Life settlements in South Africa: An assessment of the potential for a strong market to develop

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ABSTRACT
Life settlement, a transaction whereby the policyholder of a life insurance policy sells the future proceeds of the policy to a third party investor, has established itself as a legitimate alternative asset class in the United States of America (US) over the last decade. This research uses the key supply and demand side forces that fundamentally shaped and continue to underpin the US market, as a framework to assess the possibility of a South African life settlement market developing. Insurance product design, market intermediation, regulation, tax legislation, investment markets, investor rationale and more are explored through in-depth interviews with a range of industry experts. Results suggest that, in principle, there is no definitive reason why a South African life settlement market cannot exist. Across some dimensions the South African primary market may even be more conducive to life settlement transactions than the US. However, in aggregate, these are overshadowed by other forces such as greater investment risk, subtle market nuances and some market size inhibitors that combine to significantly dampen the overall likelihood of the development of a strong market.

KEYWORDS
South African life settlement; traded life insurance

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1. INTRODUCTION

Life settlement is the process whereby investors pay an insured person a sum of money in exchange for the future proceeds of their life insurance policy. In addition to the lump sum paid to the policyholder, the investor takes on the responsibility of meeting future premium obligations of the policy.

The life settlement market has its origins in the emergence of AIDS in the 1980s (Balinsky, 2006; Gabel & Scott, 2009; Goldstein, 2007; Kozol, 2009; Stone & Zissu, 2006). At the time, being diagnosed with AIDS would mean a drastically reduced life expectancy – often as low as two years. Groups of investors realised that such patients required funds to pay for medical expenses and other basic costs. They identified the potential to provide liquidity to these individuals and potentially generate high returns for themselves by purchasing their life insurance policies at a large discount to the policy face value (Kozol, 2009; Stone, 2009). The concept, known as a 'viatical settlement', soon expanded to include other terminal illnesses such as advanced cancer (Gabel & Scott, 2009). The proposition of high returns for investors was founded on the perceived certainty of short life expectancies. However, advancements in the treatment of AIDS extended life expectancies and had diabolic consequences for the returns and attractiveness of these viatical settlements (Gabel & Scott, 2009; Kozol, 2009).

By the late 1990s, the viatical market had largely dried up (Goldstein, 2007). Gabel and Scott (2009) suggest that the market recovered because of the introduction of life settlements – effectively exporting the concept of the secondary insurance market beyond the terminally ill to include millions of older policyholders. They highlight that at about this time it was becoming clear that the assumptions underpinning favourable future policy projections, that had been heavily relied on in generating sales of universal life policies were not holding true. The result was that many policyholders had become disappointed with the performance of policies that had been sold to them years earlier. Gabel and Scott (2009) contend that while some participated in class-action law suits, life settlement presented itself as a less litigious response for others.

The life settlement industry has now grown into a multi-billion dollar industry in the United States of America (US). Some reports suggest that the value of traded policies through life settlements grew from a very small base in 2001 to $5 billion in 2005 and up to $15 billion by 2007 (Breus, 2008; Gabel & Scott, 2009; Goldstein, 2007; Lavine, 2008; Ziser, 2006). Other sources are more moderate in their estimates and put the market size at $3.8 billion as at 2010 (Conning Research, 2011).

With the growth in this industry in the US it is likely that life settlements will be considered more seriously in other markets including South Africa. Indeed the aim of this paper is to assess, on an exploratory basis, whether the supply and demand factors that have driven and influenced the development of the US life settlement market could apply in South Africa and contribute to the development of a local life settlement market.

The author intends for this paper to provide insights to all stakeholders whom the potential emergence of a life settlement market in South Africa would affect.

Using these insights, insurers, regulators, financial intermediaries and policyholders could develop strategies to ensure they are best-positioned to take advantage of the opportunities, or defend themselves against the threats, which the development of a life insurance settlements market would create.

This paper defines a South African life settlement market as the secondary sale of life insurance policies domiciled in South Africa to either local or foreign investors. The paper does not consider:

— the possible emergence of Stranger Owned Life Insurance (STOLI) where the policy is originated with the deliberate intention to sell it;
— the secondary market for investment products; or
— the ethical issues related to life settlement investment.

2. EXISTING LITERATURE: SOUTH AFRICAN LIFE SETTLEMENT MARKET

Negpen (2009) completed a research project as part of the requirements of an honours degree at the University of Cape Town. In his research, Negpen attempted to explain the absence of the life settlement market in South Africa. Negpen's research implies that certain market size limiting factors are the primary reasons a life settlement market has not developed in South Africa. While there is some commonality between this research and that conducted by Negpen, Negpen's research was primarily focussed on insurance product and regulatory issues. This research attempts to consider the topic more widely by also considering factors such as tax, intermediation, the investment value proposition, key investment risks and the possible reaction of industry players in addition to product and regulatory considerations.

3. RESEARCH METHODOLOGY

The research is interpretative and exploratory in nature for which a qualitative approach is normally advocated as best practice (see example by Creswell (2003) and Bhattacherjee (2012)) and this is the approach that was followed.

Existing literature was used to decompose the growth of the US life settlement market by identifying and exploring the forces that act on the supply and demand sides of the market respectively. This provided the framework for questions to be asked during in-depth interviews with research respondents to 'test' these factors within a South African context and assess the development potential of a similar local market. In addition, to validate and refine findings, and to ensure more credible research results, a structured presentation of initial findings was reviewed by two additional respondents. These respondents had more time than what would be possible in an interview, and were therefore able to consider the issues more deeply and from multiple points of view as part of the critical assessment of the findings presented to them.

Knowledge, experience and position were key considerations in deciding which respondents to invite to participate in the research and, where such an invitation was accepted, the questions asked to the particular respondent.

In aggregate, ten respondents across four different organisations participated in the research. A summary of the respondents is shown below.

Table 1 Profile of respondents

Respondent code	Nature of participation	Description of respondent
INT1	Interview to generate initial findings	A senior actuary employed in the product division of a large South African life insurance provider.
INT2	Interview to generate initial findings	A senior actuary employed in the product division of a large South African life insurance provider. Holds a qualification in financial planning.
INT3	Interview to generate initial findings	A senior actuary employed by a large international reinsurance provider. Has US life settlement market experience and previously worked within the South African insurance industry.
INT4	Interview to generate initial findings	A senior legal specialist employed by a large South African life insurance provider.
INT5	Interview to generate initial findings	A senior chartered accountant and tax specialist employed by a large South African insurance provider.
INT6	Interview to generate initial findings	A senior manager within the sales and distribution division of a large South African insurance provider. Holds a qualification in financial planning and has previous experience working as a financial planner.
INT7	Interview to generate initial findings	A senior investment actuary employed by a large South African insurance and pension provider.
INT8	Interview to generate initial findings	A senior fund manager employed by a large South African asset management firm.
STR1	Comment on structured presentation of draft findings	A senior actuary employed in the South African office of a large international reinsurance provider.
STR2	Comment on structured presentation of draft findings	A senior actuary employed in the South African office of a large international reinsurance provider.

While policyholders of insurance products do represent a key stakeholder within a life settlement market, in general, they are unlikely to be well placed to provide responses and commentary on the types of questions posed by this research. In addition, reaching a representative sample of a fragmented policyholder population was unlikely to be feasible with the data collection methodology selected for the research. Policyholders were therefore not interviewed as part of the research. The relevance of a life settlement market to policyholders was however extensively considered through the interviews of other respondents.

As described in the acknowledgements, the original research was conducted as part of the completion of an MBA degree. Findings from the original research report

were refined slightly based on feedback that was provided on the draft version of this paper and in light of a request for comment on the regulation of life settlements in South Africa, issued by the Financial Services Board (FSB) to various primary market participants in mid 2013.

The key limitations of a qualitative, in-depth interview based research methodology (see for example Bhattacherjee (2012)) should be highlighted.

— Too much data may make it difficult for the researcher to effectively process it. In addition, in-depth interviews are time intensive to conduct and process and therefore the methodology usually relies on a relatively small sample that is at risk of not being representative. Life settlements, and this paper, cover a wide range of topics that require input from very different types of research respondents. This is likely to deepen the limitation, as it further reduces the sample size within any particular topic.
— The interpretation and reconciliation of diverse perspectives, and discarding personal biases and preconceptions can prove challenging for the researcher. In this paper, the author has however attempted to protect against this by accurately reflecting the views and information provided by the research respondents and, where possible, facts, rather than relying on his own opinions to generate findings.
— Different respondents are likely to have different levels of credibility, bias and knowledge relating to the topic and possibly may have undisclosed agendas.

It is possible that the limitations associated with such research can result in misleading or false conclusions. The findings of this paper need to be interpreted within the context of these limitations and the exploratory nature of the research.

4. SUPPLY SIDE OF THE MARKET

4.1 What is the Basic Supply Side Value Proposition in the US?

In the absence of the possibility of a life settlement, policyholders have limited ways in which they can dispose of an unwanted or unneeded insurance policy. Traditionally, the only mechanism for effectively achieving such a sale would be to surrender the contract back to the insurance provider. In such a case premiums are no longer payable, and depending on the type of product, the insurance provider might pay out a lump sum known as the surrender value. In surrendering their contract, the policyholder forgoes any rights to the proceeds that would otherwise have been available on death of the insured.

At a high level, the economic intrinsic value of retaining the policy is effectively the net present value of death proceeds less the net present value of future premiums payable (Bakos & Parankirinathan, 2006; Leimberg et al., 2008). This value is directly related to the insured's health (and consequently life expectancy) at any particular point, since this fundamentally determines the expected timing of death proceeds and the expected cease date for premium payments to be made (Doherty & Singer, 2002).

On the other hand, surrender values, if offered at all on the contract, are normally

generically calculated and do not take account of how the insured's health may have deteriorated since the inception of the policy (Balinsky, 2006). This, in addition to the lack of surrender pricing pressure because of the arguably monopsonistic situation that only the insurance provider offers the surrender value, often creates the situation that the intrinsic economic value of the policy is greater than the surrender value offered by the insurance provider (Balinsky, 2006; Breus, 2008).

This disparity in values is likely to be greatest when the health of the insured is impaired and life expectancy is relatively short either because of a specific health condition suffered or simply because of old age or both (Stone & Zissu, 2007).

The life settlement market meaningfully expands consumer choice by providing an alternative policy disposal mechanism in such situations (Bakos & Parankirinathan, 2006; Gabel & Scott, 2009; Gardner et al., 2009; Gelfond, 2009; Kozol, 2009; McNealy & Frith, 2006). The policyholder transfers ownership of the policy, the future proceeds payable on their death and the premium obligations in exchange for an immediate cash sum known as the settlement amount.

Doherty and Singer (2002) and Segerstrom (2010) contend that, by design, the settlement amount considers the insured's impaired health and lower life expectancy and is therefore likely to be higher than the surrender value offered by the insurance provider where significant deterioration in health has occurred. This is because the timing of death proceeds will be earlier and fewer premiums are expected to be paid. Settlement amounts tend to average between 20% and 30% of the face value of the policy which is often between two to five times the surrender value (Balinsky, 2006; Gabel & Scott, 2009; Gardner et al., 2009; Ingraham, 2004; Ziser, 2006).

Doherty and Singer (2002) show that the relationship between the surrender value of the policy, the economic intrinsic value of the policy and the settlement amount underpin the basic motivation for individuals to supply policies into the life settlement market. Deloitte (2005) claim that in a large majority of cases the greatest expected economic value is derived by retaining the policy rather than offering it into the life settlement market. This view is based on the fact that the settlement amount, although higher than the surrender value, is often substantially lower than the economic intrinsic value. However, Bakos and Parankirinathan (2006) make the point that such an argument ignores the fact that the insured will not actually participate in that economic value in the case when the policy is retained. This is because the key driver of the economic value of the policy in this scenario is the amount payable on the death of the insured. Thus the insured does not actually directly benefit from these proceeds.

4.2 Can the Basic Supply Side Value Proposition exist in South Africa?

The basic value proposition of life settlement to the supply side hinges to a great degree on the nature and design of insurance products sold within the market. Research participants indicated that the product landscape has tended to change over time in South Africa. Early products introduced in the 1950s and 60s were 'pure risk' products, in other words premiums were charged in exchange for an amount payable

on death and there was no cash value or surrender built up inside the policy. 'With-profits' products offering the policyholder participation rights in the profits of the product (or some subset of profits) were then introduced. These products typically have a surrender value. Later with the advent of computers, the universal life style of products, which also offered surrender values, started to be sold.

Through the 1990s, price competitiveness in the market increased and two important product changes occurred to reduce initial premiums: first, investment components within universal life products were reduced (although not yet removed completely). Second, the term for which premiums were priced and guaranteed to provide cover was shortened. It is worth noting that such products were still predominantly sold on a 'whole of life' term basis meaning that, provided the revised premiums are taken up by policyholders at future premium review dates, cover continues until the insured life's death. This is an important point because term products (i.e. non whole of life) may not be suitable for life settlement transactions because the investment risk becomes too binary. The investor is at risk of not collecting the death proceeds at all.

In the early to mid 2000s there was a move towards completely splitting insurance and investment products in South Africa and once again pure risk products (with no surrender value) entered the market. These have since become the standard in the traditional retail market.

All respondents indicated that products within the South African market described above do not generally take the life assured's health into account in determining any surrender value to be offered.

Respondents did however indicate that in special circumstances where the life assured had been diagnosed with a terminal illness and was expected to pass away within 12 months, the life insurance (or part of the life insurance) could be paid out early. This is commonly referred to as a 'terminal illness benefit'. Clearly in a case where an insured's medical impairment is severe enough to qualify for such an early payout then a life settlement would probably not be an attractive proposition to the policyholder in any case. However Mott (2007) referred to similar product features available on some US products and it is therefore not unique to the South African product landscape and does not, by itself, preclude the possibility of a life settlement market.

Negpen (2009) argues that ownership of critical illness insurance (also known as dread disease insurance) might reduce the likelihood of a policyholder selling their policy into the life settlement market. Such benefits provide a sum of money on the diagnosis of specified illnesses or health events such as cancer and heart attacks. Different versions of the benefit are available – one where the cover is totally independent and another where any claims for a critical illness reduce the amount of life cover to which the benefit is attached. The argument is that should a policyholder's health deteriorate to an extent that they become eligible for life settlement, they may well be able to claim on their critical illness insurance. A life settlement might then

be less likely to occur either because part of the proceeds that would otherwise have been payable on death are no longer available or because the policyholder's financial situation is not as dire as the case when no critical illness provision existed.

Negpen (2009) points out that in relative terms, critical illness insurance is more widely sold in South Africa than in the US where it is a more recent addition to product portfolios and limits the size of the potential life settlement market in South Africa. STR2 agrees and describes the US critical illness market as "in its infancy" and believed it to be a key difference between the two primary markets.

Other respondents felt that the critical illness market could only have a limited effect on any life settlement market. STR1 argues that health conditions such as high blood pressure or high cholesterol might qualify somebody as a life settlement candidate long before these conditions lead to a critical illness claim, if they lead to a claim at all. Further he argues that sales of critical illness insurance relative to other forms of cover such as life insurance, although higher than the US, are still relatively low in South Africa and that even when the cover is sold, the insured amount is often much lower than the life insurance cover amount on the same policy.

The relationship between the surrender value (interpreted to be zero when there isn't one) and the amount payable on death is a key determinant in whether a life settlement transaction is feasible. This is because, in principle, the settlement amount would need to be greater than the surrender value to make the transaction attractive to policyholders. Relative surrender values offered in South Africa and the US are therefore important to consider in understanding whether such a market could develop in South Africa. In his paper, Negpen (2009) argues that the Statement of Intent, which came into force in 2005 and imposes maximum surrender penalties that can be applied, has reduced the market size for life settlements in South Africa. This is because, in theory, fewer policyholders can be offered competitive life settlement amounts relative to the minimum surrender value implied by the Statement of Intent than would otherwise have been the case if no restrictions applied. While respondents agreed that this might be true, some indicated that in many cases the cash build-up within the policy may be small (or not available at all) either because the product was designed to be price competitive or because investment performance has been worse than originally anticipated. In other cases, the surrender value payable may already be higher than the minimum implied by the Statement of Intent. Further still, the Statement of Intent does not actually even extend to policies that are intended to "primarily provide risk cover"[1] and therefore may be irrelevant for a large number of policies that could be considered for life settlement transactions. Therefore the effect of such prescribed maximum surrender penalties on the life settlement market may actually be quite limited.

When asked about possible alternatives policyholders had to surrender, respondents explained that some products may offer policy loans, a 'paid up' option

1 Statement of Intent. www.treasury.gov.za/comm_media/press/2005/Statementintent.pdf

where cover could continue for a period of time without premiums having to be paid or that cover could simply be reduced. Other alternatives available to US consumers identified by Gardner et al. (2009) and Leimberg et al. (2008), such as getting a family member to continue paying the premium or obtaining third party financing, are applicable in South Africa as well. Overall, US policyholders appear to have slightly wider alternatives. Most notably they may be able to exercise a tax-free conversion of their product into a different insurance product that better suits their needs. All else being equal, marginally fewer policy exit alternatives for policyholders might make life settlements slightly more likely.

Multiple respondents pointed out that term assurance products have been relatively undersold in the South African market. The longer term makes it more likely that the need for insurance will be outlived, opening up the opportunity to sell the policy. As discussed above, whole of life products are also more suitable than term assurance products for life settlement from an investor's perspective.

STR1 explained that policies tend to have been, and continue to be sold, with various premium funding patterns in South Africa. Some offer a level premium over time for a fixed amount of cover, while others offer a lower initial premium that increases over time. Neither was considered to preclude the possibility of life settlement but it was felt that the former might be the more attractive option to an investor and may be more actively targeted to back life settlement transactions.

The general sentiment of respondents was that there would be a reasonable proportion of policies in force in South Africa that have the essential cornerstone characteristics that allow the basic life settlement supply side value proposition to be created. That is, products exist where a settlement amount could be offered such that the policyholder perceives greater value in selling the policy than in retaining it. Overall, it was felt that the proportion of policies that may be suitable for a life settlement transaction may be somewhat lower than the equivalent proportion in the US market.

In addition South Africa's population is approximately only one sixth of the size of the US population. Further, respondents argued that South Africa has much higher levels of poverty, a fraction of the number of high net worth individuals and arguably doesn't have the same degree of ageing within the population as is being observed in the US. As a result, the potential supply side of a South African life settlement market would be smaller still.

Given the above, most respondents agreed that the overall number of people who would be attracted to the supply side value proposition would be relatively small in South Africa. Some respondents felt this did not, by itself, imply that a market would not develop but simply that if a market did develop it would be much smaller than the one that has emerged in the US. Others argued that the small size of the opportunity does fundamentally reduce the likelihood that the market will develop.

4.3 Supply Side Market Intermediation in the US

In the US market, life settlement brokers intermediate between the life settlement provider (which represents the investor) and the insurance agent representing the policy seller (Katt, 2011; Stone, 2009; Stone & Zissu, 2007). The life settlement broker attempts to obtain the highest possible price on behalf of the seller by presenting the case to multiple life settlement providers (Casey & Lowe, 2011; McNealy & Frith, 2006; Ziser, 2005). Their role in optimising the value for the seller in this way serves to increase the supply of policies into the market.

According to Balinsky (2006), US life settlement brokers will typically receive 6% to 10% of the policy face value, which represents approximately a third of the settlement amount. He further notes that this compensation will be deducted from the amount that would otherwise have been payable to the policy seller. As the amount represents a significant reduction in value to the policyholder, high levels of remuneration have acted as a frictional force on the supply of policies into the market.

Life settlements are complex transactions and in most cases individuals considering such a transaction would seek the help and advice of an expert financial planner or insurance agent (Kozol, 2009). McNealy and Frith (2006), establish that a significant supply side product flow constraint is that many financial planning professionals are simply not comfortable discussing the product with their clients because of their own lack of knowledge and training in relation to the transaction. They go on to state that building the knowledge and awareness required for them to start putting forward or advising on the option of a life settlement to their clients takes a substantial investment of time and finances. However, Seitel (2008) reasons that as financial planners do become comfortable, there is likely to be consolidation within the supply chain of policies as insurance agents might be able to perform the role of the life settlement broker. He contends that this will reduce value leakage in the supply chain and increase the propensity of policyholders to sell policies.

Kozol (2009) believes that besides the direct benefit of a secondary market for insurance agents, there is another more subtle benefit. He argues that a strong secondary market will improve liquidity for insurance, which will then increase the propensity of customers to make an initial insurance purchase. Insurance agents therefore stand to benefit from the development of the life settlement market and this is likely to help open up the flow of supply into the market.

4.4 What could the Supply Side Market Intermediation look like in South Africa?

Respondents' views were relatively mixed on whether there would be a specific role for an intermediary representing the policy seller in a life settlement transaction and if there was such a role, who would take it up in the South African market.

Some respondents argued that a life settlement would be a complex financial proposition and prospective policy sellers would most likely require financial advice. Therefore an intermediary would be required to represent the policy seller and ensure the seller's interests are protected, for example by sourcing multiple life settlement

offers on behalf of their client. INT6 argued further that in some cases existing financial advisers might even have a vested interest in ensuring a policy continues and may want to push the option of a life settlement where the client is considering surrendering the policy. INT3 could see no reason why the role would not develop as it initially did in the US market – that is, with existing financial intermediaries helping to represent policy sellers.

Other respondents had an opposing point of view. They argued that if a market were to develop, the most likely form it would take would be an entity sourcing policies directly from policy sellers through aggressive marketing on behalf on an investor. In other words, something close to where the US market appears to be heading – a more direct and consolidated value chain. While these respondents agree that most policyholders are unlikely to understand the true intrinsic value of the policy, they believe this is somewhat irrelevant when life settlement is viewed as a direct alternative to surrender. They question the extent to which advice would be required in a case where a policyholder has already made the decision to forgo the policy and is now simply assessing whether they would achieve (or perceive themselves to achieve) a greater financial outcome through selling than they would surrendering the policy. Further, any additional intermediaries in the value chain will result in additional costs which might make the deal unattractive to a prospective policy seller.

Respondents did however agree that if existing financial intermediaries were to be involved they would, in general, be unlikely to able to advise policy sellers appropriately relying solely on their existing skills and knowledge. Most respondents believed that thorough training and possibly even a form of accreditation would be required before advisers should be allowed to provide financial advice on such transactions. Respondents indicated that many advisers would probably not offer the life settlement option to their client simply because they were uncomfortable to provide advice on something they were not entirely familiar with even if there was no formal training or accreditation required.

Respondents also agreed that if any financial advice were to be rendered such advice would be bound by the Financial Advisory and Intermediary Services Act (commonly referred to as FAIS). FAIS regulates the provision of financial advisory and intermediary services. This would bring some level of consumer protection and transparency to the transaction.

Intermediary remuneration is a key consideration in assessing whether such intermediaries would drive such transactions. The level of remuneration might also affect the reputation of the industry and the willingness of policyholders to sell their policies into the market. When questioned about how intermediaries might be remunerated and how such remuneration might be restricted (if at all), respondents put forward the following possibilities:

— An advice fee agreed between the intermediary and the policyholder.
— A commission equal to a given percentage of the difference between the amount obtained by the policyholder via life settlement and the amount the policyholder

would have been offered if they surrendered or lapsed their policy. In principle, the intermediary shares in the 'value' they have helped to unlock through the life settlement.

In both cases, the remuneration should be supported by a signed mandate from the client if the service provided is governed by FAIS. Respondents indicated that the actual size of the fees or commission percentages would not be limited under current regulation. The implication is that incommensurately large fees or commissions could be charged initially as occurred in the early stages of the US market's development (Balinsky, 2006; Gabel & Scott, 2009) notwithstanding that the requirement for the signed client mandate may act as a counterweight.

However, given that the remuneration paid to intermediaries for both insurance and investment products covered by the Long-term Insurance Act is regulated, respondents believed that remuneration in respect of life settlements would also eventually be regulated should a market develop. Indeed even without formal regulation, some respondents seemed to indicate that commission percentages out of line with those allowed on single premium investment products would immediately start to raise concern.

Overall, differences in views amongst respondents seemed to centre on how the supply side of the market might be accessed rather than if it could be accessed. Most respondents seem to be of the opinion that a compelling case could be made to bring prospective policy sellers to a South African market one way or another.

4.5 Insurance Disposability in the US

In the US, the motivation for considering entering into a life settlement transaction is usually tied to the insurance policy no longer being needed or no longer being wanted (Ingraham, 2004; Ziser, 2005).

In many cases, the insurance would have been taken out to meet the need of the policyholder to provide financial security to dependants in the case of the insured's death (Katt, 2002). There are a number of reasons why the underlying need may fall away – Ingraham (2004), Gabel and Scott (2009), Stone and Zissu (2007) provide some examples. Children may have grown up and become financially independent. The designated beneficiary, for example a spouse or child, may have passed away. A divorce could also have eliminated the need for the insurance.

In other cases, insurance may have been purchased for the purposes of meeting estate tax which would be payable on the insured's death (Gardner, et al., 2009; Ingraham, 2004) or an outstanding mortgage balance (Kozol, 2009). A particular individual's tax burden may have reduced or the mortgage in question may have been paid off since the original policy was purchased, thus freeing up the insurance policy for disposal (Gardner, et al., 2009; Ingraham, 2004; Modu, 2012).

Gardner et al. (2009) and Ingraham (2004) offer examples of where an insurance policy may have been taken within a business context and may no longer be needed for

its original purpose. For example a policy might have been used to protect a business against the risk associated with the death of an employee considered to be critical to the ongoing success of the business. Alternatively, an insurance policy might have been used to ensure that should one of the partners in a business pass away, funds would be available for the remaining partners to buy up the equity portion of the deceased from their heirs. In such cases a number of events, for example, the sale of the business or the resignation or retirement of one or more of the insured individuals or policyholders could render the original insurance redundant.

In cases where ethically questionable sales practices were used to sell the policy or where the performance of the product has not been good relative to expectations created at the point of sale, a life settlement might be attractive simply because of negative sentiment that the policyholder may have towards the policy (Gabel & Scott, 2009).

McNealy and Frith (2006) state that improvements in life expectancies in the US mean that increasingly, people will outlive the needs of their insurance. Kozol (2009) explains how market experts forecast that there will be a rapid rise in the supply of suitable policies for life settlement as baby boomers enter their retirement years. Gardner et al. (2009) approximate that 30 000 people turn 65 everyday in the US. Ingraham (2004) quotes estimates that there is over US$500 billion of life insurance in force held by people over the age of 65 in the US.

Alternatively, economic motivations might underpin the disposal of an insurance policy through life settlement. A policyholder might find that life insurance premium increases become unaffordable – a common situation, for example, when renewal terms are offered at expiry of the original term of a term insurance contract (Ingraham, 2004). A policyholder might suffer a severe deterioration in health, for example due to the onset of a chronic illness or a disability, and this might put severe pressure on their finances. An individual might suffer a sharp decline in wealth, for example due to a major economic recession (as has recently been experienced). An individual might be presented with attractive investment opportunities but with no funds to commit. A policyholder may simply want immediate cash. In each of the previous examples put forward by Gabel and Scott (2009), Ingraham (2004), Modu (2012) and Stone (2009) a US policyholder might look to the life settlement market to generate value which more closely reflects the intrinsic value of the policy and that would otherwise have been illiquid and inaccessible beyond the surrender value offered by the insurance provider (Gabel & Scott, 2009; Ingraham, 2004).

4.6 How does Potential Insurance Disposability in South Africa compare?

Research respondents were asked to identify the main reasons life insurance is purchased in South Africa, the ways in which underlying needs evolved over time and the extent to which the insurance continues to match those needs over time.

Respondents identified insurance needs that very closely aligned to those that emerged in the literature relating to the US market and that are described in the

previous section. As in the case of the US market, dependant protection and mortgage protection needs are likely to reduce and eventually fall away over time. Business assurance needs might change or fall away as changes occur within the underlying business itself, again similar to the situation in the US market.

Multiple respondents pointed out that insurance policies in South Africa have been predominantly sold on a whole of life rather than a term basis despite that the underlying need, or at least part of the need, was not permanent. INT1 further explained that in most cases policyholders elect (or are advised by intermediaries) to have their cover amounts automatically escalate by a set percentage on each policy anniversary despite that the needs underlying the insurance often reduce over time. The implication is that in many instances policyholders will in the future, or perhaps already, own an insurance policy for which there may no longer be any underlying need. This sets up a supply market for life settlements.

Some respondents argued that there are some demographic trends in South Africa that might affect the potential disposability of insurance into the life settlement market. For example, INT6 argued that increasingly a dependant protection need may be extended compared to a generation ago because he believes that the people within the insured population are having children later in their lives and because high levels of unemployment mean that children may take longer to find work and become self-supporting.

Further, respondents mentioned that personal retirement provision was not adequate in many households in South Africa. Some respondents argued that the value obtained through a life settlement could be an attractive proposition to boost retirement provision for some policyholders. Others argued that inadequate retirement provision would make an insurance policy more likely to be needed by any surviving dependants after the retiree's death and therefore less likely to be available to the settlement market.

INT3 highlighted the effect that tax cuts had on supply within the US market. "The abolishment of estate duty tax in the early 2000s thrust the industry into prominence in the US because a large number of wealthy individuals suddenly had insurance which there was no need for." Unless similar tax cuts were introduced in South Africa this driver of supply in the life settlement market would not apply.

There was no suggestion that in circumstances where the insurance need has not fallen away, that South African consumers would have a significantly different propensity, compared to US counterparts, to sell their insurance policies.

Overall, based on respondents' feedback, it appears that insurance policies in South Africa do have the potential to outlive their original purpose. It is however difficult to assess whether the effect on supply would be greater or weaker than in the US market, and by how much, since different forces on this driver of supply would most likely act in opposing directions in the South African market.

5. DEMAND SIDE OF LIFE SETTLEMENT MARKET

5.1 Basic Demand Side Value Proposition in the US

Schwartz and Wood (2008) explain that from an investment perspective, the expected return on the investment into a pool of life settlements is a function of the purchase prices (or settlement amounts) paid for the policies, transaction costs incurred and the amount and timing of expected future cashflows which are:

— the premium payments that need to be made to keep the policy in force
— the maintenance expenses that will be incurred; and
— the revenues from policy proceeds payable on death.

A key determinant of the present value of these expected future cashflows (and therefore the overall expected return of such an investment) is the expected mortality experience of the insured lives underlying the pool.

Since mortality is generally considered to be uncorrelated with equities, bonds, real estate, interest rates and the economic environment in general, life settlements are put forward as an asset class that is uncorrelated to the rest of the investment market (Blake & Harrison, 2008; Seitel, 2008; Stone, 2009; Ziser, 2005). Finding such uncorrelated assets in an increasingly globalised financial system has become more difficult over time (Kozol, 2009).

Markowitz's pioneering work in modern portfolio theory showed how for a given return, risk could be reduced through the diversification benefits of including non-correlated assets within a portfolio. With unique forces acting on the return of life settlements, the asset class presents itself as an instrument that can be used to improve the risk-return relationship within an investment portfolio. In essence this has the effect of extending the 'efficient frontier' brought into conception by Markowitz's work and is the primary value proposition stimulating demand for life settlement investment (Dorr, 2008).

Besides the diversification benefits, investors have been attracted to US life settlements because of the prospects of their expected yields (Balinsky, 2006; Goldstein, 2007; Mott, 2007). Since the life settlement market began to develop a decade ago, expected yields have been anywhere between 8% and 16% (Goldstein, 2007; Seitel, 2009; Stone & Zissu, 2007). The interaction between supply and demand has a direct impact on profitability on offer for investors (Balinsky, 2006; McNealy & Frith, 2006). Mott (2007) draws attention to the differences in actual performance that have been achieved to date – some funds have produced returns in line with expectations, some funds have produced returns not dissimilar to LIBOR rates and some funds have found themselves in financial distress.

Traditionally, demand has been for policies of older lives with sufficiently large face value amounts (Ingraham, 2004; Schwartz & Wood, 2008; Seitel, 2008). With younger lives, life expectancies are too long and unpredictable to align to the investment proposition sought after by the investors engaging in life settlement transactions (Kozol, 2009). Minimum face values ensure transactions are economically viable

given fixed costs and relatively low 'hit rates' of policies that come under consideration (Schwartz & Wood, 2008). However, there are clear signs of shifts within target markets. As evidence of this, Seitel (2008) shows that life settlement process efficiencies have reached the point where 'small policy' programs are being launched and are still able to offer attractive returns. Such programs also give investors the additional advantage of better diversification since more policies can be purchased for the same amount of capital. Other examples of market efficiencies, effectiveness and maturation are:

— The evolution of online life settlement platforms such as LexNext and the one offered by Life-Exchange (Stone, 2009). Ziser (2007) believes that should these exchange platforms reach their full potential, an investor will be able to purchase life settlements as efficiently as they can for other securities.
— The formation of the Institutional Life Markets Association (ILMA) by some of the largest global companies to encourage the prudent and competitive development of mortality- and longevity-based products such as life settlement (Breus, 2008).
— The development of mortality indices, such as the Credit Suisse Longevity Index, launched in 2005 and the LifeMetrics Index launched by JP Morgan in 2007 (Mott, 2007). Stone (2009) states that such indices will provide an important source of liquidity and pricing information to the life settlement market.

5.2 Does the Core Demand Side Value Proposition apply in South Africa?

Respondents agreed that the investors behind pools of capital invested in South Africa would find the basic value proposition of the asset offered in the US (low correlation, high expected yields) attractive. Indeed some of the respondents interviewed are involved in a South African-based fund which has some exposure to US settlements which in essence proves the point.

Whether the asset class is truly uncorrelated can be debated. Respondents tended to argue that the asset was not correlated when, and only when, the asset was purchased and held to maturity. INT3 highlighted that from an accounting perspective the valuation of the asset might be connected to markets but that the actual underlying cashflows would be uncorrelated to other asset classes when the asset was seen through to maturity. Respondents felt that there was no fundamental difference in terms of the value proposition offered to investors on this particular aspect between South Africa and the US.

INT7 highlighted that it may be difficult for South African-based life settlement prices to reconcile at points that offer investors a high enough expected return and provide policyholders with a compelling reason to sell their policy at the same time. He argues that the South African equity risk premium (i.e. the additional investment return investors expect to earn as compensation for taking on more risk when investing in equities) is already fairly high relative to the US market. If this equity risk premium forms some baseline reference in determining the life settlement hurdle yield an investor requires, it might make it difficult for the investor to offer an amount

for the policy that is substantially greater than the surrender value. If it is achievable, INT7 believes that investors would certainly look at the asset in South Africa.

Respondents identified high net worth individuals, private equity funds, endowment funds, hedge funds and defined benefit pension funds as the most likely investors in a South African market. STR1 felt that the participation of pension funds, who account for a large share of investments in South Africa, may be reluctant to participate on the basis that they are already exposed to longevity risk.

INT7 and STR2 suggested that post the global financial crisis, investors are generally more reluctant to invest in assets that they do not fully understand. This is most likely true of both the US and South African investment market but may have more relevance to a life settlement market not yet off the ground (i.e. South Africa) than a market that has already established itself (i.e. US).

The large policies that have traditionally backed life settlement transactions in the US might not be as readily available in South Africa. In addition, as discussed already the primary market and the potential life settlement market is likely to be much smaller in South Africa and this may inhibit the viability of the development of longevity indices and life settlement platforms. In this respect, more subtle and advanced aspects of the value proposition to the demand side of the market may be weaker.

Overall, responses seemed to indicate that the main drivers of investment decisions in South African capital markets were relatively similar to those of investors in the US and therefore would be attracted to the basic proposition offered by life settlement.

5.3 Key Demand Side Intermediaries and Service Providers in the US Market

Various stakeholders and intermediaries have taken up roles and provide services that have enabled investors to allocate funds towards this asset class in the US.

Life settlement providers intermediate between investors and the life settlement broker or insurance agent representing the policy seller (Seitel, 2008). In essence the life settlement provider sources policies on behalf of the investor (Casey & Lowe, 2011; Ziser, 2007). Ingraham (2004) explains that institutional investors carefully choose the life settlement providers they deal with. He notes that they consider a range of dimensions including the life settlement provider's depth in management resources, reputation and ability to originate policies in line with their institution's investment goals for the asset class.

According to Balinsky (2006) life settlement providers typically receive commission of 2.5% to 5% of the face value of policy (approximately 15% of the purchase price) which is subtracted from the amount that would otherwise have been paid to the policyholder.

Life expectancy providers (also known as 'LE providers') provide the service of life expectancy estimation to the market. They make use of underwriters to assign mortality and life expectancy, relative to a given standard mortality table, to the insured individual underlying a potential life settlement contract (Katt, 2002).

Besides their role in developing the standard mortality tables described above, pricing actuaries may also be involved in the actual pricing of life settlements, developing the types of sensitivity testing that should be performed in the assessment of life settlement as an investment and assessing the resulting mortality experience of lives in life settlement pools (Schwartz & Wood, 2008).

5.4 What could the Demand Side Intermediation Model look like in South Africa?

Most respondents thought that investors in a South African market would be fairly unlikely to source policies directly and that an entity would intermediate on behalf of investors. Their description of the role was analogous to that played by the life settlement provider in the US market even where the respondent had no knowledge of the US market structure. Many respondents also viewed such a life settlement provider as the entity that would most likely 'kick start' the market in South Africa should it be possible.

Actuarial, entrepreneurial and medical or underwriting skillsets were identified as the core competencies that would be required to perform such a role. When questioned about the availability of resources that fulfil such roles, respondents indicated that while actuarial and underwriting skillsets were not very widely available, they thought it unlikely that a shortage of such skills would be a key impediment to the South African market developing. In some cases, respondents felt that a few individuals in the South African insurance or investment markets may already have the full range of skills required.

INT1 argued that over time, should the market reach a critical mass in South Africa, life expectancy providers may develop into a separate specialised function independent of the life settlement provider. However, initially before the market had fully developed, it would be likely that the life settlement provider would need to perform this function themselves.

5.5 Demand Side Risks and Risk Mitigation in the US

The performance of life settlements is determined by factors largely unique to the asset class – many of which were not fully understood by early investors (Bakos & Parankirinathan, 2006).

By far the largest risk facing life settlement investors is that the mortality of the lives underlying the life settlement pool is overestimated. That is, insured individuals live longer than expected (Freeman, 2007; Mott, 2007; Segerstrom, 2010; Stone & Zissu, 2011). This is also known as longevity risk or extension risk. Examples of sources of longevity risk are described below:

— Medical underwriters who provide the life expectancies that underpin settlement amounts might not have considered medical advancements that improve life expectancies of patients with a particular health impairment (as in the case of AIDS-related viatical settlements). Or it could happen that the underwriter has

simply used an inappropriate base mortality reference table in their calculations (Mott, 2007).

— Historically it has been fairly common in the industry that pricing of settlement offers simply consists of a process that builds and discounts cashflows using only the life expectancy of the insured individual (Mott, 2007). The problem with this approach is that even where the life expectancies are correctly estimated, the expected net present value of cashflows could be incorrect if the standard deviation, kurtosis and skewness assumptions that have been implicitly made through such an approach are not a true representation of the expected underlying mortality distribution (Bakos & Parankirinathan, 2006; Mott, 2007).
— Medical records on which estimates of life expectancy are based may not be complete and may not be a true representation of the insured individual's health (Mott, 2007). In addition, the sheer volume of records and health exams creates the possibility of overlooking relevant data (Perera & Reeves, 2006). Mott (2007) notes that for fear of litigation in the future, doctors preparing medical reports may have been overly cautious in a diagnosis.
— There are life expectancy improvements to the general population.

Should such risks materialise they may have severe impacts on the values of a life settlement portfolio. For example, some portfolio values were eroded by as much as 50% after US industry mortality tables that underpin much of the pricing of life settlements, were revised in 2008 to take account of general improvements in mortality of the population (Seitel, 2009; Stone, 2009).

INT3, with detailed knowledge of the US industry, believes that the biggest reason for the poor performance of the asset class was simply weak underwriting and overly optimistic life expectancy estimates provided by life expectancy providers and not the revised general population mortality tables as has been claimed in most of the literature related to the US market. He believes that the problem exists because life settlement providers and life expectancy providers are perversely incentivised to produce and use unrealistically short life expectancies.

Stone (2009) notes that, while increases to life expectancy estimates represent a cost in the short term for a life settlement fund, the reduction in return might be partially or even more than offset by the reduction in risk if the revised estimates come with higher levels of accuracy within the valuation basis.

Freeman (2007), Mott (2007) and Schwartz and Wood (2008) reason that risks can be mitigated and managed to a large extent and where risk mitigation is not possible, a more intimate understanding of the risks will at least lead to commensurate adjustments in pricing for taking them on. Collectively they provide the following as examples of such risk mitigation:

— Require strong governance, due diligence and transactional discipline. For example, by cross-checking all available and relevant documentation (e.g. health reports) for any inconsistencies before entering into life settlement transactions.

- Require a minimum number of lives within pools to increase diversification and reduce the variance of cashflows.
- Obtain full statistical mortality distributions and do not rely on life expectancy as the only statistical parameter in pricing.
- Use multiple underwriters to produce life expectancy and mortality estimates for a particular case to diversify the risk of underwriter bias error.
- Back life settlement products with other insurance products that offset longevity risk. For example, such a structured arrangement could use life annuities to provide a hedge against future premiums.
- Use of 'mortality wraps' where the issuer, normally a reinsurer, agrees to purchase any outstanding policies in a life settlement fund at a future point for a pre-agreed value, thus providing a minimum return for investors. Alternatively longevity index values could be used as a reference within a series of derivative transactions structured to hedge or mitigate extension risk.
- Define requirements for the underlying insurance policies or portfolio, for example:
  - Minimum ages of the insured
  - Minimum and maximum life expectancies (to manage standard deviations and the overall investment time horizon)
  - Minimum and maximum benefit amounts (to manage economic viability and the concentration risk of any particular policy respectively)
  - Avoid concentration risk by limiting the number of lives or aggregate face value of policies relating to a particular health impairment or medical condition.
- Use stochastic techniques to gain an understanding of the range and distribution of returns rather than just the expected return. This allows an investor to attach probabilities to certain outcomes, for example the likelihood that returns will fall within a given range.
- Scenario and stress testing to identify the sensitivity of returns to various risks.

It is however important to realise that some of the risk mitigation comes at the expense of reduced returns. For example, according to Mott (2007) a mortality wrap may charge as much as 30% of a life settlement pool's market value while the technique of using life annuities to meet the cost of expected premium payments might result in the combined expected yield dropping to levels close to, or even below, LIBOR.

Another risk relates to interest rates (Stone & Zissu, 2007; Stone & Zissu, 2011). They explain that since there is a mismatch in the timing of cashflows in and out of a life settlement fund, changes in interest rates are likely to affect the net present value of the investment. By definition, revenues generated from death proceeds of policies occur at a later date than the premiums payable and maintenance expenses allocated to those policies (Mott, 2007; Stone, 2009). Consequently, life settlement funds are at risk of interest rates rising since positive cashflows at the later durations are reduced to

a greater extent in discounting calculations in such a scenario. It is commonly accepted that such a risk may be hedged with financial derivatives such as interest rate swaps. However, such instruments would only partially mitigate risks since the timing of cashflows within a life settlement pool is uncertain given their contingency on the death of the insured (Stone & Zissu, 2011).

Investors also face a myriad of other risks. There are varying levels of guarantees attached to the future premiums of policies and investors face the risk that insurance providers increase premiums to a level that is higher than expected (Perera & Reeves, 2006). Perera and Reeves (2006) argue that investment returns within a life settlement pool could be compromised if the proceeds on death are delayed or not paid at all. This could occur in the event that an insurance provider goes insolvent (i.e. credit risk) or where an insurer disputes its legal obligation to make payment. Examples they give of the latter are where the insured life is presumed dead but the body is missing to provide the physical proof strictly required for payout, or where there are concerns that the original policyholder did not have an insurable interest when the original policy was purchased (as is the case in many STOLI transactions).

The dislocation of the US financial market in the global financial crisis provided an opportunity to test the premise that life settlements are uncorrelated to the rest of the market (Seitel, 2009). Stone (2009) notes that while some other asset classes collapsed over the period, insurance companies continued to make death payouts. He also reasons that, in theory, the perceived value, and therefore demand, of an uncorrelated asset such as life settlements would have increased over a turbulent financial period. In reality, demand for life settlements did not go unscathed during the financial turmoil because the very investors central to the demand for this asset class were the same institutions with liquidity woes at the heart of the economic crisis (Stone, 2009; Ziser, 2009).

There is a potential risk that investors rely too heavily on the assertion that life settlements have no correlation to other asset classes. The validity of the premise is particularly at risk in cases where investors are relying on financing tied to credit markets or who are not purchasing life settlements with the intention of holding onto them until maturity of the underlying insurance policy (Dorr, 2008; Stone, 2009).

5.6 Assessment of Demand Side Risks and Risk Mitigation in a South African Market

Respondents were of the view that each of the risks that apply in the US would also apply within a South African market and in many cases, risks may be significantly greater. The more pertinent risks are discussed in more detail below.

INT3 indicated that much of the poor performance of the asset class in the US market can be attributed to poor underwriting practice and unrealistically short life expectancies. He believes that this risk may be more substantial in South Africa where there is a limited pool of experience in impaired mortality underwriting. Despite the track record of the US based underwriters being poor, he believes

the experience gained has helped the market be more careful to use realistic life expectancy estimates.

A number of respondents argued that there would be lower levels of confidence in South African mortality estimates because of a lack of data, a highly heterogeneous market across factors such as income, education and race and a substantially smaller insured mortality pool. They argued that at a fundamental level this presents additional risk to investors in a South African life settlement market because of the greater potential for inaccurate mortality estimates.

INT2 and INT7 suggested that it may also be possible for individuals to make themselves appear in worse health than they really are to try and obtain a better life settlement offer. Respondents indicated that this might be particularly problematic in a life settlement market where the supply of policies is limited and life settlement providers are under pressure to source policies. They argue that when an entity's existence depends on selling more lives into the pool it is quite possible that the pool starts to be artificially inflated by illegitimate means. Arguably this risk is intensified by higher levels of crime and fraud in South Africa relative to the US and because the pool of available policies is smaller.

INT3 believes that the credit risk that insurers go insolvent and default on claim payments risk may also be greater in South Africa on the basis that in the US there are state guarantee funds that would step in to pay death benefits (normally up to US$300 000–US$400 000) in the case of an insolvent insurer. Respondents explained that there is no similar fund in South Africa. Some respondents believed that even in the absence of an official fund, the state would be likely to intervene if necessary to meet policy obligations. Further, these respondents argued that the onerous solvency management requirements placed on insurers significantly reduces the credit risk in any case.

Repudiation risk was identified as being substantially larger in South Africa by multiple respondents. In the US insurers are only allowed to contest claims within the first few years of the policy (typically two or three years). However, INT3 highlighted that this non-contestability period would not apply in cases where the insurer could show outright fraud because the policy would then be ruled to be void from inception. Therefore INT3 believes that the non-contestability period is often falsely relied on in the US life settlement market to make the assumption that there is no repudiation risk for policies that have been in force for the minimum period. Having said that, he concedes that it is often very difficult for insurers to prove such fraud and, where there is any doubt, judgement favours the policyholder. This US market nuance arguably still provides substantially more protection to an investor than what is available in the South African market where similar regulations, which restrict the ability of insurers to contest claims over time, do not currently exist.

However respondents indicated that some South African insurers might apply an internal claims practice that, in principle, is similar to the non-contestability period in the US. STR2 felt that the UK market, often a leading indicator of

developments in the South African market was starting to move towards similar non-contestability regulation as seen in the US and that similar regulation possibly could appear in South Africa. Therefore it could be argued that, despite the clear and distinct regulatory differences with respect to non-contestability of claims in the US and South African markets, the treatment of claims may not be that dissimilar in practice. Notwithstanding this, investors in a South African life settlement market would simply have no guarantee that insurers would not decide to start adopting stricter claim management practices or that non-contestability regulation will emerge in their favour in the future. While most respondents indicated that a fairly low proportion of death claims were repudiated in South Africa (especially on older policies), the effect of having just one claim repudiated could have a major impact on the returns of a life settlement fund.

Both US and South African products generally include terms and conditions that would allow the insurer to adjust the premiums or charges payable in respect of the insurance. Clearly, if insurers adjust premiums upwards, life settlement investors returns are negatively affected as the cost of investment effectively increases. This is referred to as cost of insurance risk. INT3 believes that this risk is mitigated in the US to some extent for the following reasons:

— Insurers are not allowed to target specific policies or very small subsets of policies for cost of insurance increases. INT3 referred to an example of an insurer who has attempted to do this but has been unsuccessful.
— To change the cost of insurance the insurer would need to demonstrate poor experience across a large and relevant piece of the book. Overall mortality experience has been good and therefore it would be difficult for insurers to demonstrate the required poor experience.
— Insurers may require permission from the regulator to increase the cost of insurance.
— The maximum increases that may be applied are often built into policies and stipulated at policy inception. In some cases the maximum increases are fairly high and would provide only limited protection to an investor. Nevertheless some protection exists.

Most respondents felt that South African insurers might have similar difficulties in targeting specific policies or very small subsets of policies for cost of insurance increases and that poor experience might need to be demonstrated to justify the increase. One respondent felt a case could be built for reviewing individual policies on the basis that, at the point of premium review, the insurer is entitled to take a forward looking approach in determining the revised premium rates. Therefore the insurer should be entitled to take into account that lapse rates would be expected to reduce substantially on policies that have been sold to back a life settlement. However he believes that such an argument might be aggressively challenged. South African products also often have some form of contractual maximum premium increases that may be applied built into

the terms of the policy. Responses indicated that South African insurers don't require permission from the regulator to increase the cost of insurance.

In aggregate the cost of insurance risk would most likely be a greater risk to investors in a South African market relative to the same risk faced by investors in the US market.

Respondents indicated that some of the risk mitigation tools used by investors in the US market may not be available in South Africa. For example, mortality wraps and mortality indices used to underpin derivatives may not be widely available to hedge out longevity risks. Further, the size of the South African market may make it difficult to source a sufficient number of policies within a fund to ensure a statistically stable result.

Finally, INT3 explained that in the US there was an established legal precedent for the legitimacy of life settlement transactions. He referred to the 1911 Grigsby vs Russel case in the US from which it was established that life insurance should be treated as ordinary property, which the owner should have the freedom to sell. INT4, a South African insurance legal expert, was not aware of any similar legal precedent in South Africa that would give investors the same level of confidence in the legal legitimacy of the transaction. Others argue that policy cessions are common in South Africa and legally accepted and that life settlements would not (or could not) be legally challenged.

In summary, the risks which investors would face in a South African life settlement market appear to be appreciably larger those in the US market. To some extent, the additional risk may be allowed for through a lower settlement offer but the scope to trade risk for reward is limited because at some point the policyholder will not find the difference between the life settlement offer and the surrender value compelling enough. The additional risk and fewer risk mitigation options available would therefore dampen demand relative to the US.

5.7 Resistance from the Insurance Market and Providers in the US

The insurance provider is the company that issued the original policy. Bakos and Parankirinathan (2006) believe that most insurance providers have interpreted the life settlement market to be a form of attack on the traditional insurance industry. Balinsky (2006) argues that a number of insurance providers have tried to fight the market by relying on arguments that the life settlement market is not in the interests of the broader consumer community or that the market is unethical, but believes that their opposition to the market has more to do with the financial impact that it may have on them.

While many insurance providers in the US have resisted the market, the literature is somewhat divided on whether it is actually positive or negative for them. Insurance providers use lapse-based pricing models to set the premium rates for insurance benefits (Deloitte, 2005; Doherty & Singer, 2002). Doherty and Singer (2002) explain that a policy lapsing at certain points in its lifetime may be a source of profit to the insurer because while they may pay out a surrender value, they no longer have the

obligation to pay out the face value of the policy on the death of the insured. They go on to note that this is particularly true in the case where the insured life has impaired health, since the difference between the present value of the net policy liabilities and the surrender value would typically be larger.

Some acknowledge this argument but reason that insurers are unlikely to give the issue too much attention because the life settlement business only affects a small proportion of their portfolio of policies. Others such as Bakos and Parankirinathan (2006), and Deloitte (2005), dispute the argument more fundamentally using arguments such as:

— Those with impaired health typically involved in life settlement transactions have a much lower propensity to lapse in any case. Further insurance providers may have explicitly or implicitly anticipated lower lapse rates within the pricing of older lives insured on policies at later points in the policy lifetime. Since these are the typical lives involved in life settlements, the sale of such policies is unlikely to alter overall lapse experience of the insurance provider significantly.
— The point at which the surrender represents a greater source of profit to the insurance provider than the policy continuing only occurs late in the lifetime of the policy.

Ingraham (2004) and Kozol (2009) argue that the additional liquidity provided to insurance policies as an asset class by the development of a secondary market will serve to enhance insurer profitability by engendering new sales. Doherty and Singer (2002) hold a similar view that the development of a secondary market will be positive for the primary market. To illustrate their point, they offer the example of the movie industry: movie producers benefited handsomely from the advent of the VCR even though they were initially fervently opposed to its development due to the fear VCRs would cause declines in their box-office revenues.

Bakos and Parankirinathan (2006) argue that insurance providers should attempt to participate in the market rather than fight it, to ensure that there is orderly market development, which is in their interests.

Stone (2009) considers the possibility that insurance providers might adapt product design to allow new exit mechanisms outside of the surrender value. Mott (2007) highlights the introduction of accelerated death benefits (which provide for the early payment of the death benefit subject to certain requirements) by insurance providers as historical evidence that such an approach is likely.

5.8 How might the South African Primary Insurance Market react

Respondents were questioned about the likely impact that a life settlement market would have on insurers and reinsurers within the South African market and how they might react should a market develop.

Respondents indicated that there would be two main effects for South African insurers:

— Products that are dependant on lapse profits would be negatively affected. This is because once a policy is sold onto an investor, lapse rates would tend to zero and the potential for any lapse profit on such a policy would fall away. Certain product designs, for example, risk policies that charge premiums that increase with age at every policy anniversary, are more agnostic to the level of lapses and may actually produce more profits for insurers if lapse rates reduced (assuming there was no change in average mortality levels described below).
— The average mortality of the insurers' book may worsen. This is because the lives involved in life settlements are usually in poor health. When the lapse rates of these policies reduce relative to the lapse rates of other policies where lives are in better health, the overall average level of health on the portfolio is likely to worsen. Some respondents argued that the effect of this may be limited since lives in poor health would be less likely to lapse or surrender in any case even in the absence of a life settlement market. Conversely some respondents argued that they had seen examples where consumers, despite being in poor health, had lapsed policies often because their financial situation meant they were unable to afford premiums.

For reinsurers, respondents explained that a substantial proportion of reinsurance business in South Africa is written on a 'risk-premium' basis. This means that reinsurance premiums that reflect the risk at that particular point in time are paid. As a result, reinsurers are less dependent on lapse profits and therefore, the second effect of mortality experience described above is the more relevant. In addition, reinsurers' business mixes may be more heavily weighted to large cover amounts and policies that are accepted on special terms (often referred to as 'sub-standard' cases) than those of insurers. The disproportionate exposure to large policies is likely to lead to a higher proportionate exposure to candidate life settlement policies, since policies with higher face amounts tend to be used to back life settlements. The effect of a disproportionate exposure to sub-standard cases is more difficult to assess since it is the change in the policyholder's health from inception that provides the life settlement opportunity rather than simply the poor state of health itself.

The claim made by Doherty and Singer (2002), Ingraham (2004) and Kozol (2009) that a secondary market would be positive for the primary market's sales was put to respondents. Very few respondents felt that this argument had much merit. They felt that publicising and marketing the possibility that the policyholder would be able to sell the policy should their health deteriorate, would be unlikely to be effective in generating additional business in the South African primary market.

Overall respondents seemed to believe that the emergence of the life settlement market would be economically detrimental to both insurers and reinsurers in the South African market. The effect would most likely be bigger for insurers. The possible responses from insurers and reinsurers put forward by respondents were reminiscent of those seen in the US market, for example:

- Insurers could set up groups to lobby against the development of a market. They would be likely to argue that the market is ethically questionable, that it would negatively impact the primary insurance market (for example the removal of certain product offerings) and therefore not in the interests of the broader public, and that policyholders would face risks when selling their policies.
- Insurers might be able to increase premium rates on existing policies. One respondent indicated that simply threatening to increase premiums at an early stage of a market developing may be sufficient to deter investors. Respondents agreed that a premium increase strategy might require the insurer to increase premiums across a wide group of policies rather than target specific ones used to back life settlements. However with such an approach there is a risk that the problem is simply exacerbated. This is because, in theory, when the premium is increased the propensity to surrender increases by a larger percentage for a policyholder who is in good health relative to one in poor health. Therefore the relative mix of healthy and unhealthy lives could potentially move against the insurer. This in turn causes the insurer to have to increase premiums further, which leads to further selective lapsation, which leads to further requirements to increase premiums and so on.
- Insurers might tighten claims management to increase the repudiation risk to investors.
- Some respondents indicated that product design and terms and condition adjustments to policies may be made. However such adjustments would only provide future protection as they would only be added onto new policies sold into the market. Recent product changes by one insurer in the South African market whereby policyholders are eligible for a proportion of their life insurance cover amount on built-in specified health events appears to be an example of a protection mechanism against the life settlement market.
- The possibility of offering health-adjusted surrender values was considered. Most respondents felt that insurers were unlikely to do this because of the complexity involved in generating an appropriate value and then also being able to justify it to consumers. Respondents also felt that most insurers would not want to be perceived, or create a situation where financial intermediaries are perceived to be encouraging lapses. Such a strategy might also expose them or their sales channels to reputation risk where a policyholder passes away shortly after surrendering their policy and consequently receives a much lower payout than would have been obtained if they had retained the policy until death.
- One respondent indicated that many insurers in the country are tied to large asset management companies. Such insurers could try to request the affiliated asset management company not to stimulate or participate in the life settlement industry.
- Some respondents suggested that insurers may participate in the market themselves and use their expertise as a competitive advantage.

A number of respondents felt that insurers' and reinsurers' ability to curtail a South African market, should they want to, would most likely be limited. They would however have the benefit of knowledge in respect of strategies followed by insurers and reinsurers in the US market and the associated success or failure of each.

6. TAX AND REGULATORY LANDSCAPE EFFECTS

6.1 Taxation of Life Settlements in the US

In the normal case, US life insurance contracts are tax-favoured vehicles in the sense that:

— Proceeds payable are normally tax free in the hands of the beneficiary.
— Any cash build-up within the insurance contract is not taxable provided it remains in the contract.
— Where a contract is surrendered, only the portion of the surrender value in excess of cost basis (i.e. the cost of acquiring and maintaining the policy) is taxable where cost basis is usually taken as the aggregate premiums paid.

Where the policy has been transferred for value, parts of the favoured tax treatment are lost (Casey & Van Brunt, 2009; Gardner, et al., 2009).

Prior to 2009, the US Internal Revenue Service (IRS) had issued relatively little guidance on the tax treatment on disposal of a life insurance policy especially in respect of life settlement transactions. The issue is highlighted in a life settlement case study conducted by Katt (2002). He explains that some practitioners believed that on the sale of a life settlement the full difference between the settlement amount and the cost basis would be taxed as ordinary income, while others believed only the difference between the surrender value and the cost basis would be taxed as ordinary income and the proceeds in excess of the surrender value would be taxed as capital gains. Breus (2008) makes an argument based on jurisprudence that a life insurance policy represents a capital asset and consequently the character of any income on the disposal of such an asset should be capital gain except for any cash build-up within the policy which should be treated as ordinary income.

In May 2009, the IRS provided two rulings, 2009–13 and 2009–14, which took the form of scenario case studies to provide help in interpreting the tax issues surrounding life settlements (Gelfond, 2009). 2009–13 provided guidance on the taxation that would apply in the instance of an original owner who disposed of an insurance policy through surrender or life settlement (Gelfond, 2009), and is therefore more relevant to the supply side.

Ziser (2009) explains that the 2009–13 ruling generally provides that in both the cases of surrender or sale to a third party the difference between the surrender value or life settlement value that the owner receives and cost basis, is taxable as ordinary income. However he notes the key difference that in the case of surrender, cost basis will be the premiums paid, while in the case of policy sale, cost basis must be reduced by the portion of the premiums used to cover insurance costs within the policy. Casey

and Van Brunt (2009) contend that this creates the situation that arguably similar asset disposal transactions are taxed differently. Since the tax treatment of life settlements is less favourable because there is lower cost basis and therefore a greater taxable amount, such a tax ruling would have had a constraining effect on what would otherwise have been supplied.

Ruling 2009–14 issued by the IRS in May 2009 addresses the tax treatment of a gain made by an investor upon a subsequent sale or the death of the insured individual (Ziser, 2005). This ruling is therefore relevant to the demand side of the market. The ruling implies that, in the case of the death of the insured, the excess of the death proceeds over cost basis will be taxed as ordinary income whereas, if the investor sells the policy before maturation, the difference between the sale proceeds and cost basis will be taxed as capital gain. In both cases, cost basis is the purchase price plus any additional premiums paid to keep the policy in force (Casey & Van Brunt, 2009). Casey and Van Brunt (2009) point out however, that in either of these scenarios the investor is not required to reduce cost basis as is the case for the original policy seller covered under ruling 2009–13. As a result, they believe that there are arguably unjustified inconsistencies in the tax treatment of: the sale of a policy by the original owner compared to that of a subsequent owner and also between the sale of a policy by a third-party investor compared to that investor retaining the policy to receive the death proceeds on the passing of the insured.

The impact that such rulings had on demand for life settlements would differ from investor to investor and would depend on their pre-ruling perception of the tax treatment of the asset class and the relative levels of their ordinary income and capital gains tax rates. For example, Gardner et al. (2009) – prior to the rulings – interpret that the gains will be taxed as ordinary income. Therefore in their view, the tax treatment in the case of a policy sale by an investor prior to the insured passing away would have become more favourable as a result of the ruling (provided the capital gains tax rate is lower than the ordinary income tax rate for the investor in question). Conversely, Casey and Van Brunt (2009) argue that most investors expected that the gain would always be taxed as a capital gain. Therefore the case where the gain is taxed as ordinary income in the case of the insured passing and death proceeds being paid out would imply that the tax treatment would become less favourable in the eyes of investors who were expecting their taxable amount to be treated as a capital gain.

6.2 Taxation of Life Settlements in South Africa

In understanding the tax implications of life settlement transactions within South Africa, the interview with respondent INT5 was heavily relied upon as he was the only insurance tax expert within the sample group.

A detailed description of the taxation of insurance in South Africa is beyond the scope of this paper. For the supply side, the primary concern is to establish whether policyholders would receive more or less favourable tax treatment through life settlement as opposed to surrender. INT5 explained that paragraph 55(1) of the

Eighth Schedule of the Income Tax Act 58 of 1962 (quoted below for ease of reference) is the key piece of tax legislation to consider.

55. Long term assurance

(1) A person must disregard any capital gain or capital loss determined in respect of a disposal that resulted in the receipt by or accrual to that person of an amount—

a) in respect of a policy, where that person—
   i. is the original beneficial owner or one of the original beneficial owners of the policy;
   ii. is the spouse, nominee, dependant as contemplated in the Pension Funds Act, 1956 (Act No. 24 of 1956), or deceased estate of the original beneficial owner of the relevant policy and no amount was paid or is payable or will become payable, whether directly or indirectly, in respect of any cession of that policy from the beneficial owner of that policy to that spouse, nominee or dependant; or
   iii. is the former spouse of the original beneficial owner and that policy was ceded to that spouse in consequence of a divorce order or, in the case of a union contemplated in paragraph (b) or (c) of the definition of "spouse" in section 1 of this Act, an agreement of division of assets which has been made an order of court;

b) in respect of any policy, where that person is or was an employee or director whose life was insured in terms of that policy and any premiums paid by that person's employer were deducted in terms of section 11 (w);

c) in respect of a policy that was taken out to insure against the death, disability or severe illness of that person by any other person who was a partner of that person, or held any shares or similar interest in a company in which that person held any share or similar interest, for the purpose of enabling that other person to acquire, upon the death, disability or severe illness of that person, the whole or part of—
   i. that person's interest in the partnership concerned; or
   ii. that person's share or similar interest in that company and any claim by that person against that company,
   iii. and no premium on the policy was paid or borne by that person while that other person was the beneficial owner of the policy;

d) in respect of a policy originally taken out on the life of a person, where that policy is provided to that person or dependant by or in consequence of that person's membership of a pension fund, pension preservation fund, provident fund, provident preservation fund or retirement annuity fund;

e) in respect of a risk policy with no cash value or surrender value; or

f) if the amount received or accrued constitutes an amount contemplated in section 10(1)(gG) or (gH). (Republic of South Africa, 1962)

INT5 indicated that paragraph 55(1)(a)(i) effectively states that in the hands of the original policyholder, any capital gain or loss in respect of proceeds of the policy will be disregarded for Capital Gains Tax (CGT) purposes. This is irrespective of whether such proceeds are a result of surrender or the policy being ceded or sold. The implication is that, from a tax perspective, the policyholder is neutral to disposing their policy via life settlement or surrender.

This tax treatment is more favourable than what applied in the US both pre and post the 2009 IRS tax rulings. All else being equal, South African policyholders should therefore be more willing to sell their policy into the life settlement market than their US counterparts.

For the demand side, the tax implications for two key scenarios need to be considered. First, one needs to consider the tax implications if the investor purchases the policy and holds it until maturity (i.e. receives the proceeds on the death of the insured). Second, one needs to consider the tax implications if the investor purchases the policy and then resells it prior to maturity.

Once again INT5 referred to paragraph 55(1) of the Eighth Schedule of the Income Tax Act 58 of 1962 as the key piece of tax legislation to test the scenarios against. Certain pieces of this paragraph in the act make a distinction between pure risk policies (i.e. policies with no surrender value) and those that do have a surrender value and therefore the two types of policy need to be considered individually.

Where an investor, who is not the original beneficial owner of a policy, purchases a policy which has a cash or surrender value and then derives proceeds from the policy either because of surrender, subsequent sale or because of the death benefit being paid, those proceeds will be subject to Capital Gains Tax as they would not qualify for any of the exemptions listed in paragraph (55)(1). Broadly this is in line with the tax treatment of any other asset that is capital in nature.

INT5 does however explain that there would be some degree of double taxation which creates some tax inefficiency. This is because the cash build-up within the policy is already taxed in the hands of the insurer. It must be kept in mind though that an investor in life settlement predominantly derives their value from collecting proceeds from the policy in excess of the purchase price and premiums paid and not the value of the cash value. The tax inefficiency that is created is arguably relatively small in the context of the whole transaction. INT5 believes that the capital gain would most likely be considered to be the proceeds derived less the cost of acquiring the policy including any premiums paid to keep the policy in force.

Where an investor, who is not the original beneficial owner of a policy, purchases a policy that is a pure risk policy with no cash or surrender value, paragraph 55(1)(e) of the Act exempts any proceeds from the policy from Capital Gains Tax (irrespective of whether the proceeds were derived from surrender, sale or a death benefit being paid out). INT5 notes however that this exemption was only recently added and was only included on the basis that there is no active secondary market for such policies. He argues that it is fairly clear that, should an active secondary market develop, this

exemption would be removed or modified resulting in tax treatment similar to policies with a cash or surrender value.

From the above, it appears that the demand side tax treatment is more favourable than applied in the US market after the IRS issued its revised rulings in 2009 because in some instances proceeds would be taxed as ordinary income in the US. The slight double taxation effect on policies with a cash or surrender value is unlikely to be a strong deterrent in the South African market. Where a pure risk policy is used to back the life settlement, very favourable tax treatment, at least in the short term, is available. This should stimulate the demand for life settlements in South Africa, all else being equal.

6.3 Life Settlement Regulation in the US

The US life settlement market has arguably been characterised by unscrupulous participants and opportunists that have tarnished its image (Bakos & Parankirinathan, 2006; Goldstein, 2007). Historically there has been a lack of regulation and exorbitant intermediary commissions have cast shadows on the market, therefore having failed to serve the interests of policyholders engaging in life settlement transactions (Balinsky, 2006; Gabel & Scott, 2009).

Gabel and Scott (2009) and Ziser (2007) explain that, in general, state level regulation currently applies to life settlements in the US. They and Seitel (2008) go on to comment that most of the states base their regulation on one of two model acts: The Life Settlement Model Act drafted by the National Conference of Insurance Legislators (NCOIL) or The Viatical Settlement Model Act originally drafted by the National Association of Insurance Commissioners (NAIC) in 1992 (Ingraham, 2004) with a revised version later promulgated in 2001 (Ziser, 2007).

The main recent regulatory developments with respect to these acts took place in the mid to late 2000s (Breus, 2008; Kozol, 2009; Ziser, 2007). Key changes include:

— Increased requirements for certain information (for example intermediary remuneration) to be disclosed to policy sellers (Kozol, 2009; Seitel, 2008).
— The functions allowed to be fulfilled by various market participants including the extent to which life settlement providers and life settlement brokers need to be registered and licensed (Kozol, 2009; Seitel, 2008; Ziser, 2007).
— Disclosure of information requirements, for example information to be provided to authorities in respect of industry transactions (Kozol, 2009; Seitel, 2008).
— Attempts to eliminate the scope for STOLI transactions (Ziser, 2008). The NAIC tried to deal with STOLI in the Viatical Settlement Model Act by extending the prohibition of a sale of a life insurance policy from two years to five years from inception (Seitel, 2008). On the other hand, NCOIL dealt with the issue by trying to define STOLI within the context of life settlements and then ruling that such transactions are illegal (Kozol, 2009).

While Seitel (2008) believes some of the more recent regulatory changes have not been beneficial to the demand side of the industry, Balinsky (2006) and Kozol (2009) argue

that regulatory and legislative developments are what have helped, and will continue to help, life settlements reach higher levels of legitimacy as an asset class. They argue that for such a market to grow and become sustainable, it must become more efficient and reduce transaction leakage and there must be a suitable level of regulation to ensure that market participants can transact in a fair and transparent environment.

6.4 Regulation of Life Settlements in South Africa

The responses of INT4 were relied on heavily in assessing the regulatory environment in South Africa and how it may apply to a life settlement market as it was felt that, as an insurance legal expert, she was best positioned to provide a credible view.

INT4 confirmed that there are currently no regulations in South Africa that have been developed to apply to life settlement transactions. There is no direct regulation that prohibits a policyholder selling their life insurance policy to an investor.

INT4 believes that regulation would be developed should a market emerge. She indicated that this might take a significant amount of time and drew a parallel with the hedge fund industry where, according to her, the regulator has only fairly recently started to focus on the industry's regulation despite it being in operation for some time in South Africa. However, in mid-2013, the FSB requested commentary from various primary market participants in respect of life settlement regulation. It could be argued that the seeds of regulation have already started to be sown.

If a life settlement market starts to develop and regulatory developments lag behind, the market could lack credibility. As was the case in the US, this is likely to constrain supply into the market. The impact on demand is less clear, especially in the short term.

A case could be made that South Africa has some pieces of regulation such as FAIS (discussed in the supply side market intermediation section) that might help to avoid some of the unscrupulous behaviour that characterised the early US market. In addition, it could be argued that regulatory frameworks specific to life settlements developed for the US market could be tailored to the South African market in a shorter amount of time than they took to develop from scratch in the US.

INT3 explains that market participants relied on self-regulation as a means to provide credibility and to shape the regulatory direction in their favour in the US. South African market participants may take a similar approach in the absence of any other regulation.

STR2 argued that the life settlement's poor reputation in the US (and Germany) might mean that any potential market in South Africa may face additional resistance. He believes this is particularly true in light of the Treating Customers Fairly (TCF) principles-based regulation, which is embedding itself within the South African financial services industry. He argues that when the US market began emerging, a formal TCF framework did not exist.

Considering the legislative and regulatory environment more broadly, multiple respondents indicated that levels of law enforcement and fraud prevention are most

likely lower in South Africa than in the US and, as a result, policyholders might have a lower propensity to sell their policy (and therefore an economic interest in their death) to a stranger.

In summary, the effect of the relative differences of regulatory environments of the US and South Africa on the likelihood of a life settlement market developing is difficult to assess as there are forces acting in opposite directions. Critically though, there does not appear to be any current South African regulation that precludes the possibility of a life settlement market.

7. CONCLUSION

Overall the life settlement market opportunity in South Africa bears close resemblance to that presented by the US insurance market across many aspects: a reasonable proportion of products sold in the market would be likely to be eligible for life settlements; the supply market appears to be accessible whether through an intermediary or more directly; it would not be uncommon for policyholders to reach the stage where they no longer need or cannot afford their insurance policy; the lack of regulation is no different to the original situation in the US market; the basic investment value proposition is likely to be attractive to South African capital markets; the skills required to price and source policies on behalf of investors is fairly rare but not absent; and the power insurers and reinsurers are likely to have to curtail the market does not appear substantially stronger than in the US.

To some degree one could even argue that certain characteristics of the South African market make it even more conducive to life settlements than in the US. For example: large numbers of pure risk policies with no surrender value to beat exist in South Africa; large numbers of policies sold on a whole of life basis and high take-up of automatic annual cover escalations increase the likelihood that in time policyholders will own insurance that they no longer need; some regulatory protection against unscrupulous intermediary behaviour arguably already exists in the form of FAIS and tax treatment appears to be more favourable to both the demand and supply side of the market.

In line with previous research by Negpen (2009), it was found that the potential market size is small and is further potentially limited by high take-up of critical illness insurance relative to the US market (and perhaps to a smaller extent by regulated surrender penalties). The market could also be dampened relative to the US market because of a greater sensitivity to crime and fraud in South Africa.

However it is the risks faced by investors that appear to be the largest inhibitor to a market developing in South Africa. In particular, credit risk, repudiation risk, cost of insurance risk and the risk of incorrectly predicting mortality levels and trends appear to be substantially higher in South Africa. Further, despite there being no apparent regulations that prohibit life settlements, a South African legal precedent that fundamentally establishes the legal legitimacy of a life settlement transaction in the same way the Grigsby vs. Russell case has done in the US did not clearly emerge in the research.

It is clear that, for a life settlement market to thrive, it requires a high degree of investor confidence. In this asset class, the extent to which risk can be traded for additional return is limited. To be compelling to policy sellers, the life settlement offer needs to beat any surrender value on the policy convincingly and therefore only so much risk can be 'priced-in'.

The results of this research suggest that, while there are many similarities between the primary insurance markets of the US and South Africa within the factors tested, there are also subtle, but important differences. These differences are arguably significant enough to conclude that the development of a life settlement market in South Africa is substantially less likely to occur than in the US. However we cannot go quite as far as to conclude that it would not be possible for a South African life settlement market to develop.

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