Many of the issues with the EEA Life Settlement Fund are centred on the various statements and concepts of Risk. This Working Paper attempts to clarify some of these issues in relation to the positions of EEA, the Guernsey and UK Regulators, Financial Advisors (FAs) and Investors at various points in time.

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1. Introduction

RISK and CHANCE are two side of the same coin. The Chance that something will turn out well or the Risk that it won't. Risk is an expression of the possibility that something can or will go wrong, or results will not turn out to be as well as expected. It's a very subjective assessment, but various branches of engineering and mathematics try to quantify it in terms of probability (an xx% risk of the adverse effect occurring. A 30% probability of rain today, etc). Risks aren't always binary – nothing adverse could happen, or it might only drizzle for an hour, or it might be a deluge lasting several hours, possibly accompanied by high winds, and so on).

In addition to the probability of something adverse occurring, we also have to factor in the possible consequences – a short shower will be uncomfortable, but not do any real damage. A hurricane can cause all sorts of damage and havoc. If we can understand risks in terms of probability and consequences, then we can try and plan contingencies, in case it happens (take an umbrella, wear boots, wear a sou'wester, or stay at home).

If there are several risks, then they might materialise singly (if at all) or in various combinations and severities (either through common elements, cause and effect or just because of Murphy's Law). A risk that materialises can also render the situation more vulnerable or susceptible to a different risk materialising, and/or increase the severity of the consequences.

2. Investors

There are some basic rules of thumb (and foresight) that investors in Funds such as EEA should have been aware of. Human optimism tends to focus on the rewards (chances) rather than the risks :

- The higher the rewards, the higher the risk (and *vice versa*)
- The more complex the investment, the higher the risk
- The more subjective factors involved, the higher the risk
- The more probabilistic factors involved, the higher the risk
- The higher the inducements or incentives, the higher the risk
- The more obscure the structure, the higher the risk
- The greater the number of risks means a higher overall risk
- The longer the period of exposure, the higher the risk, and so on.
- The less (truly) independent oversight, the higher the risk.

What contingencies can an investor make to avoid the risks or mitigate any adverse consequences ?

- Understand the risks and potential consequences (due diligence)
- Spread the risks (diversify)
- Don't risk more than you can afford to lose (prudence)
- Avoid the sharks (and know how to spot them) (security)
- Rely only on trusted guidance and advice plus common sense (wisdom)
  If it looks too good to be true, then it probably isn't.
- Understand the Regulatory and Compensation Environments (Safety Net)

3. UK Financial Advisors

UK FAs are licensed and regulated by the Financial Conduct Authority (FCA) and have to follow a number of rules when advising clients or recommending investments, and there are additional rules when dealing with investments (such as EEA) which are not regulated by the FCA itself. UK FAs are also required to carry appropriate Professional Indemnity (PI) Insurance at the time that the advice was given. However, many insurers have since removed UCIS investments from their cover and the FA is no longer authorised to recommend UCIS products. This means that the original advice is no longer covered by the PI insurer in respect of claims which arise after the UCIS cover was removed. This itself is a risk that should have been disclosed to clients with UCIS investments when the insurance cover was withdrawn.

When making a recommendation to invest in the EEA Fund, FAs must address all the risks and factors mentioned in section 2 above, and review them with the client. He or she must also carry out their own due diligence, and apply their own knowledge and experience of the investment sector concerned – not just rely on the information provided by the Fund Manager, or their Marketing or Promotional materials. They must also discuss the position of the other Regulator concerned (in this case the Guernsey Financial Services Commission) – their track record of effective regulation / supervision, any compensation or redress schemes available, and any complaint or ombudsman services available.

In most cases the recommendation boils down to an assessment of the investor's attitude to risk (low, medium, high or on a scale of 1 – 5, 1 – 10 or similar), the likelihood (probability / possibility) and consequences of failure of the Fund to repay the original investment and/or expected returns and the Fund's own risk category (low, medium, high) in relation to the investor's attitude to risk.

However, from a Regulatory perspective, the FCA (echoed by the GFSC) have increasingly stated their view that by definition, UCIS Funds and Life Settlement Funds in particular are inherently "high risk" and not suitable for the majority of retail investors. This places additional responsibility on the FA both when making a recommendation, and also when monitoring or reviewing the investment periodically to determine its ongoing suitability within the client's portfolio.

In many cases, the FAs and investors relied on the information provided by EEA, the fact that the Fund was regulated by GFSC and that the expected 8-10% pa returns were much higher than the 2-4% available at that time from other retail investments. Some FAs also carried out extensive due diligence into the structure and operation of the Fund, the safeguarding of the assets and management of investor's cash, especially following other UCIS and Life Settlement Fund failures in 2010 and 2011 and the failure of other Guernsey based / regulated investments in 2012 and 2013.

4. EEA Fund Management (Guernsey) and IAG Guernsey

Most FAs (and investors) relied on the "Low Risk" statements issued by EEA on its earlier marketing brochures and fact sheets, and probably didn't notice when they later changed to say "Lower Risk" and nothing specific about risk from early 2010. The Fund Manager (EEA Fund Management (Guernsey) Ltd are responsible for producing and distributing these brochures and fact Sheets and their Compliance Officer (IAG Guernsey Ltd) is responsible for ensuring that the material complies with all relevant rules, and are approved by the Regulator GFSC, including any changes or amendments.

EEA are also responsible for including appropriate Risk ~Warnings in its Offering Memorandum and Supplements, which are the contractual basis ("Prospectus") between the Fund and the Investor upon which the purchase of the shares is based. It is therefore incumbent on the FA and Investor to specifically review these warnings before applying to purchase the shares. An investor might find these warnings difficult or complicated to understand, and therefore be totally reliant on his or her FA to consider them as part of the FA's advice and recommendation.

Prior to 2011, the Fund published ten Risk Warnings in its Offering Memorandum and Supplements. In April 2011 they added a further seven Risk Warnings and four more in the Restructure documents issued in September 2013 , effective from 1st January 2014.

Prior to April 2011	Additions from April 2011
INVESTMENT RISK	VALUATION OVER-/UNDER-STATEMENT RISK *
AVAILABILITY RISK	INSURED FRAUD RISK *
LEVERAGE RISK	POLICY PRICING RISKS *
CUSTODY RISK	LIQUIDITY RISK *
BUSINESS RISK	MISSING INSUREDS RISK
HEDGING RISK *	COUNTERPARTY RISK
REDEMPTION CHARGES RISK	US FEDERAL AND STATE TAX RISKS
CURRENCY FLUCTUATION RISK *	**Additions from January 2014**
CELL RISKS	NEW FUND, FATCA, DELISTING RISKS
CONCENTRATION RISK	FORWARD LOOKING STATEMENTS RISK *
* Risk that has actually or apparently adversely materialised	

Comment : The risks added in 2011 are very similar to those identified by Peter Smith (FSA) in his speech to the European Life Settlements Association (ELSA) in February 2010. It can be argued that these were known and obvious risks for the Life Settlements sector and that EEA were negligent in not disclosing them in earlier Offering Memoranda, or issuing a Letter to Shareholders when they were added in April 2011. The new "Forward Looking Statements Risk…" added from January 2014 also looks ominous, given our conclusion that the Fund will not meet EEA's limited run-off projections of redemption values and timeframes.

5. Guernsey Financial Services Commission (GFSC)

The GFSC is authorised and operates under The Protection of Investors (Bailiwick of Guernsey) Law,1987 (as amended) and licences firms such as EEA Life Settlements Fund PCC Ltd, EEA Fund Management (Guernsey) Ltd and International Administration Group (Guernsey) Ltd to offer, manage and administer the EEA Fund to investors worldwide. GFSC also issues the Rules that licensees must observe, and a Finance Sector Code of Corporate Governance which the Companies must observe when organising and conducting their affairs. The EEA Fund is governed by THE COLLECTIVE INVESTMENT SCHEMES (CLASS B) RULES 1990 ("Class B Rules")

Many investors and FAs view this Regulatory environment as being "similar" to the UK, and believe that it minimises the risks of investing in Funds such as EEA. In relation to the marketing and promotion of Investment schemes, The GFSC rules clearly state that it must:

> *"Ensure that the scheme particulars do not contain any untrue or misleading statement or omit any matter required by these rules to be included in the scheme particulars" and*
>
> *"Without prejudice to any liability incurred apart from this rule, be liable to pay compensation to any person who has acquired any units in the authorised scheme and suffered loss in respect of them as a result of any such statement or omission".*

However, it appears (based on our experiences over the past three years) the GFSC is very weak on enforcement of its rules, and that Guernsey companies know this, and take advantage of it, by being based in Guernsey in the first place. However, it is also clear that many professional investors and FAs in the UK also know this, from past experience, and there have been a number of scandals and fund failures over the past few years involving GFSC, the Channel Islands Stock Exchange (CISX – now CISE under new ownership and management). FAs advising clients on EEA investments should have at least been aware of this "Regulatory Risk" and advised clients accordingly, either initially or as facts emerged prior to the EEA Fund suspension in November 2011.

FAs should also have specifically pointed out, in their advice, that the EEA Fund does not qualify for any compensation under either the UK FCA or the Guernsey GFSC jurisdictions. It could be argued that Guernsey Regulation itself is a medium or high risk factor.

In October 2013 and January 2014 the GFSC specifically told members of the EEA Investors Group that they agreed with the FCA view that EEA was a "High risk" investment that was unsuitable for retail investors.

Comment : In February 2014 The EEA Investors' Group submitted to GFSC a summary of 26 complaints against EEA and GFSC. We are now investigating the "Low Risk" terminology used by EEA prior to 201 and whether it was approved / endorsed by GFSC who now claim that it was high risk, as stated by the FCA.

6. UK Financial Services / Conduct Authority (FSA/FCA) and FOS

As detailed in Working Paper 8A, the FSA/FCA has issued several statements and warnings during 2010, 2011, 2012 and 2013 and 2014 about the risks of investing in Traded Life Policy Investments (TLPIs – or Life Settlement Funds) and recently EEA specifically. They clearly state that they believe that such investments are "high risk" and unsuitable for the majority of retail investors. Even if this opinion wasn't visible at the time of the original FA advice and investment recommendation, it should raised cause for concern and further review as the situation evolved. Many FAs did question and investigate the concerns raised by the FSA/FCA, and the collapse of Funds such as KeyData / LifeMark, Arch Cru, Ark, Mansion Students Fund, Connaught etc and either decided (or relied in information and assurances from EEA, KPMG and others) that these concerns were not relevant to the EEA situation and that the investments were still "safe". The FCA continued to disagree and

Feedback from the FOS Claims processed so far in 2014 also confirm that (in their view) the EEA Fund is inherently "high risk" and should not have been recommended to clients with a "Low" or "Medium" attitude to risk.