



# Blue Chip Secured High Income Fund

## Frequently Asked Questions

### Definitions

**Fund:** The Blue Chip Secured High Income Fund, Ltd.

**Servicer:** The Health Care Receivables Servicing company.

**Obligors:** U.S. government agencies and U.S. insurance companies providing health care coverage and possessing minimum S&P credit ratings of 'A-AAA'.

**Medical Providers:** Doctors, hospitals and other health care practitioners that sell Health Care Receivables at a discount.

### 1. What is Asset Securitization?

Asset securitization capitalizes fixed and anticipated revenue streams. When a bank sells off a package of its mortgages to investors at a discount, creating asset backed securities, that's asset securitization.

Among other things, commercial and residential mortgages, credit card receivables, automobile loans and leases, and even the future record sales of rock stars have been securitized.

Excluding mortgage-backed securities, more than \$60 billion of asset backed securities were created in 1993. That number has more than doubled in 1996. The U.S. Securities and Exchange Commission has stated that asset securitization is now one of the largest forms of corporate capital formation in the United States.

### 2. What are Health Care Receivables and how can the Fund use them to earn money for its shareholders?

Medical Providers often find themselves in a cash flow crisis. Although they possess extremely high credit ratings, U.S. government health care agencies and insurance companies are notoriously slow to make payment. To pay their monthly expenses, Medical Providers often need to establish a bank line of credit. Banks, however, are reluctant to accept Health Care Receivables as collateral for lines of credit because of the specialized knowledge, time and cost required to collect upon them. As a result, many practitioners must pledge personal assets, such as their homes or retirement savings, as security.

An industry has evolved that offers Medical Providers an alternative. By purchasing the Health Care Receivables at a discount to their face value and employing sophisticated computer collection techniques, health care receivable servicing companies can create significant profits for investors supplying the capital and significantly reduce the amount of paperwork required of



Medical Providers, allowing them to practice medicine. More-over, Medical Providers benefit by immediately receiving cash from receivables to pay their operational expenses.

**3. With interest rates at historic lows, a secured 7.0% investment yield is well above average. Realistically, how can the Fund expect to pay this high yield to its Preferred Shareholders?**

The Health Care Receivable Servicer is able to collect upon and reinvest receivables three to four times per year. The Servicer negotiates the purchase of the receivables at a discount of approximately 10 percent of their face value. Because of the rapid turnover and discount, the Servicer can earn gross revenues (before expenses) of 25-30 percent per annum. With this amount of gross revenue, the Servicer can easily afford to pay expenses plus the interest obligation on the Asset Backed Structured Notes that secure the Fund's assets.

The Asset-Backed Notes' interest obligation to the Fund has first priority on the monies deposited in the lock box account as a result of the redemption of the Health Care Receivables. Hence, the Servicer receives only what is left over after the terms of the Asset-Backed Notes have been satisfied.

**4. In the Fund's marketing materials, why are terms like 'fully secured' and 'fully collateralized' used instead of the word 'guaranteed'?**

The word 'guarantee' implies an absolute 100 percent without qualification. In the opinion of the Fund's management, as well as various regulatory authorities, no such investment exists.

Many of the world's largest financial institutions, law firms and securities regulatory agencies now prohibit or severely restrict the use of the word 'guarantee' in describing any financial product for the above mentioned reason.

A full and candid disclosure of the Fund's risks and benefits permits prospective investors to reach their own conclusions regarding its security.

**5. What is an Asset Backed Structured Note?**

The Asset Backed Structured Notes are debt securities that are fully secured by the payment obligations of S&P 'A-AAA' rated government healthcare agencies and large insurance companies. Repayment of principal is made in one lump sum at the end of 3-year term and interest earned on the Notes is paid quarterly in arrears.

Both the principal amount of the Asset Backed Structured Notes and the current quarterly interest obligations thereon are 100 percent collateralized by either cash or qualified Health Care Receivables.

**6. What happens if a receivable is uncollectable?**

If a particular Health Care Receivable proves uncollectable within 180 days, the original Medical Provider (doctor, hospital, etc...) must replace the receivable with another of equal value.



## **7. What is 'Investment Grade?'**

Debt instruments rated in the top four rating categories ("AAA," "AA," "A," and "BBB") are commonly referred to as 'investment grade' securities and are considered eligible for bank investment under present commercial bank regulation issued by the Comptroller of the Currency.

Although 'investment grade' also includes "BBB" and "BBB+," the Fund has limited qualified Obligors to those possessing a credit rating of "A-" or better.

## **8. What happens if one of the Obligors becomes insolvent?**

Due to the fact that Obligors must possess an 'A-AAA' credit rating, the risks due to Obligor insolvency are statistically insignificant. Several variables should be considered when analyzing the 'theoretical' risk this poses:

a) To obtain and maintain an investment grade credit rating requires a great deal of third-party oversight and financial disclosure. It seems a highly remote possibility that the credit rating agencies would fail to recognize the signs of imminent financial collapse of an Obligor and thereby maintain their investment grade credit rating on that Obligor.

If an Obligor were to become financially distressed, the credit rating agencies would lower their credit rating and receivables issued by that Obligor would no longer qualify as collateral.

b) Insurance companies must be licensed in each State before they can sell health-care insurance. To get licensed in any State, an investment grade credit rating is required because should the insurance company become insolvent, the State must stand behind and honor their debt obligations.

## **9. Does the Fund have a credit rating?**

No. It is inaccurate to suggest that simply because the Fund's investments are ultimately based upon the payment obligations of S&P 'A-AAA' rated entities that the Fund itself assumes the collective credit worthiness of the underlying Obligors.

Given the relative ease of assessing the level of investment risks associated with the Fund and the annual cost and time requirements to maintain a credit rating, the Fund does not intend to obtain a credit rating.

## **10. What is the minimum investment in the Fund?**

US\$10,000 is the minimum initial investment in the fund.

## **11. Is an investment in the Fund 'liquid'?**

No. To achieve the Fund's primary investment objectives of securing the Fund's investments while providing a regular, above-average dividend yield to its Preferred Shareholders, it is



necessary to sacrifice short-term liquidity. In the case of an unforeseeable financial crisis, however, the Investment Manager of the Fund may redeem all or part of a shareholder's investment prior to the specified redemption date. Such a redemption, however, will be made only if it does not jeopardize the financial security of the Fund and its remaining shareholders.

## **12. Does the Fund permit reinvestment of dividends?**

No, the Fund does not permit reinvestment of dividends. If a shareholder wishes to re-invest dividends, the Fund offers new 3-year subscriptions of Preferred Shares on a monthly basis.

## **13. What safeguards has the Fund implemented to ensure the integrity of the Preferred Shareholders' investments in the Fund?**

To safeguard the reception and distribution of funds received at the time of subscription, distribution of dividends and redemption of the principal investment at the end of three years, the Fund has implemented a system of internal checks and balances:

- a) The Investment Manager controls investment management decisions, but does not have signing authority on the Fund's bank account, and may not control or modify provisions governing the Fund.
- b) The Director controls and may modify provisions governing the Fund, but does not have signing authority on the Fund's trust accounts and may not make investment management decisions.
- c) The Administrator has signing authority on the Fund's bank accounts, but may not control or modify provisions governing the Fund or make investment management decisions.

The Fund is audited annually, and such audit is submitted to the Bahamas regulators. Given the importance of international asset management to the Bahamian economy, it is not surprising a high level of fiduciary responsibility and regulatory compliance is imposed upon any company acting in a financial management position.