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01/2014

Capital Life Advisors/Capital Life Securities S.A.

Design and advisory work associated with Fixed Coupon Life Insurance Backed Securitisation

Profile

Approach	design and advisory work associated with Fixed Coupon Life Insurance Backed Securitisation
Rated Party	Capital Life Advisors AG
Website	www.capitallifeadvisors.com ; www.capitallifesecurities.com

Investor's Profile

Investment Horizon	mid- to long-term (min. 7 Years)
Risk Classification	medium
Return Expectations	positive performance largely independent of capital markets
Loss Tolerance	losses are possible

Subject of the rating:

Subject of the rating is the process to be used in the cooperation between *Capital Life Advisors AG* and *Capital Life Securities S.A.* for the design and advisory work associated with Fixed Coupon Life Insurance Backed Securitisation. The rating specifically refers to the processes to be used, as defined by *Capital Life Securities S.A.* for a Direct Secured Limited Recourse Debt Obligation – the *Compartment One*. No ratings of investment products, legal or tax-related analyses have been performed during the rating process, thus being neither the subject of the report nor of the assessment made in the form of the rating grade.

TELOS-Comment

Capital Life Advisors AG (CLA) is a subsidiary of the Swiss-registered company *Capital Life Management AG*. The company is part of a close circle of private owners. CLA was founded in April 2013. The object and philosophy of the company involve the design of innovative financial products. The CLA team currently comprises a number of members. The members of the Management Board in particular benefit from many years of internationally-oriented and broad expertise acquired in the banking and insurance sectors and also in auditing. CLA is thus able to offer a full range of products, from money market and mortgage products, loans and secondary insurance, to derivatives, and can offer these products to professional investors as either standard or bespoke total solutions from a single source. The product solutions are intended to serve at all times as value-preserving assets, while simultaneously securing adequate cash flows. The products developed are designed to distinguish themselves through their low correlation with the equity and bond markets. Before issuing such a product, CLA uses its diverse and international contacts with institutional investors (pension funds, insurance companies, [private] banks, trusts and family offices), exchanging ideas in great depth to enable the development of solutions that will suit both the market and its clients. CLA is also committed to the principle of "social responsibility", and complies with the 10 principles of the United Nations Global Compact".

CLA has also applied this basic philosophy to the "Compartment I" product to which this report relates, a solution involving the secondary life insurance market. As the initiator of this product idea, CLA has used a broad network of professional service companies and international partners, most of whom are global players, to meet the challenge of additionally developing and offering integrated new products on the secondary insurance market. The bond, which relates to secondary insurance market products, is issued by *Capital Life Securities* (CLS), which is registered in Luxembourg and in the ownership of private owners.

The product is based on the highly fungible US market for secondary life insurance policies. For a variety of reasons (shortage of money, the desire to fulfil a specific wish), a large number of insurers in the USA are selling their existing life insurance policies. They use the secondary insurance market in order to achieve the highest possible return from the sale. Buyers such as CLS essentially

substitute the insurer for legal purposes in the policy holder's interest, when these sell their policies to CLS at a fair price via a registered insurance broker. CLS receives the amount insured. When it designed the product, CLA put in place a number of selection criteria and conditions in order to secure the quality of the product (minimum age of the insurer, fair but not excessively high sums insured, minimum rating of the insurance company underwriting the policy among others).

It was decided to securitize the product in legal terms by issuing a compartment (product name: "Compartment I") under Luxembourg law. The product is a special purpose vehicle (SPV), which essentially excludes issuer risk.

The subject of this rating is not the bond itself, but the investment process underlying it ("Compartment I"). This process essentially involves seeking out and integrating the best insurance policies on the US secondary insurance market (Traded Life Policies, TLPs) into "Compartment I", followed by ongoing management and supervision of the portfolio, and also processing and securing all payment flows (premium payments, insurance benefits due). These complex procedures are undertaken using a broad network of specialist service companies, which have been collaborating for some time in comparable situations and thus operate as a well-rehearsed team. The partners include the depositary Hauck & Aufhäuser Privatbankiers, Luxembourg, which acts as paying agent. Quintet House, Luxembourg is responsible for identifying suitable secondary life insurance policies for the "Compartment I" product, while Data Life Associates provides the actuarial expertise during evaluation of the individual insurance policies. Torrey Pines Securities undertakes the day-to-day administrative services associated with the policies (documentation, life expectancy certificates). Darion Capital Management, Netherlands, the Investment Manager, is responsible for the allocation of funds within the "Compartment I". Wilmington Trust acts as Trustee for the investors in the "Compartment I" bond.

Appropriate written agreements have been concluded with all the partners.

The subscription period for the bond begins on January 10th, 2014. Bond subscriptions with the issuer CLS are open exclusively to institutional and qualified investors (as per Mifid regulatory). The investment process is rated "AA" (very high quality).



AA
01/2014

Capital Life Advisors/Capital Life Securities S.A.

Design and advisory work associated with Fixed Coupon Life Insurance Backed Securitisation

Organisation

The company *Capital Life Advisors* (CLA) is the "spiritual father" and thus the "initiator" of the secondary insurance market product "Compartment I", which was developed for institutional and qualified clients (as per Mifid regulatory). CLA is a wholly-owned subsidiary of *Capital Life Management AG*, which is also based in Switzerland and is itself primarily owner managed.

CLA was founded in April 2013 and is made up of a team of 10. The Management team consists of highly experienced people, most of whom come from the financial world. All the members of the Management team held key positions in international banks, insurance companies and also auditors for a considerable time. These decision-makers pool their abilities and their existing network, and use them to the benefit of the investors. As a result, contact with professional investors is a key element of CLA's philosophy. Affinity with clients was also an important factor during product development. During the design of the "Compartment I" process underlying this rating report, a number of institutional decision-makers from various countries were consulted, with a view to optimising the structure of the product, and their ideas were incorporated into the product design.

"Innovations" focuses on the development of new, non-standard, off-the-shelf product solutions. "Customer Solutions" implements these innovative ideas for specific projects and clients. The "Investment Support" staff then support and advise clients. The "Corporate Responsibility Center" is responsible for ensuring that all client-related projects and product solutions adhere to the compliance rules relating to both social responsibility and environmental compatibility.

CLA and *Capital Life Securities* (CLS), the "Compartment I" issuer, has also adopted this principle of social and environmental responsibility. For example, the organisation has subscribed to the globally recognised declarations of the "Ten Principles of the United Nations Compact", which include the "Universal Declaration of Human Rights", and also the "Rio Declaration on Environmental Development". CLS has undertaken to donate a proportion of the profits to worthy causes. CLA and CLS also see this social commitment as their company's USP, marking it out from its competitors.

CLA and CLS have also paid particular attention to the selection of the right partner and service companies for the issue and ongoing servicing of the "Compartment I" product. The companies "Quintet House" (Originator), "DarionAsset Management" (Investment Manager) and "Torrey Pines" (administrator and manager, including in

relation to life expectancy certificates for the insured persons), also collaborate as partners, for example within the financial group "Global Fund House" (GFH), Luxembourg. The cooperation partners and their areas of expertise are described briefly below. The special duties associated with management of "Compartment I" are described in the section "Investment Process / Risk Management".

"Quintet House S.a.r.l.", Luxembourg has a broad network of insurance brokers and extensive expertise in the secondary insurance market. As part of the procedural process, Quintet House has the primary responsibility of identifying potential insurance policies and offering them to CLS for purchase. To this end, CLS has granted Quintet House extensive powers to undertake policy identification as efficiently as possible during the preparatory stage. In addition to recording and documenting the outline data in relation to each individual life insurance policy, this also includes intrinsic analysis of the policies and examination of the life expectancy certificates of the insured person.

"Data Life Associates", New Jersey/USA, is an actuarial service company, which has in-depth knowledge of the US insurance market and offers its services to the entire insurance industry. Data Life uses sophisticated software to provide all operators on the life insurance market, such as insurance companies, brokers and home offices, with substantiated evaluations and graphical illustration systems in relation to insurance policies.

"Darion Capital Management B.V.", Netherlands, conducts an additional quality check, as an intermediate "Investment Manager" between "Quintet House" and CLS. Since 1966, Darion Capital Management's core business has involved the design of financial products that are not correlated to the capital markets. Secondary life insurance policies fall into this category. Darion Capital Management, similarly to Torrey Pines, is integrated in the services of the Global Fund House Group (GFH) as third party service providers. These two companies have already collaborated with complete confidence on a number of projects.

"Torrey Pines Services LLC", California (USA) is responsible for the day-to-day management and supervision of all the processes associated with the secondary life insurance policies within the portfolio. Torrey Pines is one of the best known and most innovative service providers in the USA in this sector. Torrey Pines supplies CLS promptly



AA
01/2014

Capital Life Advisors/Capital Life Securities S.A. Design and advisory work associated with Fixed Coupon Life Insurance Backed Securitisation

with all the detailed information it requires regarding the Traded LIPs in question.

Hauck & Aufhäuser Privatbankiers KGaA, Luxembourg, in its traditional role as depositary, is both the custodian and manager of the "Compartment I" product and also its paying agent. Hauck & Aufhäuser has lengthy and extensive experience in the legalities of setting up a compartment under Luxembourg law, and is also highly conversant with the day-to-day management and servicing of this well-recognised and extensively used Luxembourg investment vehicle.

The company "Wilmington Trust N.A." acts as the legal owner of the traded life insurance policies acquired by the issuer. . Wilmington Trust SP Services (Frankfurt) GmbH acts as a security trustee, representing the legal interests of the bond holder in the event of default.

The partners are all concerned with the important confidence-building stages of the product issue process and the tasks associated with setting up the product, and thereafter with the work involved in servicing the "Compartment I" product. Details of any other cooperation partners will appear in the "Investment Process / Risk Management" section.

When setting up the "Compartment I" product for the secondary life insurance market, CLS selected this legal option because it is an established and recognised legal construct, which involves high issue requirements coupled with flexible handling options.

In addition to being conversant with the use of this legal vehicle, CLS and CLA believe that the broad and lengthy experience of their Management teams in particular makes them highly suited to offer this initial product from the life insurance sector (secondary market / Traded LIPs). The extensive expertise of their employees also ensures that they will be in a position to provide optimum control and supervision of the various cooperation partners. Before selecting the service partners, CLA therefore checked that each individual company has offered good continuity over recent years. The systematic use and involvement of this experienced network of partners also has a positive effect on the intrinsic secondary life insurance policy selection process. The abilities of CLA and its Management team, who are able not only to contribute their expertise during the product development stage, but who also play a controlling role during the ongoing post-issue process, and are able to step in as a higher authority and make corrections where necessary, make this a truly distinctive product, even in comparison with its peers.

Description: Secondary market of life insurance policies:

In recent years, the secondary market for life insurance policies, known as the life settlement market, has emerged as a growing alternative class for institutional investors. One reason for this is that this asset class offers returns which are uncorrelated with external (equity or bond) market influences.

As a definition a life settlement is a transaction in which a life insurance policy owner sells an insurance policy before maturity to a third-party for more than the cash surrender value (CVS) offered by the life insurance company. Especially in the US a large number of insureds are currently selling their existing life insurance contracts. This decision is driven by a combination of factors and for a variety of reasons, e.g. desire to fulfill a specific wish, need for liquidity or increase in medical costs. The policy holders use the secondary market in order to achieve the highest possible return from the sale. It's in the policy holder's interest to settle their life policies in the secondary market and sell them at a fair price to CLS via a registered Insurance broker. The buyer pays all subsequent premiums for the life insurance contract to the life insurance company and receives the net death benefit of the policy at its maturity. The policyholder not only profits from the life settlement market as a new option to realize the market value of the policy as an up-front cash lump sum, but also eliminates the burden of having to fund future and sometimes increasing premium payments. Overall the evidence suggests that the life settlement market has helped significantly in enhancing the welfare of policyholders. Institutional investors owning portfolios of life settlements require deep knowledge not only of the secondary market for life insurance policies but intrinsic understanding of risks like longevity risks as the primary risk in a life settlement transaction. Accordingly various management techniques like the ones of CLS are necessary for managing products in the life settlement market.



AA
01/2014

Capital Life Advisors/Capital Life Securities S.A.

Design and advisory work associated with Fixed Coupon Life Insurance Backed Securitisation

Investment Process / Risk and Quality Management

The concept of issuing the "Compartment I" bond and the underlying complex investment process is based on the US Traded LIP market. The size of the entire life insurance market in the USA amounts to around \$ 9.3 trillion. Around \$ 1.4 trillion of this total, namely one seventh of the policies, is offered in the secondary market. The effects of the financial crisis mean that a large proportion of insurants in the USA are forced to fall back on existing policies such as life insurance policies and to sell them. The overall life insurance market in the USA is experiencing growth, which also works in favour of the relatively young Traded LIP market. The strict regulation of the secondary insurance market in the USA means that it offers a high level of security. A further advantage of this market segment lies in the fact that there is virtually no correlation between products on the secondary insurance market and traditional asset classes, which represents a positive feature in the current financial market environment.

The issuer CLS and also CLA have used this situation to their advantage in the development and issue of the "Compartment I" product. In legal terms, all the rights to the life insurance policy are assigned to CLS, in its capacity as the beneficiary. When the policy matures, for example when the insurant dies, CLS receives from the insurance company the sum insured under the policy; in return, CLS takes over payment of the regular insurance premiums for the policy holder from the point at which it takes over the policy, and pays the policy holder a calculated policy value, which is higher than the surrender value that the insurance company would be prepared to pay if the policy were cancelled.

A written agreement has also been drawn up between CLA and CLS, under which CLS has instructed CLA, as the "Initiator", to develop and set up the "Compartment I" bond product for secondary insurance policies in such a way that it suits both the market and its clients. Particular attention is taken to aspects such as minimising risk, tax efficiency and ensuring an attractive target return. The figures quoted in relation to secondary insurance policies in the USA prove that the market may be described as highly fungible. As an alternative, policy holders would

only have the option of returning their life insurance policies directly to the insurance company at the redemption value. However, the surrender value is significantly lower in comparison with selling the life insurance policies through the secondary insurance market. This being the case, through CLS as the issuer of the "Compartment I" bond, CLA has developed an innovative product, whose assets are used to purchase policies on the secondary insurance market within the "Compartment I" wrapper. The funds invested in this way are therefore obtained through the "Compartment I" bond that is placed with institutional investors. The funds obtained from the sale of the bond can only be invested in a closely defined range of specific asset classes. In addition to the life insurance policies from the secondary market, these also include money market products and short term deposits (up to 12 months), and also derivatives, which must be linked to secondary life insurance policies (Traded LIPs).

The product has a conservative investment policy, which seeks to achieve an optimum balance between the three goals of "capital protection, liquidity position and enhancement of the net asset value of the portfolio".

Traded LIPs make up the bulk of the investments. As a result, the CLS Management team see the search and selection of the Traded LIPs to be included in the portfolio as one of the decisive factors in the achievement of an attractive net asset value for investors. The members of the CLS Management team are all highly experienced, having been working in the market for over 20 years. As regards the process of evaluating the best life insurance policies, CLS considers its approach to be extremely professional, including in comparison with peer products. CLA and CLS cooperate with experienced service partners, who have been selected on the basis of an intrinsic analysis. On the one hand, this close network of cooperation partners ensures clear and stable processes. On the other hand it secures professional control of all procedures, and allows adjustments to be made, where necessary, to take account of current developments during the life of the bond.

The companies that are primarily responsible for selection of the policies (the "Originators") include "Quintet House", which has lengthy experience in this field, and also "Longevity Partners". Both collaborate with a broad network of insurance brokers. In close consultation with the issuer CLS, a list of narrow restrictions has been defined, and these must be strictly observed during policy selection and portfolio construction. They include criteria such as:

- the insured person must be at least 70 years old;
- the face values must be around mid range, for which a Government guarantee is provided;
- the life expectancy of the insured person must be between 3 and 7 years, and in 80 % of cases, between 3 and 5 years;
- the insurance company with which the policy was contracted must be domiciled in the USA;
- all the life insurance policies must be free of third party rights and must be transferable, and they may not be encumbered by any premium arrears;

When selecting suitable life insurance policies, strict standards are also set as regards the insurance companies underwriting the policies. Some of the defined limits, which must be strictly observed, are listed below:

- at least 80% of the volume of the Traded LIPs must originate from US insurance companies with a minimum rating of "A" (AM Best, Standard & Poor's, Fitch IBCA) and A2 by Moodys ;
- the remaining 20% of the volume will have an investment grade rating, too.;
- policies which are contracted with an insurance company and are to be integrated into "Compartment I" may account for no more than 10% of the total volume.

By imposing these high rating requirements, CLS is thus seeking to ensure a broad and conservative spread of life insurance policies, in order to keep the risk low. All the cooperation partners must observe these principles during the selection process.

In addition to the above conditions, care is taken to

ensure adequate diversification of the policies / insured persons across almost all the States in the USA. Average life expectancy differs significantly between the individual States, and thus represents an important element during product calculation and in the (sales) costs incurred when purchasing the policies. CLA and CLS retain high cost-awareness.

As soon as "Quintet House" and "Longevity Partners" have identified insurance policies as being suited to the portfolio, based on the specified terms and conditions, they are offered for sale to the issuer CLS through the Investment Manager "Darion Capital Management". "Quintet House" has significant experience and considerable expertise in the US secondary insurance market. "Quintet House" is therefore closely involved in the selection process for the secondary life insurance policies. The company is responsible for providing CLS, as the issuer, with all the information and related documentation it requires for the final decision for or against the purchase of the individual policies. These include the basic data in relation to the policy (insurant's name, sum insured etc.), life expectancy certificates and a detailed list of all the cost calculations (premium development, purchase price, broker commission).

The company "Data Life Associates", which is registered in the USA, has been called to act as actuary, to assess the outline data. Its extensive expertise in the actuarial assessment of the life insurance policies, and the fact that it is "on the spot" in the USA, enable "Data Life" to play a key role in the value-added chain, by determining whether the policies on offer are suited to the "Compartment I" portfolio.

The company "Trust House Luxembourg S.A." has been called to take over administrative duties, and in particular accounting.

CLS uses an Investment Manager, the company "Darion Capital Management", to perform an additional quality check. Darion Capital Management manages the allocation of the asset classes admitted to "Compartment I", i.e. predominantly Traded LIPs and also money market investments and derivatives. Darion executes all portfolio transactions across all asset classes. All policies offered from Quintet House to CLS undergo an additional quality check undertaken by Darion. The company is therefore very closely involved in the process of selecting or rejecting a policy, although CLS and its Management team make the final decision.



AA
01/2014

Capital Life Advisors/Capital Life Securities S.A. Design and advisory work associated with Fixed Coupon Life Insurance Backed Securitisation

Following this intensive selection process, 300 to 400 insurance policies are incorporated into the portfolio.

Once a life insurance policy has been added to the portfolio, it must be the subject of ongoing management and control.

This falls within the remit of "Torrey Pines Services LLC", which takes responsibility for all day-to-day business, under the supervision of Darion Capital Management. Its principal duties include

- the (electronic) documentation of all information and correspondence with the insurance company regarding regular transactions (e.g. premium payments) in connection with the policy;
- tracking services in relation to all transactions of relevance to the policy, including regular contact with the insured persons; also
- the production of annual life expectancy certificates.

Each of these specific duties to be undertaken for CLS is associated with a precise timing requirement. This enables CLS to ensure transparency in relation to all the Traded LIPs in "Compartment I", which is in itself an important criterion for the calculation of product data.

Darion Capital Management is responsible for fine-tuning the portfolio and, subject to clearly defined limits, for including other asset classes in the portfolio in addition to the Traded LIPs, which themselves make up the actual product assets. These other asset classes include investments in money market instruments (MMIs), including short term deposits, derivatives that are directly related to Traded LIPs and other investments, such as options,

futures and other hedges (which may be used to hedge currency risks). These asset classes are also subject to the conservative conditions applicable to the product, with a view to achieving capital preservation, ensuring liquidity at all times and enhancing net asset value. If MMIs are used, their term may not exceed 12 months and their issuer must have a minimum rating of "A+" (based on the S&P standard).

Hauck & Aufhäuser Privatbankiers KGaA, Luxembourg performs a dual function. Firstly, the bank acts as depositary, and is involved in custody and management of the "Compartment I" product. Secondly, all payment flows associated with "Compartment I" are processed through Hauck & Aufhäuser, so that the bank also acts as the paying agent.

"Wilmington Trust SP Services (Frankfurt) GmbH" plays an important role in connection with the bond holder, acting as the service trustee for "Compartment I". If the issuer CLS commits breaches of contract or fails to fulfil its obligations, Wilmington Trust, by agreement with the bond owners, represents their legal interests, if necessary also in court. Wilmington Trust thus performs a confidence-building function, thereby putting the finishing touches to this complex product.

The international law firm "Speechy Bircham, UK" (which also has an office in Luxembourg), is contractually responsible for all legal aspects, including during the design stage of the "Compartment I" under Luxembourg law.

"Deloitte Audit Société à Responsabilité Limitée", which is also based in Luxembourg, has been appointed as auditor. The developers of the "Compartment I" product, CLS and CLA, are thus able to call upon a broad network of professional cooperation partners.



AA
01/2014

Capital Life Advisors/Capital Life Securities S.A.

Design and advisory work associated with Fixed Coupon Life Insurance Backed Securitisation

Team:

Including all of the departments involved in CLA / CLS – Project Management, Regulatory Compliance, Financial Control – the management board consists of responsible and result-driven managers. CLA / CLS only involves staff members with over 20-year experience and track record in all disciplines required in terms of professional development of investment solutions for institutional investors. Well experienced specialists at CLA used to work for well-known and international banks, insurers, accountants and advisors and are considered leaders in the finance industry. The team is highly qualified and prepared to engineer structured products like „Compartment I“ (TLP) which is part of this rating report. With the appropriate experience of the management CLA / CLS are able to ensure stability of the complete investment process of „Compartment I“. At group level about 10 staff members are available. The team members offer huge diversity in terms of added qualifications. The culture of CLA / CLS is extremely team-driven.

Piet Saarloos is a co-founder of CLA and is also acting as Board member. He has three decades of experience as a business leader. He has undertaken numerous green-field developments and restructuring projects for top financial institutions.

Nikolas Hinoporos, presently acting as CEO, joined the team of CLA in 2012. In former times he served at management positions at several international banks. He is in charge of structured product development, trading

and investment strategies.

Cornelis Prins is CEO at CLS. He is highly experienced as an insurance and re-insurance professional. He obtained a bachelor degree in Economics and a master degree in law.

CLS profits also from the experience of Mr. *Cornelis den Boer* and Mr. *Bram Boon* in their function as board advisors. Mr. *Cornelis den Boer* held several positions on the management level at international insurance companies. Mr. *Bram Boon* has master degrees in mathematics, actuarial science and business administration and used to work for international banks.

Next to Mr. *Cornelis Prins* the board consists of Mr. *Marcel Learbuch* and Mr. *Roel Schrijen*. Mr. *Learbuch* is a highly experienced banker and fund manager with many years of work experience also in the environment of risk- and fund management. Since 2010 he is one of the managing directors of several financial undertakings within the Global Fund House Group where he is responsible for amongst others the day-to-day fund operations in Luxembourg.

Mr. *Schrijen* is specialized in the structuring and management of private equity and investment holding structures as well as solutions for HNW's and Corporate Clients. With his academic background in legal aspects such as tax he supplements the academic knowledge of Mr. *Learbuch* in Commercial Economy.



AA
01/2014

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Design and advisory work associated with Fixed Coupon Life Insurance Backed Securitisation

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