

PART

One

Life Settlement Basics

COPYRIGHTED MATERIAL

CHAPTER 1

A Brief History of Life Settlements

Vishaal B. Bhuyan

Managing Partner, V.B. Bhuyan & Co.

The legal and conceptual basis for a secondary market in life insurance originated from the U.S. Supreme Court case of *Grigsby v. Russell* (1911), which established that policy owners have the right to transfer an insurance policy in a manner similar to any other asset. Justice Oliver Wendell Holmes represented that life insurance contained all of the legal attributes of property such as real estate, stocks, and bonds, so was therefore “transferable without limitation” by the policy owner. Holmes stated, “Life insurance has become in our days one of the best recognized forms of investment and self-compelled saving.” The case set forth the rights of a policy owner, allowing an owner to:

- Name the policy beneficiary.
- Borrow against the policy.
- Sell the policy to another party.
- Change the beneficiary designation of the policy.

The first form of the modern day life settlement market was the viatical settlement market of the 1980s, where men diagnosed with AIDS sold their life insurance policies to third party investors. A viatical settlement is defined as the sale of an insurance policy when the insured’s life expectancy is less than two years. The majority of the population diagnosed with AIDS in the 1980s was homosexual, so most did not have wives or children to consider when making their financial plans. Moreover, these transactions allowed viators to generate cash for their medical expenses. At the time, the medical community understood very little about the virus, so life expectancies were

typically very short once a patient was diagnosed. But as researches started to effectively prolong the lives of infected individuals, investors holding viatical settlements in their portfolios started to amass considerable losses. Moreover, the generally controversial nature of the investment curbed institutional interest in the market.

Although a small number of U.S. and European investors continued to participate in the viatical settlement market in the mid 1990s, due to favorable tax regulation (viatical settlements were not subject to income or capital gains tax), the market's rebirth occurred around 2000 when regulatory bodies began to establish industry standards to minimize fraud and encourage best practices. Moreover, the formation of the Life Insurance Settlement Association from the Viatical and Life Settlement Association of America in 2004, further helped to establish the modern day life settlement market and separate it from the controversial and speculative market of viatical settlements.

Today, life settlements are experiencing tremendous growth, exploding from a \$3 billion market in 2003 to more than \$15 billion in 2008 and are projected to grow to a whopping \$160 billion market in the next several years, according to Conning & Co. Moreover, trade associations such as the Institutional Life Markets Association, which is composed of major financial institutions focusing on the regulation and development of life settlements and other life-linked financial products, helped to legitimize the industry.

The growth of the market can also be attributed to strong demographic shifts such as the aging baby boomers and instable financial markets, which are creating further incentives for seniors to part with their life insurance policies and attracting investment funds that wish to gain exposure to assets with a low correlation to other markets.