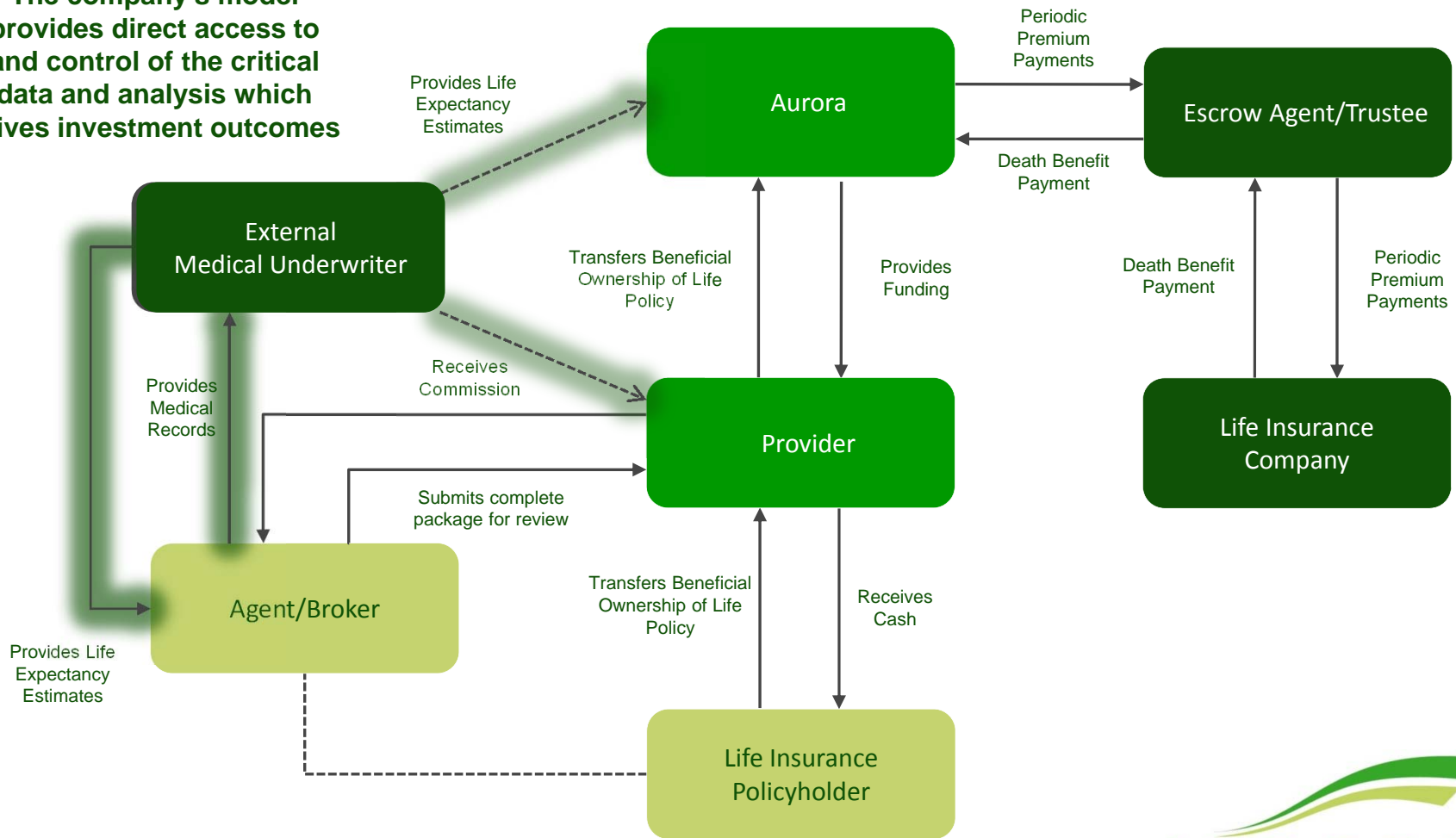
Typical secondary market transaction





Aurora secondary Market transaction

The company's model provides direct access to and control of the critical data and analysis which drives investment outcomes





Selection process

Policy Component

- Reverse-engineering policies is complex and detailed oriented
- Most market participants have developed this skill
- The mathematics involved is well-established
- Policy types and products change constantly

Quantitative

- Data over time is growing and improving
- Actuarial math requires large volumes of data
- Negative valuation is possible
- Most policies are not suitable

Life Component

- The life of the insured drives 80% of the outcome
- Start with the source of the data
- Verify, validate and then assess the assessors
- Establish and maintain connection to the insured

Qualitative

- Who, what, how, why, where and when matter
- Underwriting is not a math problem
- Medical data is subject to interpretation
- Life expectancy assessment is part science and part art



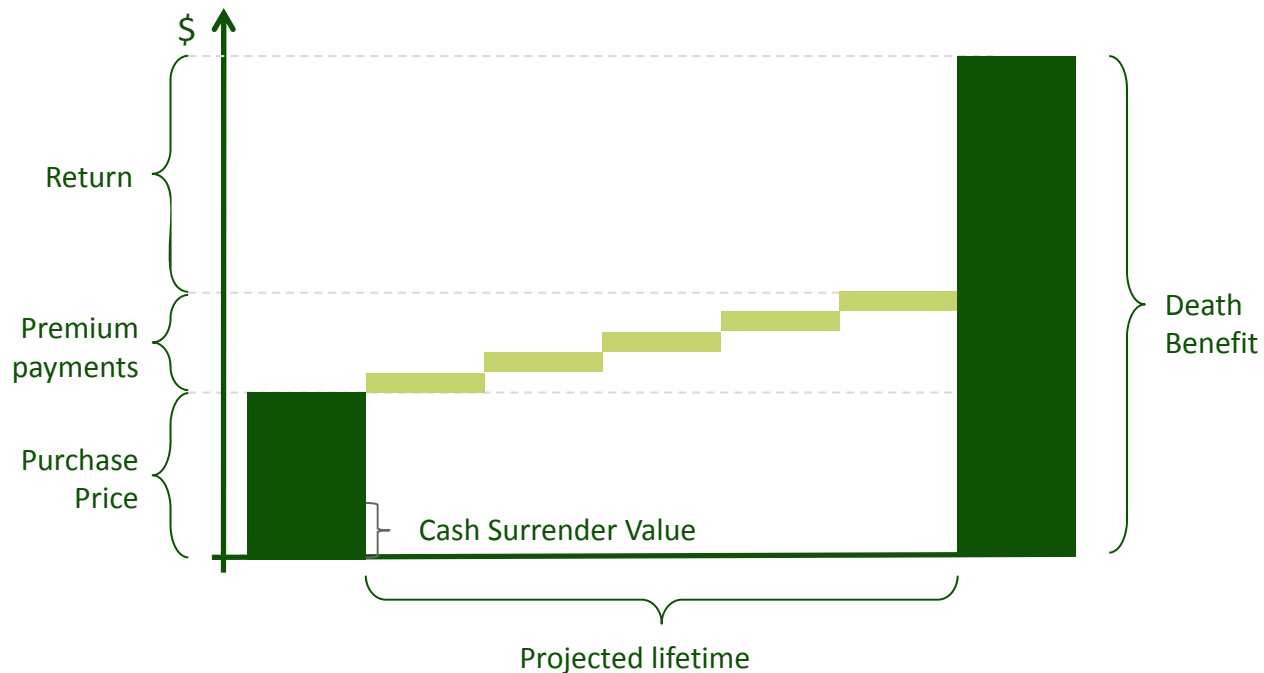
Life settlement valuation

How is the value of a life settlement determined?

- The death benefit will be paid
- The question is when
- The answer is tied to the life expectancy of the insured
- Premiums must be paid while the insured is living
- The value of the policy is determined by discounting the value of the expected future payment (death benefit) MINUS the future value of the premiums you expect to pay while the insured is living
- There are only two possible outcomes along the way:
 - a) The insured **lives**, you pay premiums and don't collect the death benefit
 - b) The insured **dies**, you collect the death benefits and stop paying premiums



Life settlement valuation



Keys to success:

- An experienced team with intelligence, expertise and common sense
- Rigorous and exhaustive medical underwriting consistently applied
- Control over critical activities, processes and procedures
- Adaptive systems managed for now and the future

▶ A life settlement represents an opportunity to purchase a ***fixed sum payable in the future*** by a highly-rated institution at a significant discount



Life settlement valuation

Four approaches:

- Purchase price + Premiums paid
- Purchase price + premiums paid plus LE assumptions
- Maximum purchase price – discounts + premiums paid plus LE assumptions
- **Purchase price + premiums paid adjusted for current prices paid for “like kind” assets**



Valuation methodologies

Mark to Model

- Assumes life expectancy “erodes” uniformly over time
- Generally appears as a “staircase” or gradual slope of rising value
- Breaks down when insureds reach expected date of death but are still living
- Inhibits ability to manage
- Enables management to collect incentive fees based on calculations not actual outcomes
- Overstates share value for later stage investors
- Discourages valid re-underwriting-new LEs may reveal actual extensions and cause devaluation
- Unlikely to enable borrowing if needed

Mark to Market

- Compares assets in portfolio to “like kind “ assets being transacted in the market
- Can be validated by current experience
- May understate value of portfolio assets
- Current indices do not adequately segment the market
- Uses actual transactions from origination platforms
- Market volume directly affect volume of data used for index
- Not all market participants contribute data
- Not all investors use the same underwriting approach
- More likely to enable borrowing if needed
- Much, much more transparent
- Better method of handling extension risk
- Allows management to be active buyers and sellers
- Reflects the true volatility of prices



A brief history

The way it was:

- Small policies
- Younger ages
- Shorter life expectancies
- Simplified underwriting
- Single impairment focus (AIDS)
- High fees
- Fractional interests
- No formal structure
- Deterministic valuation
- No leverage (gearing)

The way it went:

- High, simultaneous, uniform demand
- Supply perceived as limited
- Rapidly rising prices
- Decreasing returns
- Institutions tried to outsmart insurers
- “Manufactured paper”
- Unrealistic expectations
- Over-leveraged structures
- Global credit crisis
- Numerous institutional structures fail



The opportunity

The way it is...

- Lowest prices in history
- Lowest costs in history
- Very attractive returns
- Low leverage
- More robust underwriting
- Growing, more diverse supply
- Diverse range of LEs
- Straightforward structures
- Rational expectations
- Much more transparency
- Challenges remain...

What it means:

- Best values are available now
- The most cost-effective terms
- Highest returns possible
- Returns are not leveraged
- Investors can be highly selective
- Smaller policies being ignored
- True diversification is possible
- Simple products are available
- Lessons have been learned
- Disclosures are more robust
- Building a strong portfolio takes time



The opportunity

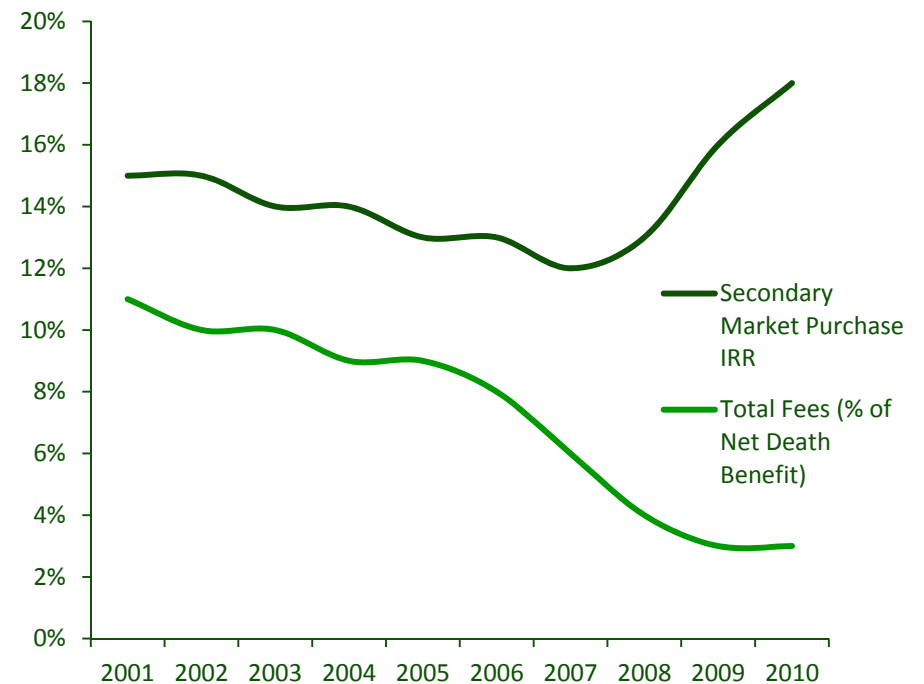
Secondary Market

- Now is the best time in the market's history to "organically" originate assets at high yields
- Prices and transaction costs are at all-time lows
- Regulatory environment-industry favorable
- Favorable demographics
- Process efficiencies are beginning to penetrate

Tertiary Market

- Rapid growth in tertiary market over the past 3 years as financial crisis has turned many investors into distressed sellers
- Largely impaired portfolios
- Expected growth to over \$115B over next 5 years
- Demand for portfolios is increasing, but supply of properly originated and managed portfolios is not

Gross Purchase vs. Cost Divergence





Aurora

Features & Benefits

- 6 year track record
- Mark-to-model valuation
- 7 to 9% returns with no leverage
- Transitioning to direct investment
- Buying at historically low prices
- 100% of upside returns paid to investors
- 10% bonus share allocation
- Low management fee of 1.25% per annum
- \$10,000 minimum investment
- Experienced management team
- Independent valuation based on actual market data
- Attractive non-correlated returns
- Hyper-selection of best assets at lowest prices = better outcomes
- Best time to buy in 20 years
 - Lowest costs
 - Lowest prices
- Immediate upside through extra shares



Things to remember

Investors considering life settlement investments should:

- ASK QUESTIONS!
- Understand the risks, features and benefit
- Understand that making money takes time AND discipline
- Understand that all life settlement investments are not the same
- Position life settlements in their portfolio properly
- Avoid buying overvalued shares
- Buy low, sell high
- Question outrageous claims, headlines, statements, etc.
- Question the sense of mark-to-model valuation
- Think of the “market” as having one sector
- Don’t give away the upside
- Use common sense (it’s not very common)
- Do it now



Aurora & EEA

	Aurora	EEA	Notes
Portfolio	<ul style="list-style-type: none"> Traded Policies Fund Cash Transitioning to direct investment 	<ul style="list-style-type: none"> Viatical & Life Settlements Cash Direct investment 	<ul style="list-style-type: none"> Aurora is transitioning to direct investment at the bottom of the market-buying low is good EEA started right before the market peak, used mark-to-model during the Table Shift Event Of 2008. EEA is in suspension and cannot buy when conditions are ideal
Market Position	<ul style="list-style-type: none"> Buying life settlements at historic lows Small fund with mark-to-market valuation Equal treatment for all shareholders 	<ul style="list-style-type: none"> Fund currently in suspension Mark-to-model valuation Extension risk method is flawed 	<ul style="list-style-type: none"> Mark-to-model only works in rising markets Re-underwriting, lapses and sales expose actual values Conflict between need for liquidity and need to preserve valuation Premium burden could be rising rapidly
Underwriting	<ul style="list-style-type: none"> AVS 21st Services Fasano Associates Proprietary underwriting on a case-by-case basis 	<ul style="list-style-type: none"> Two independent reports Claims to re-underwrite Uses nurses to track insureds Uses single impairment stats (coding issue) 	<ul style="list-style-type: none"> Nurses are not medical underwriters and tracking is not underwriting Single impairment diversification is invalid Verification, validation and assessing the LE companies is critical
Premiums	<ul style="list-style-type: none"> 12 month premium-to-face amount ratio <4% 	<ul style="list-style-type: none"> 12 Month premium-to-face amount ratio is 6.27% (60% higher) 20+% of portfolio over 90 years of age-premiums high 	<ul style="list-style-type: none"> Enough cash on hand to pay premiums for 9 months 12 months premiums = 1.33% of cash on hand = \$96MM Total premium to face amount ratio 6.27% 77.4% of portfolio is 80 to 99 years of age Premiums could outstrip cash on hand
Policy Types	<ul style="list-style-type: none"> Flexible premium adjustable life (Universal) Convertible Term Life (to Universal) 	<ul style="list-style-type: none"> Universal Group Term Whole Life Variable Term 	<ul style="list-style-type: none"> Documents divide Flexible Premium Adjustable Life & Universal Life-THEY ARE THE SAME THING Whole Life is expensive Term may not be convertible Group term hard to service



Aurora & EEA

	Aurora	EEA	Notes
Fees	<ul style="list-style-type: none"> Transparent fee for buying and selling with minimums and caps 	<ul style="list-style-type: none"> Pays fees to buy and 75% of upside to manager and sub-advisor-highest incentive fees in the industry 	<ul style="list-style-type: none"> At a given size, AUM fees and sharing of upside should be in line with other hedge fund products (2 & 20) Aurora incentivizes buying more policies
Extension Risk	<ul style="list-style-type: none"> Diversification of life expectancies Can make decisions to sell, lapse, buy or hold-no mark-to-model constraints 	<ul style="list-style-type: none"> 22.49% of portfolio insureds are 69 or younger 21% of portfolio insureds are 90 or older Concentration risk on either end of curve 	<ul style="list-style-type: none"> LEs for younger ages are extremely volatile Policies without maturity extension could lapse Premiums at extreme older ages are high The longer you live, the longer you're likely to live The younger you are, the more time you have to get healthy
Servicer	<ul style="list-style-type: none"> Full service, post-purchase administration-affiliate of manager Insureds tracked by regulated parties Preserves relationship with insured Servicing is comprehensive and tied to original valuation & pricing 	<ul style="list-style-type: none"> Servicer does not optimize premiums Key management function is outsourced Mark-to-model approach affects expected premium streams 	<ul style="list-style-type: none"> Tracking is required by law to be done by a licensed provider in some states Servicing is an asset management function-should not be outsourced
Custodian	<ul style="list-style-type: none"> 2nd largest bank custodian in market 2nd largest Securities Intermediary in market Team started and built Wells Fargo's settlement system and operations Efficient, high touch service 	<ul style="list-style-type: none"> Custodian not known in US settlement market Bank does not have broad client base or experience in life settlements 	<ul style="list-style-type: none"> Policies held in custody is common Securities intermediary structure enables marker making Experience is critical (BONY lapsed policies and lost lawsuit)
Valuation Agent	<ul style="list-style-type: none"> Widely known in the US settlement market Credentialed actuarial consultancy 	<ul style="list-style-type: none"> Not known in the US market Not an actuarial firm 	<ul style="list-style-type: none"> Mark-to-market valuation agent uses public index data and well-established actuarially sound processes Mark-to-model approach typically uses fund's model with out validation or external data



Market vs Model

	Mark-to-market	Mark-to-model	Comments
Price	<ul style="list-style-type: none"> Price + premium compared to index 	<ul style="list-style-type: none"> Price + premiums + assumptions Value is disconnected from price 	<ul style="list-style-type: none"> Some funds mark-up the value of policies they buy-The DAY AFTER PURCHASE!
Market	<ul style="list-style-type: none"> Recent market transactions the current price and value of like-kind assets Current transactions can be compared to market 	<ul style="list-style-type: none"> The model calculates the value of all assets held based on assumptions Current data is ignored for valuation Valuation agent runs model but does not assess validity 	<ul style="list-style-type: none"> Life expectancy does NOT erode on a straight-line or uniform basis Re-underwriting, lapses and sales expose flaws Extension risk is dealt with based on assumptions not action
Volatility	<ul style="list-style-type: none"> Market is dynamic Market is transparent Supply & demand affects prices Future value of death benefits is not affected 	<ul style="list-style-type: none"> Tendency to hold even bad assets as lapse or sale reveals real value Tendency to consistently overstate share value Enables incentive fee payments regardless of actual outcomes 	<ul style="list-style-type: none"> Mark-to-model funds are less liquid as forced sales reveal flaws, borrowing is difficult and expensive The 2008 “Table Shift Event” caused mark-to-model funds to write down share values 40 to 60%



For further information

Should you have any questions or require any further information please contact:

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Appendices





Life Insurance Market Size

Primary Market

\$18.425 Trillion
Aggregate face value
in force in 2010

284,335,000
Number of in-force policies

\$2.876 Trillion
Total face value of new
policies in 2010

\$165,291
Average face value issued
in 2010

Lapse Rates

1.42 %
Policy surrender rate in 2010

5.37 %
Policy lapse rate in 2010

> 85 %
Total in-force policy death
benefits that are never paid

Secondary Market

\$45 Billion
Volume of U.S. secondary
market (aggregate face value)
2002 - 2010

\$114 Billion
Estimated market potential
(aggregate face value) by 2017

\$10 Billion
Additional proceeds for
policyowners via secondary
market 2004 - 2010

Sources: ACLI: Life Insurers Fact Book 2009, Conning Research & Consulting: Life Settlements 2010

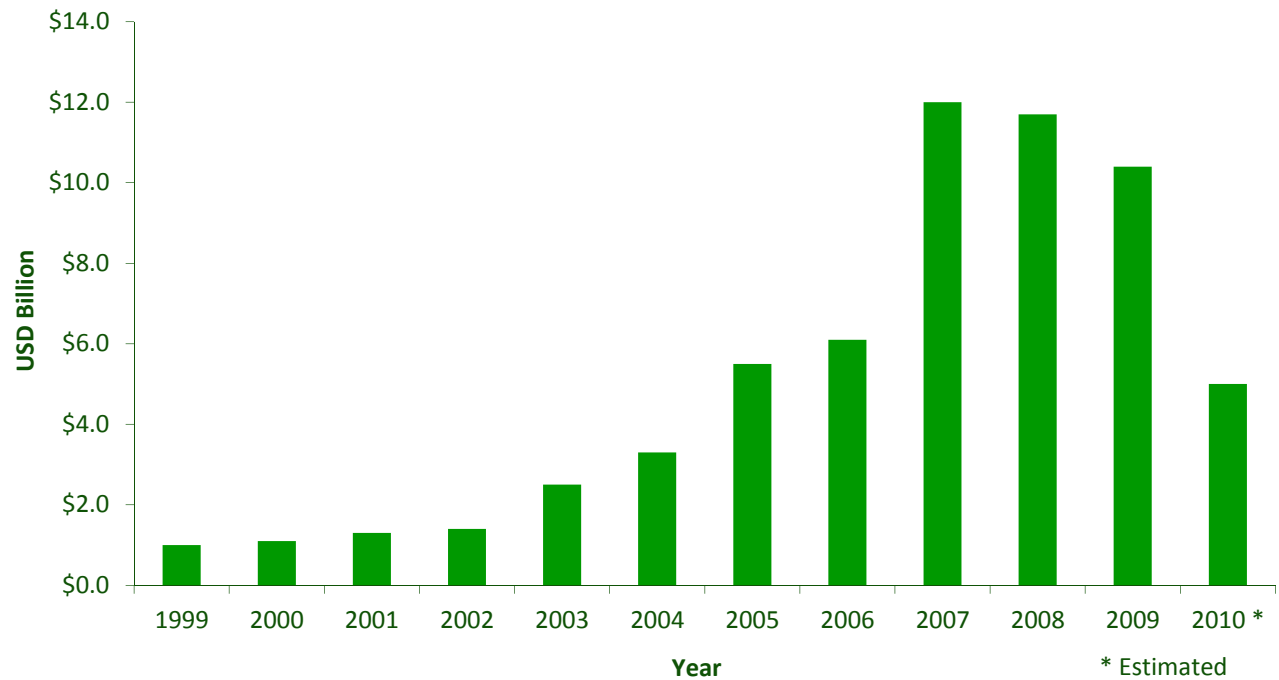


Market Growth

Influences

- + Long-term growth of older age demographic
- + Uniformity and stability in regulatory framework
- + Increasing consumer and supply-side awareness
- + Appetite for uncorrelated alternative investments
- + Need to hedge against long-term liabilities
- +/-Continued degradation of macro-economic environment
- +/- Heightened diligence by carriers helping to curtail excesses
- Challenges in obtaining leverage
- Unforeseen regulatory change

Life Settlement Secondary Market Transaction Volume

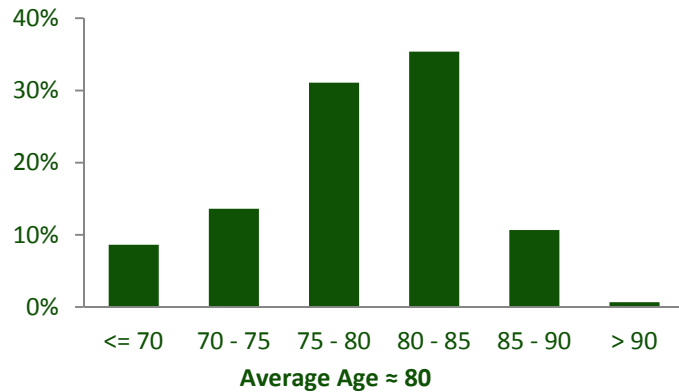


Sources: Insurance Studies Institute, Conning Research & Consulting

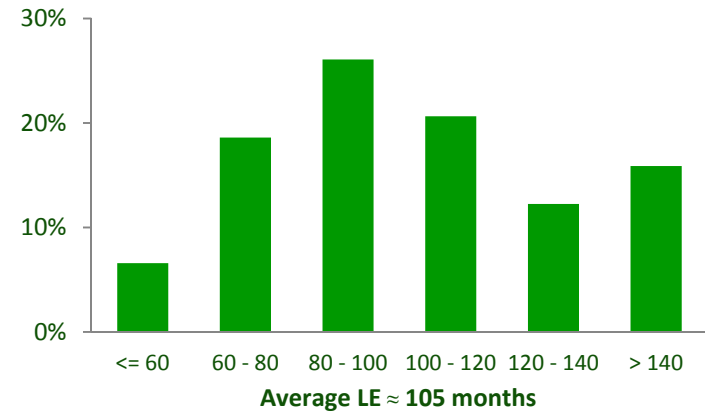


Typical Portfolio

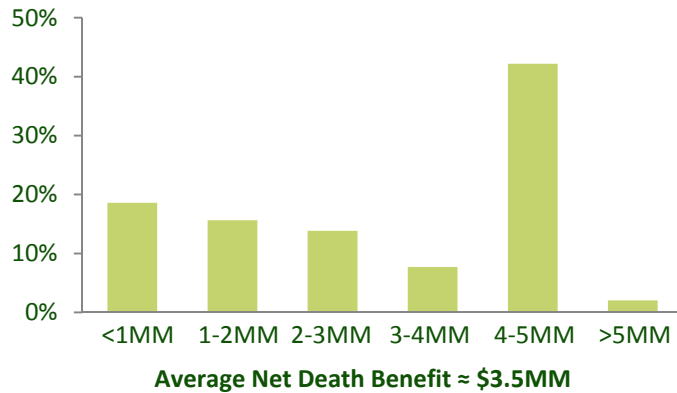
Age Distribution



Life Expectancy Distribution



Net Death Benefit Distribution



Insurance Carrier Distribution

