INDUSTRY STANDARDS – ANNOUNCEMENT OF NEW EDITION OF ELSA'S CODE OF PRACTICE

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OUTLINE

- Background
- Key Additions
- Other Changes
- Awareness, Compliance and Enforcement

BACKGROUND

- First published in July 2010.
- Targeted at Product Designers, Managers and Distributors.
- Organised into Product Design, Disclosure and Reporting, and Sales and Marketing.
- Separated into requirements (denoted "R") and guidance (denoted "G").
- Now in Edition 4.0.

KEY ADDITIONS

A1.4 [G] Policies should not be purchased if the life settlement broker has not disclosed to the policy owner or his/her appointed representative, prior to purchase, the total of any and all commissions or fees it expects to receive in connection with the purchase.

A3.2 [R] Performance attribution: Changes in the value of Products from one period to the next should be broken out into:

A3.2.1 Changes in cash. [G] For example, premiums, fees, commissions, expenses and interest paid, and interest received;

A3.2.2 Realised gains and losses. [G] For example, gains and losses from Policy maturities and Policies sold, purchased or traded; and

A3.2.3 Unrealised gains and losses. [G] Gains and losses on Policies held in the Product due to, for example, value “accretion”, updates to life expectancies or changes in the Product’s valuation methodology or assumptions.

KEY ADDITIONS (CONT'D)

A3.3 [R] Managers should recognise and be able to quantify the impact on the value of Policies resulting from:

A3.3.1 A material change in the underwriting methodology of any medical underwriter used; and

A3.3.2 A material change in the mortality table(s) used.

[G] In addition, Managers should disclose the impact of the changes above to Investors, even if the Policies' values have yet to be formally changed.

A3.6 [G] In determining the fair value of Policies, a discounted cash flow model should be used with either a probabilistic or stochastic methodology. A deterministic methodology is inappropriate and should not be used.

A3.7 [G] The value of Policies at purchase should be their purchase price. Generally, there should be no write-up in the value of Policies at purchase. Exceptionally, an increase in the value of a Policy may be justified if it can be demonstrated that a "bargain purchase" was made at a time of market dislocation, and this increase should be determinable from the Product's financial statements.

KEY ADDITIONS (CONT'D)

A3.8 [G] In open-ended Products where Investors' subscriptions and redemptions are made on the basis of a net asset value (NAV), that NAV should be highly correlated with, and reconcilable to, the fair value of the Policies.

A4.1 [R] Managers' performance fees should be based on realised portfolio gains, distributable proceeds, actual cash distributions or another similar measure of actual performance. They should not be based on a mark-to-model valuation of the Product or any other measure of expected performance. Nor should they be based on Policy-by-Policy gains or proceeds if such proceeds are, or are intended to be, reinvested in the Product rather than distributed to Investors.

A4.3 [R] Products structures should include the use of an independent fund administrator or a similar facility to handle subscriptions, capital calls and distributions. This will ensure that there is independent verification of the existence of the Investors' assets and the cash reported to the Investors.

KEY ADDITIONS (CONT'D)

A4.5 [R] Product structures should include procedures that prevent the inappropriate disclosure of individually-identifying and other confidential information. All service providers and other third parties associated with the Product should follow the current laws and regulation in their local jurisdiction in respect of data, or "cyber", security. The terms of confidentiality agreements, for example between participants in Policy auctions, should be strictly adhered to.

A4.7 [R] Products should be structured such that life expectancy estimates will be updated regularly, so that new estimates are developed or updates are obtained at least biennially. Whenever possible, such newly-developed or updated life expectancy estimates should be based on updated medical records.

A4.8 [G] Medical underwriters' databases and other external sources of data can help inform the usage of, and possibly support adjustments to, medical underwriters' life expectancy estimates, and their purchase, if affordable, is encouraged.

KEY ADDITIONS (CONT'D)

B2.16 [G] If the present value discount rate(s) referenced in B2.6.8 above is based on the sale IRR(s) of Policies from recent market data, the source and size of the dataset and details of the Policies should be disclosed sufficient to demonstrate the rationale behind their selection and the degree to which they are comparable with the Policies being priced or valued. Sale IRR(s) based on life expectancies provided by specific medical underwriters should not be used in the pricing or valuation of Policies with life expectancies provided by different medical underwriters without adjustment, or without their applicability having been demonstrated.

B3.4 [R] The status of the Product in respect of COI increases, including:

B3.4.1 [G] A summary of the Policies in the portfolio where (i) the servicer has actually received notice of changes, (ii) the insurer has announced changes, (iii) the insurer has announced that they are considering making changes, (iv) the insurer has not announced changes but, with reference to the breadth of the COI language in the original contract, has the capacity to do so in the future; and

B3.4.2 [R] A statement of the impact of the COI increases that have actually been received. This could take the form of, or include, a summary of future net Product cash flow (including fees, commissions, expenses, interest and leverage) both with, and without, these increases.

OTHER CHANGES

- FOREWORD renamed PURPOSE AND USAGE. Rearranged and shortened.
- EDITION HISTORY added.
- SUMMARY OF CONTENTS added.
- Requirements listed before guidance in each section.
- Reference to 2008 Valuation Basic Table replaced with 2015 Valuation Basic Table.
- Conduct risk added to list of risk factors.
- Product cash flow qualified with “(including fees, commissions, expenses, interest and leverage)”.
- Examples of market developments that impact the Product’s Investors added.
- Minor textual changes made throughout.

AWARENESS, COMPLIANCE AND ENFORCEMENT

- "ELSA members that are Product Designers, Managers or Distributors must comply with the required elements of the Code and are expected to comply with its guidance. ELSA members that are not Product Designers, Managers or Distributors are expected to encourage the Code's use in the Products with which they are associated."

- "ELSA members certify their compliance with the Code when they apply for membership and annually thereafter. Failure to comply with the Code will result in suspension and ultimately expulsion from the association."

- Non-compliant members have been encouraged to, and have, resigned their membership.

- Members have been asked to, and have, confirmed their compliance on specific points.

- Potential members generally check their compliance before applying for membership.

- Non-members have been asked to, and have, removed references to membership from their marketing materials.