

Life Settlement Focus Report

The Performance of Life Settlement Investments

Life settlements are one of the few asset classes offering structurally uncorrelated returns driven by mortality rather than financial markets. They represent life insurance policies of US policyholders that are sold to investors. Life settlements have been traded in substantial quantities since the early 2000s. Thus, life settlements are nothing new, and there has been a multitude of investment products including open-end funds, closed-end funds, securitizations and certificates.

The charm of an investment in life settlements is threefold: (i) the absence of correlation with traditional financial markets, (ii) generally high credit quality of the insurance carriers that owe the death benefits, and (iii) attractive projected returns.

The key risk, however, is longevity i.e. insured individuals living longer than expected.

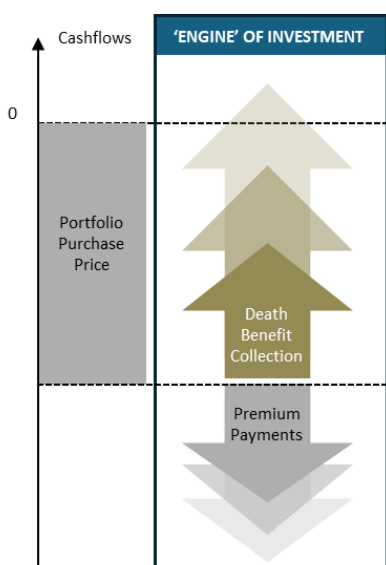
How are returns generated?

From a hold-to-maturity perspective, a life settlement investment can be understood as a simple cash flow 'engine'.

An investor acquires a portfolio of policies at an initial purchase price. Over time, the portfolio generates two types of cash flows:

- Cash-out: premium payments and other costs
- Cash-in: death benefits collected at maturity of policies

The performance of the investment is therefore entirely determined by the balance of these cash flows. A positive return is achieved if the balance of cash-in versus cash-out exceeds



the initial acquisition cost of the portfolio. The investor is paid back the initial investment and receives a profit on top. Conversely, if cash-in fails to sufficiently exceed costs, the investment results in a partial or total loss. In essence, life settlement performance is a function of lifetime net cash flow generation.

The role of longevity risk

Longevity is the dominant risk in life settlements and directly impacts both sides of the cash flow equation.

First, longer lifetimes of insureds delay or reduce the realization of death benefits, thereby lowering cash-in. Second, they increase the duration and magnitude of premium payments, as policies remain in force for longer and cost-of-insurance charges typically rise with age of insureds.

This dual effect makes longevity risk particularly powerful: it simultaneously reduces inflows and increases outflows. As a result, deviations in experienced mortality from life expectancy assumptions translate directly into deviations in realized profitability.

Implications for performance measurement

Given this structure, the most relevant metric for assessing a life settlement investment is its actual cash flow profitability i.e. the realized balance of cash-in and cash-out over time.

While the net asset value (NAV) of an investment is commonly reported, it is inherently model-based and dependent on assumptions, particularly life expectancy estimates and discount factors. As such, a NAV alone is not a sufficient indicator of underlying performance.

A transparent view of cumulative cash flows allows investors to directly assess whether a portfolio is generating the expected economic value and to distinguish between model-driven valuations and realized outcomes.

Implications for reporting and benchmarking

For asset managers, this implies that reporting should include clear and consistent disclosure of cash-in and cash-out metrics alongside traditional valuation measures. Without such transparency, investors are left with an incomplete picture and may effectively be exposed to a "black box".

For investors, cash flow-based profitability provides the most robust basis for performance assessment and enables meaningful comparisons across managers, independent of valuation methodologies.

Importantly, this information is readily available from standard fund accounting.

Conclusion

Life settlement investments are governed by a simple principle: the performance is ultimately determined by the relationship between cash inflows and cash outflows.

Transparency on these cash flows is not optional, it is essential. Only by understanding the underlying profitability of a portfolio, investors can properly assess performance, compare managers, and make informed allocation decisions in this asset class.

AA-Partner is a boutique company specialized on life settlement consulting. The company is domiciled in Zurich, Switzerland and provides services as independent 3rd party for institutional clients.

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