FLASH Report

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New York • London

Alternative Fixed Income

Freeman & Co. LLC

iMAX Your Yield

Alternative Fixed Income Gains Popularity

In the current interest rate environment, investors continue to struggle to secure meaningful yield from highly rated assets. As a result, we have seen investors broaden the asset classes and investment types they are considering. Many of the "newer" asset classes that are now analyzed by investors fit into what we refer to as alternative fixed income or "AFI".

AFI products range from high quality, cash paying, transferable credit obligations (e.g. structured settlements and lottery payments) to more traditional near prime consumer debt (e.g. micro ticket loans). The highly rated obligations provide yields in the mid to high single digits while the consumer credits provide yields in the low to mid teens. These obligations can be purchased directly from the originator on either an individual or portfolio basis – often providing a pick-up of several hundred basis points over an investment in a comparable credit.

Several factors have contributed to the growth of this asset class. Key among the factors is the increase in consumer demand. Combine the decrease in available borrowing options for near and sub prime borrowers, the tough labor market, and the decline in home equity and you have a tightly squeezed consumer. With few other options, consumer borrowers holding non-traditional assets have sought to monetize them to meet their own short term liquidity needs.

Although some of the traditional lenders to these businesses exited the industry in 2008, the exit coincided with an increase in demand among new lenders and investors. These new participants are often wealth managers, asset managers, insurance companies and others with long term capital. The new players are searching for high quality yield and are able to manage the illiquid nature of the assets. We should highlight that although most AFI assets are illiquid, many of them have short durations. When the assets are purchased as a portfolio or as part of a flow program they can be held for a targeted term.

The purchase of a portfolio of assets, which generally come with a servicer attached, can provide an investor with immediate scale and the opportunity to "try out" an asset class as a closed-end, fixed return investment.

Transactions that we have recently worked on include the sale of portfolios of assets by originators seeking liquidity as well as structuring purchase and warehouse facilities for companies with growing businesses.

We are currently working on opportunities within lottery settlements, structured settlements and several forms of legal finance (pre-settlement, post settlement, class action, commercial claims). The subsequent pages of this flash report will highlight the most active sectors that Freeman & Co. covers in our AFI practice.

For more information please contact:

Andrew D. Clark T: (212) 830-6192
aclark@freeman-co.com

Structured Settlements

- Purchase of future annuity payments from individual seeking current cash
- **Key Risks:** Credit risk of insurance company

Credit Rating	A or better
Expected Return	6-10%
Investment / Collateral Ratio	NA
Default Rate	< 1%
Duration	> 60 months
Liquidity	Mid

Lottery Receivables

- Purchase of future annuity payments from a lottery or casino winner seeking current cash
- **Key Risks:** Ability to recapture tax payments made directly to state and local governments

Credit Rating	A or better
Expected Return	5-7%
Investment / Collateral Ratio	NA
Default Rate	0%
Duration	> 60 months
Liquidity	Low/Mid

Litigation Pre-Settlement

- Cash Advance to plaintiff against the potential outcome of a personal injury lawsuit
- **Key Risks:** Contingent success of case; timing of disbursement; attorney fraud

Expected Return, net	8-15%
Investment / Collateral Ratio	10-15%
Loss Rate	1-2%
Duration	22 months
Liquidity	Low

Litigation Post-Settlement

- Purchase of settled case receivables from plaintiffs or attorneys
- **Key Risks:** Disbursement timing; appeals

Expected Return, net	8-15%
Investment / Collateral Ratio	60%
Loss Rate	< 1%
Duration	6 - 12 months
Liquidity	Low

Life Settlements

- Purchase of life insurance policy; including the assumption of future premium payments
- **Key Risks:** Longevity

Expected Return	16-18%
Investment / Collateral Ratio	10%
Default Rate	NA
Duration	> 60 months
Liquidity	Mid

Healthcare Receivables

- Consumer receivables purchased from hospitals and healthcare providers at a discount to book value
- **Key Risks:** Collection

Expected Return	16-18%
Investment / Collateral Ratio	2-10%
Default Rate	NA
Duration	36 months
Liquidity	Mid

Consumer Receivables

- Small loans to near prime consumer for discretionary purchases (e.g. appliances, cosmetic surgery)
- **Key Risks:** Underwriting

Expected Return	12-14%
Investment / Collateral Ratio	70-80%
Default Rate	10%
Duration	36 months
Liquidity	Mid

Reverse Mortgages

- Government Guaranteed GNMA securities
- **Key Risks:** Underwriting; Servicing

Expected Return	4-5%
Investment / Collateral Ratio	45-50%
Default Rate	0%
Duration	> 60 months
Liquidity	High

Recent Publications by Freeman & Co.

FLASH Reports
- *Shadow Banking – Opportunities and Threats (May 2012)*
- *Low Interest Rates – Issues and Opportunities (February 2012)*
- *Converging Issues for U.S. Insurers (November 2011)*

Asset Management Reports
- *The Year That Wasn't (December 2011)*
- *Slowly but Surely Coming Back (April 2011)*
- *Slogging Through the Mud (September 2010)*

Financial Technology Reports
- *Who is Buying (or Not Buying) What (December 2011)*
- *Convergence: Servicing the Trader, PM and Back Office (April 2011)*
- *Out of the Frying Pan and into Regulatory Reform (September 2010)*

Insurance Industry Focus
- *Converging Issues for U.S. Insurers (November 2011)*
- *The Marriage of the Decade (July 2011)*
- *Is A Terrorist Lurking in Your Investment Portfolio? (January 2011)*

Private Equity Focus
- *Another New Normal (September 2011)*
- *Show me the Money (September 2010)*
- *Waiting for the Turn (September 2009)*

Securities Industry Reports
- *Post-Crisis: A Rapidly Changing Environment (October 2011)*
- *Filling the Void in the Middle Market (January 2011)*
- *Focus Shifts From Survival Mode to Strategic Mode (October 2009)*

Specialty Finance & Asset Focus
- *Inaugural Issue: Special Education (March 2011)*

New York

Freeman & Co. LLC

645 Fifth Avenue

9th Floor

New York, NY 10022

Tel: +1 212 830 6161

Fax: +1 212 265 4998

London

Freeman & Co. International LLP

N° 1 Cornhill

London , EC3V 3ND

United Kingdom

Tel: +44 (0) 207 743 6535

Fax: +44 (0) 207 743 6528