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STATE SECURITIES ACTS COMPLIANCE ISSUES FOR TERTIARY MARKET LIFE SETTLEMENT POLICY TRADERS

In this article, the authors begin by describing how life settlement transactions work for life settlement providers and investors. They then examine whether non-fractionalized life settlement investments are securities under the Supreme Court's four-part Howey test for investment contracts, and the circuit court decisions applying the test to these investments. They close with application of state blue sky laws to resales of life settlement policy investments.

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The secondary market continues to grow for investments in in-force life insurance policies as an alternative asset with low correlation to market changes in valuations and investment returns in stocks, bonds, and other traditional financial products. Once an investor has acquired an in-force life insurance policy in the secondary market following a regulated transaction through a state licensed life settlement provider, the policy may later be sold by that investor in a resale transaction, either alone or as part of a portfolio of similar policies, to another investor in what the life settlements investment industry calls the tertiary market. The tertiary market for non-fractionalized life insurance policies that are not variable life insurance policies is largely unregulated.[1] Under federal securities laws, tertiary market trades of the entire ownership and beneficiary rights of a non-variable (i.e., fixed) life insurance policy generally are not a securities transaction. However, some state blue sky securities laws treat these transactions as the offer and sale of a new security, making the seller subject to securities fraud risk and requiring it to rely upon an exemption from registration at the state level.

HOW LIFE SETTLEMENT TRANSACTIONS WORK

A life settlement, or secondary market life insurance transaction, is a fairly straightforward transaction: the

[1] Variable life insurance policies are securities because the policyholder bears the investment risk of the assets in which the policy's premiums, after deductions for mortality and

footnote continued from previous column…

administration expenses, are invested, which affects the amount of the policy's death benefit.

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