

Understanding the Legal and Regulatory Framework of the Life Settlement Industry

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For investors considering capital allocation in life settlements, a comprehensive understanding of the legal and regulatory framework is essential. This framework governs the buying and selling of life insurance policies and ensures consumer protection while fostering a stable and transparent market. The life settlement industry, which allows policyholders to sell their life insurance policies for more than their cash surrender value but less than the death benefit, has evolved significantly over the last century.

The Cornerstone of Life Settlements: 1911 Grigsby v. Russell

The legal foundation for the life settlement industry was established with the 1911 Supreme Court case **Grigsby v. Russell** (222 U.S. 149). This landmark decision recognized life insurance as personal property, affirming that policyholders have the right to transfer ownership of their policies. This recognition provided policyholders with greater flexibility and financial options, laying the groundwork for the modern-day life settlement market.

Grigsby v. Russell solidified the notion that a life insurance policy could be assigned or sold, similar to other personal property. This precedent became the cornerstone of the life settlement industry, enabling a secondary market where policyholders could monetize their policies to meet financial needs.

The First Life Settlement and Regulatory Milestones

Although Grigsby v. Russell set the stage, the first documented life settlement transaction occurred in 1998. The growth of the market prompted the need for a regulatory framework to address consumer protection and market transparency. Significant milestones in the regulatory evolution of life settlements include:

- **2000: The National Conference of Insurance Legislators (NCOIL)** drafted the Life Settlement

Model Act. This Act provided a template for states to regulate life settlements, emphasizing disclosures and protecting policyholders.

- **2001: The National Association of Insurance Commissioners (NAIC)** revised its Viatical Settlements Model Act to address life settlements. These revisions aimed to enhance transparency and strengthen consumer disclosures, ensuring that policyholders were fully informed of their options and the implications of selling their policies.
- **2007:** Both NCOIL and NAIC modified their respective Model Acts to address the growing concern of **Stranger-Originated Life Insurance (STOLI)** practices. These modifications strengthened consumer protections and introduced stricter regulations to prevent the misuse of life settlement transactions.
- **2013:** By this year, **43 states and Puerto Rico** had adopted comprehensive laws regulating life settlements, covering approximately 90% of the U.S. population. These regulations ensured uniform standards for licensing, disclosures, and consumer protections.

Key Regulatory Developments

- 1. Life Insurance Consumer Disclosure Model Act (2016):** NCOIL re-adopted this Model Act to mandate that insurers inform policyholders of alternatives to policy lapse or surrender. This Act empowered policyowners by ensuring they were aware of their right to sell their policies in the life settlement market.
- 2. NAIC Endorsement of Life Settlements (2017):** The NAIC formally endorsed life settlements as a viable financial tool for seniors to fund long-term care needs. This endorsement highlighted the growing acceptance of life settlements as part of comprehensive

financial and retirement planning strategies.

3. Tax-Free Rollovers for Healthcare Costs (2021):

In 2021, legislation was reintroduced to allow seniors to roll over life settlement proceeds tax-free to fund healthcare and long-term care costs. This initiative aimed to provide additional financial relief to seniors facing rising healthcare expenses.

Current Legal and Regulatory Landscape

The regulatory framework governing life settlements ensures that policyholders are protected from fraudulent or predatory practices while fostering market growth. Key aspects of this framework include:

- **Licensing and Regulation of Life Settlement Providers:** State laws require life settlement providers and brokers to obtain licenses and adhere to strict regulatory standards.
- **Mandatory Disclosures:** Regulations mandate clear and comprehensive disclosures to policyholders, including the financial implications of a life settlement, the tax consequences, and alternatives to selling their policies.
- **Consumer Protections Against STOLI Practices:** To prevent STOLI schemes, which involve third-party investors initiating life insurance policies for the sole purpose of selling them, regulators have implemented measures to detect and deter such practices. These measures include requiring a two-year contestability period be completed before a policy can be sold in the secondary market.
- **Privacy Protections:** Laws safeguard the confidentiality of policyholder information, ensuring that sensitive data is not disclosed without consent.

Conclusion

The life settlement industry has come a long way since the landmark Grigsby v. Russell decision. A century of legal and regulatory developments has transformed life settlements into a legitimate and highly regulated market, providing policyholders with financial flexibility and investors with unique investment opportunities. By understanding the legal and regulatory framework, allocators can make informed decisions and confidently participate in this growing asset class.



The LifeCap Advantage

LifeCap specializes in providing institutional investors and family offices unparalleled access to longevity-oriented investments through our strategic relationships with leading companies in the secondary market for life insurance.

The LifeCap team has spent more than 20 years working alongside institutions, advisors, and individual investors alike to educate investors about alternative assets, with a focus on longevity-oriented investments.

To learn more about life settlements and how LifeCap can enable you to leverage the potential of the longevity-oriented asset class, schedule a call with us at lifecap.com.

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