

Additional Governmental Oversight Recommended for Life Settlement Industry

Two new publications—one a staff report by the SEC and the other a survey by the Government Accountability Office (“GAO”)—suggest that additional governmental oversight may be on the way for life settlements, an asset class that some believe is poised for significant growth. Despite a perceived increase in interest and activity surrounding the life settlement space, the reports serve as a reminder that the short-term forecast for the life settlement market remains unclear, as we observed last autumn. This article provides a brief overview of the latest regulatory developments.

Report from the SEC's Life Settlement Task Force

On July 22, 2010, the SEC's Life Settlement Task Force (the “[Task Force](#)”) released a staff report containing a number of recommendations for the SEC to consider, most notably a recommendation that Congress expressly subject life settlement transactions to federal securities laws.¹ SEC Chairman Mary Schapiro established the Task Force in 2009 to determine whether gaps existed in the oversight of the life settlement market. The recommendations contained in the report fall into five general areas.

First, the report advises the SEC to recommend to Congress that it amend the definition of “security” under the Securities Act of 1933, the Securities Exchange Act of 1934 and the Investment Company Act of 1940 to include life

settlements, in an effort to clarify the treatment of life settlements under federal securities law. Such a change in law would not only subject market intermediaries to the regulatory framework of the SEC and FINRA, but would mean that all offers and sales involving life settlements, except for those qualifying for an exemption, would need to be registered with the SEC and would need to satisfy disclosure requirements. In addition, under the 1940 Act, the new definition of “security” would mean that a pool of life settlements could be treated as an investment company, unless it were to fall under an exemption.

The second recommendation of the Task Force, which would follow upon the inclusion of life settlements within the federal securities law, is that the SEC staff be instructed to monitor that the new legal standards applicable to life settlement brokers, providers and other market participants are met.

Life settlement securitization is the focus of the report's third recommendation. The Task Force advises that the SEC staff be instructed to monitor developments in respect of life

¹ *Securities Exchange Commission Release 2010-129*, SEC Releases Report of the Life Settlements Task Force, July 2010, available at <http://sec.gov/news/press/2010/2010-129.htm>.

settlement securitization, citing a lack of public information in this area due to the fact that all life settlement transactions to date have relied upon exemptions from registration with the SEC. The report notes that adoption of the SEC's proposed revisions to its rules relating to asset-backed issuers,² which would be applicable to life settlements, could be expected to increase the amount of relevant information available to the SEC.

The fourth recommendation contained in the report is that the SEC should press federal and state legislators to consider expanded regulation of life expectancy underwriters, the companies that provide the life expectancy reports upon which policy valuations are based. Areas of possible regulatory focus might include licensing and qualifications of underwriters, privacy of customer information and physician review standards.

An investor bulletin, the final recommendation of the Task Force, was issued by the SEC in conjunction with the report.³ It provides basic information on life settlements as an asset class, and summarizes a handful of considerations that should inform an individual investor's decision to invest in life settlements, including uncertainties relating to life expectancy and the possibility that a payment may be challenged for fraud or other reasons.

GAO's Report to the Special Committee on Aging, U.S. Senate

A report from the GAO addressing the results of, and conclusions derived from, GAO's research and surveys of state insurance commissioners and licensed life settlement providers regarding life settlement industry regulation, practices and future challenges, also released last week, reinforces the message that additional governmental oversight of the life settlement

² *DechertOnPoint*, SEC Proposes Extensive Reform to the Rules and Regulations for Public and Private Offerings of Asset-Backed Securities, April 2010, Issue 32, available at http://www.dechert.com/library/Finance_and_Real_Estate_04-10-32_SEC_Proposes_Extensive_Reform.pdf; see also Securities Exchange Commission, Release Nos. 33-9117 and 34-61858 – Asset-Backed Securities – Proposed Rule, available at <http://www.sec.gov/rules/proposed/2010/33-9117.pdf>.

³ Securities and Exchange Commission, Investor Bulletin on Life Settlements, available at http://sec.gov/investor/alerts/lifeselements_bulletin.htm.

industry may be on the horizon.⁴ Because the current regulatory scheme applicable to life settlements involves multiple state and federal regulators, the GAO recommends that Congress consider taking steps to ensure that policy owners involved in life settlements are provided consistent and minimum levels of protection. Notably, the report does not advocate a specific approach to regulation to be adopted by Congress.

Conclusion

Taken together, the recent reports suggest that additional oversight of the life settlement industry may be inevitable. While federal regulation—particularly regulation that is overly broad or which does not address the concerns of market participants—is likely to have a negative impact on the life settlement industry in the near term, it could well be that a properly conceived regulatory scheme that is harmonized across all fifty states may, over time, help the market mature and flourish. To be successful, any such regulatory scheme will need to reduce the uncertainties and occasional occurrence of abuses that have tarnished the asset class without dramatically increasing transaction costs. We will continue to monitor and keep market participants apprised of further developments impacting the life settlement market as they occur.



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⁴ *Government Accountability Office Report to the Special Committee on Aging, U.S. Senate, Life Settlements: Regulatory Inconsistencies May Pose a Number of Challenges*, July 2010, available at <http://aging.senate.gov/letters/gaolifeselements.pdf>.

Practice group contacts

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