The past year has seen significant changes in the life settlement business as the business continues to grow and the regulatory environment gradually shifts.

A 2004 ruling, by a respected group of state-based regulators, had an immediate effect for agents because it enabled many to begin counseling their clients on settlements without any additional licenses. Other developments will shape this business for years to come.

A life settlement is the sale of a life insurance policy to a third party for a present value of the net death benefit. Transactions like this traditionally have been performed for the terminally ill. Under the right circumstances, however, they can be useful for seniors and the chronically ill.

Companies have been performing life settlements for the past four or five years, but the business has matured in the past two as institutional investors have learned the value of these transactions and invested in many top provider companies.

In a usual transaction, an elderly policyholder sells a term, whole, universal, variable, or survivorship life insurance policy for a percentage of the policy’s face value. The percentage is based on life expectancy, but a policyholder need not be terminally ill. A life settlement might be desirable for many reasons, including a change of life...
situation, change of need for insurance, change of business, or increased tax liability or estate planning needs.

For nearly 10 years, the life settlement business has worked closely with the National Association of Insurance Commissioners (NAIC) to promote intelligent and consistent regulation of this business.

The NAIC regularly has adopted positions and made recommendations about how and to what extent this business should be regulated. Because insurance regulators from throughout the United States are involved, it is one of the few sources of uniform regulation for this business. The NAIC’s positions are not law, but are recommendations for each state. For states that already regulate settlements, the NAIC might have less effect, while the effect likely is greater in states that don’t have settlement regulations on the books.

Last June, the NAIC adopted a settlement model regulation that does not require separate licenses for agents who recommend settlements. This change removes a layer of bureaucracy among producers, policyholders, and settlement companies, and it makes it easier for and actually encourages producers to give clients advice about settlements.

In some states, the previous regulations required producers who wanted to recommend a settlement either to obtain a specific broker license or work with a licensed broker.

Consumer protection was at the heart of the discussions about the model regulation, but in the end it was agreed that consumers should have the right to talk with their agents about settlement options should their insurance policies not be performing as the consumers would like. In some respects, this is a validation of settlements that we have not seen before now. For practical purposes, the model regulation will lessen the role played by settlement brokers and ultimately increase the size of settlement offers given to consumers.

In July 2004, another regulatory body, the National Council of Insurance Legislators (NCOIL), also strengthened its consumer protections and backed efforts not to require separate licenses.

NCOIL is an organization of state legislators whose main area of public policy concern is insurance legislation and regulation. Many legislators active in NCOIL either chair or are members of the committees responsible for insurance legislation in their respective state houses across the United States.

This group even considered requiring insurance companies to send a mandatory notice to policyholders that a life settlement is an option. Such a requirement, long pushed by the life settlement business, was not adopted by NCOIL.

In another legislative move to regulate this business, a draft of the State Modernization and Regulatory Transparency Act (SMART) released by the U.S. House of Representatives Financial Services Committee contains several sweeping proposals that would alter the way the business is regulated. Among them, it asks that states that fail to create their own life settlement regulations be compelled to follow the model act. According to many, this controversial act will not go into effect for about a year if it is passed at all.

Another major development stems from the Mutual Benefits Corporation case in Florida. The company was seized by regulators from the Securities and Exchange Commission (SEC) earlier this year, and Mutual Benefits is disputing the SEC’s jurisdiction. This raises long-debated questions about whether life settlements should be regulated as securities.

Regulators have struggled with this issue for years. Those in the business say it is part of the insurance business while the government says that life settlement investments should be governed as securities. Until last year, the life settlement business was winning the argument. In 1996, the SEC filed a civil case against Texas-based Life Partners, Inc. A federal appeals court sided with Life Partners’ argument that it fundamentally was selling an insurance product. This ruling had been the cornerstone of the business’s anti-security stance.

In June 2004, a federal judge ruled that the SEC has the authority to regulate the life insurance settlements sold by Mutual Benefits Corporation. In making his ruling, the judge recommended that his decision immediately be appealed and reviewed by the district court with jurisdiction in this matter. This issue still has not been resolved.

The current ruling does not immediately affect the life settlement business, but the appeals court’s decision dramatically could change how settlement companies are structured and regulated.

On the whole, the life settlement business had one of its busiest years ever from a regulatory standpoint — and this was outmatched by the overall growth of the business itself. These changes are good news for producers and even better news for their clients.