Bespoke Financial Services

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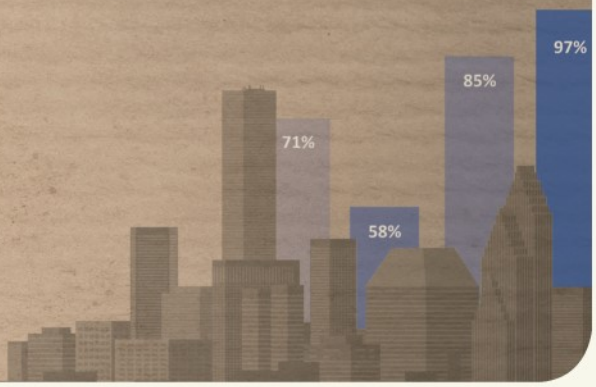

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Better late than never

South Africans have, on average, between four and 47 percent of the life cover they need and between 30 and 45 percent of the disability cover they need, the latest life assurance gap study released by the Association for Savings & Investment South Africa (Asisa) shows.

This means that, unless you are one of the exceptions who has sufficient cover, you and/or your family will suffer financially if you die or are disabled before you retire. The families of middle- and high-income earners may never fully recover from this financial setback, while low-income earners are often plunged into a debt spiral, Peter Dempsey, the deputy chief executive of Asisa, says.

The life assurance gap study, carried out for Asisa by True South Actuaries and Consultants, shows that income-earning South Africans and their families are under-insured by a staggering R28.8 trillion. And, because there are 14 million income-earners in South Africa, the total shortfall of R28.8 trillion equates to an average shortfall of R2.1 million per breadwinner. Just less than half this average shortfall is for life cover and just over half is for disability assurance.

The results of the study are based on the assumption that families would maintain their existing standard of living after the breadwinner dies or is disabled. The calculation of the gap assumes that families would have to replace the breadwinner's income until he or she would have reached retirement, and that contributions to the breadwinner's retirement fund would continue until retirement age.

It does not take into account any short-term expenses related to death or disability before retirement, such as funeral costs, medical costs and modifications to homes and cars.

It also excludes cover – known as temporary disability cover – for a disability that results in your being incapable of working for a short period. The calculations are for permanent disability only.

The 2.8 million richest South Africans, who earn more than R214 245 a year and on average close to R500 000 a year, have only 47 percent of the disability cover they need and only 45 percent of the death cover they need. They need, on average, life cover of almost R4.5 million, but they have on average almost R2.4 million too little.

People in this group, on average, require disability cover of R6 million, but, on average, have R3.3 million too little in disability cover. As a result, to maintain their standard of living, households supported by those who fall into the top 20 percent of the country's income-earners would have to find additional income of almost R13 000 a month if a breadwinner died and more than R17 000 a month if a breadwinner became disabled.

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Alternatively, they would have to cut their household expenditure by 36 percent if the breadwinner died, or by 32 percent if he or she became disabled.

The study found that older South Africans have more life and disability cover than younger South Africans.

The most likely reason is that full-time permanent employees usually have group life and disability cover, in many cases through their retirement fund.

Hugo says the gap in life cover has increased relative to the gap in disability cover, probably because of the change in the taxation of income protection benefits. Until March 1 last year, the premiums for income protection policies were tax-deductible, but the benefits paid out were taxed. Since then, the premiums have not been tax-deductible, but the benefits are tax-free.

If you have not adjusted your premiums, your benefit will have increased by the amount of tax you would previously have had to pay.

How much is enough?

South African families are under-insured against the death or disability of their breadwinners by nearly 60 percent. As a result, they will have to cut their living expenses by 30 percent or more if the breadwinner dies or becomes disabled.

On average, it costs 4.2 percent of after-tax income to buy adequate life cover, while it costs 2.4 percent of net income to take out sufficient disability cover. The lowest 20 percent of income-earners need, on average, to set aside an additional 4.1 percent of their income to buy enough life cover; middle-income earners need to spend close to seven percent; and the top earners need to spend, on average, another 3.3 percent of their income.

High-income earners could remove the shortfall in their disability cover by spending two percent of their net income, while middle-income earners need to spend as much as 3.6 percent.

Claims are paid

Peter Dempsey, the deputy chief executive of the Association for Savings & Investment South Africa (Asisa), says many consumers do not invest in adequate financial protection, because they believe life assurers do not pay claims. But Asisa's statistics show that assurers honour the overwhelming majority of claims on underwritten policies (where you have to answer questions about your health or undergo medical tests).

Last year, life assurers paid out R45.5 billion in life and disability claims, a claims ratio of 99 percent.

Dempsey says that, where claims were not paid, it was mostly because policyholders had not been honest when disclosing details about their health or lifestyles.

Article appeared in Personal Finance, 5 November 2016

Origins of "Bury your head in the sand"

This comes from the supposed habit of ostriches hiding when faced with attack by predators. The story was first recorded by the Roman writer Pliny the Elder, who suggested that ostriches hide their heads in bushes. Ostriches don't hide, either in bushes or sand, although they do sometimes lie on the ground to make themselves inconspicuous. The 'burying their head in the sand' myth is likely to have originated from people observing them lowering their heads when feeding. The story also relies on the supposed stupidity of ostriches, and of birds in general. In fact, there's little to support that either as birds have a significantly larger brain to weight ratio than many other species of animal. The notion is that the supposedly dumb ostrich believes that if it can't see its attacker then the attacker can't see it.

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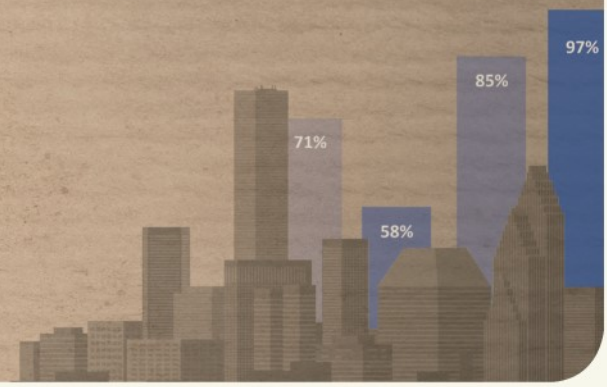

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Trusts: A brief history

Trust law developed in England at the time of the Crusades, during the 12th and 13th centuries. At the time, land ownership in England was based on the feudal system. When a landowner left England to fight in the Crusades, he needed someone to run his estate in his absence, often to pay and receive feudal dues. To achieve this, he would transfer ownership of his lands to a friend, on the understanding that the ownership would be conveyed back on his return, or if he didn't return, the land would be passed to the deceased Crusader's family.

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SARS Attacks!

It has been estimated that there are currently over 300 000 active trusts registered with SARS. Anyone using a trust for their estate planning should be aware that SARS are intending to implement certain tax changes to the treatment of loans to trusts with effect from 1 March 2017.

Trusts are used in estate planning for many reasons, but their use in "pegging" an estate with the intention of limiting, or even avoiding, estate duty on death, is often the motivating factor. Estate duty "pegging" (or "freezing") works like this: assets such as shares, unit trusts or a fixed property are transferred from the planner to the new trust. This is done in order to keep future growth on these assets out of the founder's estate. Estate duty, levied at 20% on the value of an estate over R3.5m (subject to certain rollovers), when the founder dies, is not levied on the assets in the trust.

In implementing the "pegging" strategy, the founder usually avoids simply donating the assets to the trust, as this would attract donations tax on the value of the donation (also at 20%, the first R100 000 donated each year being exempt). The founder thus usually sells his or her assets to the trust, but as the newly created trust has no funds, the arrangement is that the unpaid sale price will be "on loan account" i.e. no fixed terms for the repayment are stipulated. And the loan by the founder usually remains interest free, due to there being no adverse tax implications in doing so.

Anyone using a trust for their estate planning should be aware that SARS are intending to implement certain tax changes to the treatment of loans to trusts with effect from 1 March 2017.

In mid-2016 SARS announced certain proposed changes to the way these interest free (or low interest) loans to trusts would be treated. In terms of the initial proposals, in cases where no interest (or interest lower than the SARS official rate of 8% p.a.) was charged, the founder/lender would now be "deemed" to have earned interest on the loan at 8% p.a. (or the difference between any lower rate charged and 8%). The taxpayer's tax free allowance on annual interest earnings could not be applied to this deemed interest. This change could potentially have led to dramatic tax consequences for the founder of a trust: for every R1m of interest free loan account made to his or her trust, the founder would have

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R80 000 added to his taxable income (for an amount he hadn't in reality earned or received). Thus on an interest free loan of R2m, the founder would be deemed to have earned R160 000 in "interest": the founder's extra tax obligation due to making a R2m loan could have been anything up to R65 600 per year (R160 000 x maximum 41% marginal tax rate). Such a regime could have led to many founders seeking to wind up their trusts, especially where the trust's only asset was an illiquid one, such as the founder's home.

Fortunately, in the revised draft legislation announced towards the end of 2016, a less draconian tax treatment is now proposed. Essentially, the failure to charge interest (or the charging of it at a rate lower than 8% p.a.) will to that extent now be deemed to be a donation by the founder to the trust, and as such will attract the 20% donations tax. The R100 000 annual tax free donation amount will also be allowed to reduce the donations tax liability. Thus on the same R2m interest free loan described above, donations tax of R12 000 would be payable each year ([R160 000-R100 000]x20%). Importantly, the new draft legislation excludes its application to loans made for a trust to acquire the founder/lender's primary residence.

These new tax laws are proposed to come into effect from 1 March 2017, and it makes sense for anyone using a trust in their planning to get the trust's affairs and financial statements up to date and to seek advice on the implications of the new rules.

Trusts: A brief history *(continued)*

However, a Crusader would often return to find his erstwhile friend (and now legal owner of his property) refusing to hand it over. As far as the courts were concerned, the land belonged to the latter, who was under no obligation to return it. The disgruntled Crusader could petition the king, who would refer the matter to his Lord Chancellor. The Lord Chancellor could do what he considered "just" and "equitable", having the power to decide a case according to his conscience, rather than strictly based on law. The Lord Chancellor would usually consider it unjust that the legal owner could deny the claims of the Crusader.

The Lord Chancellor's court would continually recognise the claim of a returning Crusader. The legal owner would thus be seen to be holding the land for the benefit of the original owner, and would be compelled to convey it back to him when requested. In effect, the Crusader was the "beneficiary" and the friend the "trustee". The term *"use of land"* was coined, and in time this concept developed into what we now know as a *trust*.