

**Learning outcomes****STUDY UNIT 1- Personal Financial Planning pg 4-6**

1. Explain the importance of personal financial planning
2. Recognise their position in the financial planning cycle
3. Identify the different steps in the personal financial planning process
4. Explain the advantages of personal financial planning
5. Recognise the different personal financial planning areas

**STUDY UNIT 2- the measurement and assessment of personal financial performance pg 6-9**

6. Assess annual financial statements
7. Explain the relationship between an income statement and a personal budget
8. Recognise the principles of preparing a budget
9. Draw up their own household budget
10. Measure their own financial performance
11. Explain the importance of having a personal budget
12. Identify the advantages of keeping an effective household record system

**STUDY UNIT 3- the Time Value of Money pg 9**

13. Explain the meaning of the time value of money
14. Demonstrate different calculations regarding the time value of money
15. Demonstrate the influence of time value on personal finances

**STUDY UNIT 4- Credit Planning pg 9-17**

16. Explain the importance of credit planning
17. Identify the problems that result from making excessive use of credit
18. Explain how to apply for credit
19. Identify the steps involved in handling a debt crisis
20. Apply debt self-management
21. Evaluate banking services
22. Explain the functioning of credit services
23. Examine a credit agreement critically
24. Identify and quantify the different aspects of buying or selling a car
25. Explain the use of e-shopping and e-banking
26. Define micro lenders and the role of the NCR
27. Ensure that their name never appears on the credit information bureau's black list

**STUDY UNIT 7- Starting a Business: Entrepreneurship pg 17**

28. Define what is meant by the concept "entrepreneur"
29. Describe a business opportunity
30. Explain the pitfalls associated with a family business
31. Evaluate the different forms of business ownership
32. Explain the outlay, content and advantages of a business plan
33. Explain different methods of financing a small business
34. Explain related matters such as location; registration; administration; insurance; employment; your bank; business problems; legal matters; business advisers; succession planning; e-business; business management and growth and importing and exporting

**STUDY UNIT 8- Buying a business pg 18**

35. Evaluate an existing business enterprise as an investment opportunity
36. Assess the financial performance of an existing business
37. Draw up annual financial statements for a business (using various documents)
38. Identify problems associated with buying an existing business
39. Evaluate the purchase price of an existing business
40. Evaluate the location of a business in order to rent, buy, and build or to work from home

**STUDY UNIT 9- Buying a franchise pg 18-19**

41. Define the concepts "Franchise", "Franchisor", "franchisee" and "franchise package"

42. Evaluate a franchise opportunity
43. Explain how to finance a franchise

**STUDY UNIT 10- Estate Planning pg 19-26**

44. Define the meaning of the concept "estate planning"
45. Explain the importance of timely and continuous estate planning
46. Identify the different steps in the estate planning process
47. Recognise estate-planning pitfalls and identify methods for avoiding them
48. Recognise the influence of their lifestyle on their estate planning
49. Explain the influence of lifestyle on personal finances
50. Identify the different steps in the administration of an estate (winding up)
51. Draw up a cohabitation agreement, an antenuptial contract, a will and a divorce settlement
52. Identify the uses of a trust
53. Explain the effect of a matrimonial property regime on estate planning and personal finances
54. Identify techniques for decreasing the size of their estate and avoiding paying estate duty

**STUDY UNIT 11- Investment planning pg 27-**

55. Evaluate investments by means of general investment principles
56. Evaluate investments according to different investment criteria
57. Explain how to avoid investment pitfalls
58. Choose a broker
59. Explain the functioning of the different types of investment in both the money and the capital market
60. Apply different investment approaches
61. Evaluate ordinary shares, preference shares and fixed investment-bearing securities
62. Interpret share prices and other information in the newspapers
63. Analyse the meaning of the various economic indicators on television
64. Explain the functioning of retirement packages
65. Evaluate personal financial planning models

**STUDY UNIT 12- Buying a Dwelling Chpt 8**

66. Explain the financial implications of buying a residence
67. Realise the importance of the decision to buy
68. Demonstrate some aspects regarding the value and valuation of a residence
69. Identify and quantify the cost items involved in buying a residence
70. Be aware of the Board and the Institute that regulate the conduct of estate agents
71. Explain the position of trust that exists between estate agents and their principals (the buyer or seller)
72. Identify what services estate agents offer in return for a commission
73. Identify the situations when estate agents are entitled to receive a commission
74. Define the various mandates that may arise between the seller(s) of a residence and an estate agent(s)
75. Explain under which circumstances you should make use of a particular type of mandate
76. Explain which parties (natural persons and legal persons) may or may not be involved in the purchase and sale of a residence
77. Identify the financial implications that the Rent Control Act may have for buyers and sellers
78. Identify some of the financing methods that may be used to buy a residence

**STUDY UNIT 14- Offshore investments pg**

79. Explain the reasons for making offshore investments
80. Identify the homework to be done before investing in foreign countries
81. Explain the different types of offshore investment
82. Illustrate the relationship between offshore investments and their estates

**STUDY UNIT 15- Protection planning pg**

83. Identify and quantify the various risks a household is exposed to
84. Explain which financial products protect against which risks
85. Explain long-term, short-term, medical and business insurance

86. Explain the importance of protection planning

**STUDY UNIT 17- Retirement planning pg 68**

- 87. Explain the importance of timely retirement planning
- 88. Identify the different methods that may be used to provide for retirement
- 89. Explain the functioning, problems, advantages and disadvantages of the different methods
- 90. Identify many other very important retirement issues
- 91. List the many questions they have to ask themselves when they consider retiring

**Study Unit 1: Personal financial planning**

- ⇒ Uncertainty is created by the following factors:
    - Changing legislation
    - The development of new financial products
    - The influence of the media both as a marketing tool and an advisor
  - ⇒ Personal financial planning consists of a number of different planning areas. Investment planning is one of those areas
  - ⇒ Financial independence does not necessarily suggest great wealth, but rather that the individual has made optimum use of his or her income, irrespective of the level of that income
  - ⇒ Reason for the increasing complexity of Personal financial planning:
    - Changing economic conditions
    - The changing political climate
    - Inflation
    - The large number of financial institutions
    - Advertisements in the media
    - A multitude of financial instruments and products
    - Conflicting financial advice
  - ⇒ Household resources: assets, skills, trained persons, knowledge, money, equipment and entrepreneurial spirit
  - ⇒ The financial function of an enterprise comprises the flow of funds to and from the enterprise. It consists of the acquisition of funds and the employment of funds in order to achieve the primary objective of the enterprise: maximum prosperity for the owners of the enterprise over the long term.
  - ⇒ In a household, the financial function comprises the flow of funds to and from the household. Funds have to be acquired and employed in order to achieve the primary objective of the household: to attain financial independence after retirement
- Management**
- ⇒ Planning, organising, leading and controlling
  - ⇒ Planning reduces risk and uncertainty and helps to avoid crisis management. It involves goal setting and the development of plans to attain these goals. Consider your financial strong and weak points, and the threats and opportunities in your environment
  - ⇒ Organising involves the allocation of resources in order to execute the plans, the clarification of authority and responsibility and the division of work between household members
  - ⇒ Leading: the person who manages the household's money must also take the lead in financial matters
  - ⇒ Controlling involves a comparison between the goals and the actual performance (results) of the individual or household. Concentrate on serious deviations only

"Personal financial planning is the organisation of an individual's financial and personal data for the purpose of developing a strategic plan to constructively manage income, assets and liabilities to meet near and long-term goals and objectives"

"Personal financial planning involves the determination of immediate, short-, medium- and long term goals by means of a personal financial planning process based on your own identified lifestyle, phase of the lifecycle, risks and needs in all the various personal financial planning areas in order to be able to retire with financial independence"

- ⇒ The phase of the human life cycle: youthful years (20- 30); family tears (40-50); pre-retirements years (50-60); retirement years (55+)
- ⇒ A prerequisite for planning and a budget is an efficient system of household records in which all documentary evidence of income, expenses, agreements, guarantees, investments and loans are kept
- ⇒ Your financial needs (risks) differ: they are constant; increasing, decreasing, fluctuating, permanent, temporary or future
- ⇒ Risks: loss of income; loss of property; personal liability; business risks; estate duty; estate administration costs; retirement; estate planning; too much debt accumulated in pursuit of desires;

- ⇒ Inflation; income tax; constantly changing legislation; interest rate risk; market risk; business risk; financial risk; exchange risk; national risk; health risk
- ⇒ To determine your financial goals- where you want to go, you first have to determine where you are
- ⇒ Knowledge of family particulars: death and disability benefits; pension benefits; group benefits; expected inheritances; and current and potential sources of income are required for planning
- ⇒ Immediate goals precede the setting and achievement of short- medium and long-term goals
- ⇒ External influences must be taken into account
- ⇒ Methods of meeting goals: reduction of spending, securing credit, risk avoidance, loss prevention and control, different kinds of insurance, retirement annuities and other investments

### The personal financial planning process

- ⇒ 3 activities: analysing your present situation; setting financial objectives and preparing a budget for the achievement of objectives

### Gathering information and preparing personal financial statements

- ⇒ Information needs to be gathered. Everybody should be able to determine their present financial position since all further decisions or plans will be based upon these aspects. The next step would be to prepare a personal income statement and a balance sheet. A personal income statement indicates the financial activities that took place over a specific period and includes income, expenditure and contribution towards savings and/or investments. A personal balance sheet indicates your welfare, which is reflected in the way in which assets are funded and not by the number of assets owned. Equity capital is calculated by deducting TA-TL

### Identification of objectives and needs

- ⇒ Evaluation and persons involved
- ⇒ The formulation of objectives is a statement by a person of the prospects for his financial future
- ⇒ Immediate or short-term objectives are aspired to in the early stage of the life cycle and must be very specific. Funds for such objectives are generated from current income and/or savings or investment plans
- ⇒ Medium term objectives usually occur during the working years and stretch over the largest part of the life cycle. The achievement of objectives during this stage is a prerequisite for achievement of objectives in the long term. Spending patterns could be adjusted to provide for needs over the medium term
- ⇒ Long-term objectives provide the greatest flexibility during planning. Retirement planning is usually the most important planning component of the last stage of the life cycle
- ⇒ Listing of priorities: a distinction must be made between urgent and important needs. Higher priority must be given to important needs
- *Identification of constraints*
- Comparison of current situation with identified needs
- ⇒ A comparison between the current situation and all identified needs indicates which needs have already been provided for, and which needs still have to be provided for.

### Analysis of investment opportunities

- ⇒ It is essential to examine the purpose of each investment alternative, as well as the advantages and disadvantages involved in each.
- Development of the plan
- ⇒ A person must decide which investment will provide for which need.
- ⇒ Needs are expressed in terms of the risks involved in the occurrence of certain events

### Balancing the budget

- ⇒ A surplus of deficit in the budget indicates that the planning process requires further attention

### Implementation of the plan

- ⇒ No plan can be implemented if there are not sufficient funds!

### Periodic revision of the plan

- ⇒ The plan should be revised once a year

### The advantages of personal financial planning

- ⇒ Financial needs are identified
- ⇒ Household risks are identified
- ⇒ Reasons for cash flow problems are identified
- ⇒ There is budgeting regarding expenses and investment to reach immediate, short, medium and long term goals
- ⇒ Financial crises are identified in time
- ⇒ The uncertainty regarding retirement planning is removed
- ⇒ Provision is made for the maintenance of a particular standard of living before and after retirement
- ⇒ The entire household is involved and learns more about financial matters

### Personal financial planning areas

- ⇒ Career; project; family; income tax; estate; investment; protection; credit; productivity; healthcare; retirement; emigration and business planning

## Study Unit 2: Measuring and assessing personal financial performance

### Annual financial statements

#### The balance sheet

- ⇒ A balance sheet gives an indication of your financial situation at a given time
- ⇒ Assets: assets represent everything a person owns.
- ⇒ Fundamental assets are those assets a family owns by reason of the function they perform in the household
- ⇒ Investment assets are assets acquired in order to earn a return on them
- ⇒ Cash and deposits are employed primarily to satisfy the transaction motive- the conclusion of transactions with such funds
- ⇒ Leased assets appear on the balance sheet after the last installment has been paid off
- ⇒ Savings can be described as a restraint of spending
- ⇒ Fixed assets comprise of land and buildings, machinery, equipment, furniture, vehicles and long-term investments. Current assets comprise of cash, fixed deposits, debtors, marketable securities and stock
- ⇒ Liabilities Are all debts.
- ⇒ Long-term liabilities may be long term debt and mortgage bonds on fixed property, such as a home.
- ⇒ Short-term liabilities may be an overdrawn bank account, a loan from a private person, arrears expenditure, creditors and any accounts
- ⇒ Net worth: A household's net worth (or owners equity) is determined by deducting all liabilities from the total assets

#### Income statement

- ⇒ Income
- ⇒ Is all funds a household receives, irrespective of their origin or sources
- ⇒ Expenditure
- ⇒ All payments for which a household is liable, whether for meeting needs or redeeming debt, are regarded as personal expenditure
- ⇒ Contribution towards savings
- ⇒ Total income- total expenditure

### Evaluation of Financial Statements

- ⇒ The net profit or loss is carried over to the balance sheet. It forms part of the net worth, which indicates the person's wealth
- ⇒ Any additional income is usually associated with additional expenditure- ensure that the additional expenditure does exceed the additional income.
- ⇒ After-tax income should be hire that the additional expenditure

- ⇒ Employment of capital – those items on the balance sheet in which long-term funds have been invested
- ⇒ Liabilities- Current liabilities refer to creditors, short-term loans, and accrued expenses. Liquidity problems refer to an inability to meet short-term obligations. Solvency refers to an ability to meet long-term financial obligations
- ⇒ Capital employed- Share capital, owner's equity, long-term liabilities and accumulated profit.
- ⇒ The statement of changes in equity- the statement of recognised gains and losses; net profit or loss for the period, each income and expenses item etc.
- ⇒ The cash flow statement- there is an indication of the cash flow that the business itself generates.
- ⇒ The cash flow from other sources is shown as well as the employment of cash i.e. the outflow of cash is also represented.
- ⇒ Using ratios- aids in order to obtain certain information regarding the financial statements

### The personal financial budget

- ⇒ A budget is a plan and a control mechanism. It is a plan expressed in financial terms. It is a mechanism used in order to exercise financial control
  - ⇒ The lifestyle of the family will determine trends and tendencies in the personal budget
- The purpose of a budget
- ⇒ A budget is a financial plan for the household over a given period.
  - ⇒ The income and expenditure over this period must be estimated or forecast. This forecast is based on the expectation of the compiler of the budget regarding his or her future financial situation.
  - ⇒ The purpose of a budget is to enable individuals or families to achieve their objectives

### Principles involved in drawing up a budget

- ⇒ Involvement- the household budget should have the support of all the members of the family
- ⇒ The budget should be used as a means of keeping track of income and expenditure to see whether there are any discrepancies between actual expenditure and anticipated expenditure- why did they occur? Who was responsible? What was done to prevent it? What was done to prevent it happening again? How was it rectified?
- ⇒ Efficient organisation- the authority and responsibility within a family to incur certain expenses must be clearly stated
- ⇒ A proper administration system- specific responsibilities concerning the budgeting, process and implemented for purpose of the budget
- ⇒ Good communication- communication is a process of informing or reporting in order to achieve a mutual understanding between 2 or more people. To achieve household objectives, such objectives must be communicated to the whole family
- ⇒ A realistic budget- each variable that may occur should be anticipated in respect of: their specific time horizon; and an acceptable internal and external environment that will reign during that period
- ⇒ A budget should also be flexible
- ⇒ Budget figures are based on pre-estimate or forecasts. Forecasting means that certain assumptions are made about the future and certain factors, which could lead to alteration of the budget are taken into account
- ⇒ Forecasting indicates whether or not a future plan is feasible. Budgeting indicates how and when the stated objectives can be achieved.
- ⇒ Planning and time- planning horizons and timetables
- ⇒ Planning horizons are those periods in the future that must be budgeted for- usually one year
- ⇒ Timetables indicate the specific time within the planning horizon at which a certain decision will be implemented
- ⇒ As far as forecasting is concerned: immediate (0-1 month); short term (1-3 months); medium term (3months- 2years) and long-term (more than 2 years)
- ⇒ As far as budgeting is concerned: short-term (0-1 year); medium term (1-5 years) and long term (more than 5 years)
- ⇒ Flexible application- budgeted figures must be based on certain assumptions. Once these assumptions change, the budget must also be changed.

- ⇒ Human behaviour- members of the same family usually differ; members of the family may have different personal objectives; it is essential that every receives recognition for their contribution; the family may lose focus and the family may lose status

### The appropriateness of a personal budget

- ⇒ Costs are low
  - ⇒ It is the best way to achieve personal objectives and it can only be to the benefit of the family
  - ⇒ It is a simple process
- Limitation of a personal budget
- ⇒ A budget is based on assumptions. These assumptions must be based on all available facts and on good judgment
  - ⇒ All members of the family should contribute actively to ensure that the stick to the budget
  - ⇒ A budget is not the solution to all problems
  - ⇒ The success of the budget depends on people
  - ⇒ A budget is based on forecasts
- Advantages of a personal budget
- ⇒ A budget compels a family to do financial planning
  - ⇒ Financial problems can be identified at an early stage
  - ⇒ It compels a family to think about their financial future and household objectives
  - ⇒ The personal objectives of each member are identified and integrated into a financial plan
  - ⇒ It provides unity in objectives with the financial resources of the family
  - ⇒ Priorities in the household are identified and placed in logical sequence
  - ⇒ It promotes togetherness in the family

### Preparing the budget

- ⇒ Estimating anticipated income- is estimated on a monthly basis: salary, bonuses, commission, interest received etc.
- ⇒ Estimating anticipated expenditure- fixed and variable expenses
- ⇒ Comparing estimated income and expenditure- in order to calculate the financial surplus or shortfall on a monthly basis. At the end of the month the budgeted figures must be compared with the actual figures
- ⇒ Should the family find that they cannot balance their income and expenditure, they should seriously consider their financial affairs. Corrective steps /alternatives:
  - Repay a loan over a longer period
  - Where a person has a housing bond, the repayment period can be extended | pay reduced bond instal
  - A personal loan can be taken over a short period
  - Defer certain expenses for 3 or 4 months / Reduce certain exp
  - Use an existing investment to defray expenses
  - Use an existing investment as security to take out a loan
  - Sell on of the family's possessions
  - Close an account
  - Lower the family's standard of living by selling their home and buying a smaller one or buying a cheaper car

### Residential area and cost of living

- ⇒ A cheaper residential area requires a lower income than a more expensive area in order to maintain the same standard of living
- ⇒ More expensive the residential area the higher the property tax, home insurance, travel costs and maintenance of the home

### Record system

- ⇒ Documentary proof must be kept of income, expenditure, accounts and financial agreements
- ⇒ Documentary proof is not kept solely for purposes of a personal budget but also for income tax purposes

**Study Unit 3: The time value of money**

Deposit required for Future sum of money:  $FVA = PMT \times (FVIFA_{1,N})$   
 $\frac{FVA}{(FVIFA_{1,N})} = PMT$

Loan Repayment:  $PVA = PMT \times (PVIFA_{1,N})$   
 $PMT = \frac{PVA}{(PVIFA_{1,N})}$

Determination of Growth Rates:  $PV/FV = PVIF$

Determining interest:  $PVIFA_{1,N} = PV/PMT$

Future Value Annuity:  $FVA = PV \times (FVIFA_{1,N})$

Future Value Lump Sum Investment:  $FVL = PV \times (1+i)^n$   
 $FVIF_{1,N} = (1+i)^n$   
 $FVL = PMT \times (FVIF_{1,N})$

Present Value Lump Sum Investment:  $PVL = PV \times \frac{1}{(1+i)^N}$

Present Value Annuity:  $PMT \times (PVIFA_{1,N})$

Effective interest Rate:  $KEFF = (1 + i/N)^N - 1$

Calculator:

$\pm 60\,000 (PV)$  PV must be negative if FV is missing  
 $5 (N)$  PV missing  
 $18 (I)$  PV missing  
 $0 (PMT)$  PV missing  
 (Magnified glass button)  $[FV]$   
 $= 137286.47$

**Study unit 4: Credit planning**

- ⇒ A personal budget should make provision for the repayment of credit
  - ⇒ It is vitally important to maintain a planning programme before making use of credit facilities
  - ⇒ Most people who find themselves in a debt crisis have done one of the following:
    - ❖ Continued to accumulate debt without realizing the long term effects
    - ❖ Ignored the use of a personal or household budget
    - ❖ Begun tomorrow's dreams today
    - ❖ Stood surety for someone else
    - ❖ Lost employment
    - ❖ Married or divorced
  - ⇒ Credit is the ability to obtain goods and services immediately at a promised future cash repayment
  - ⇒ Debtors buy goods or services and promise to pay for them in the future in terms of a mutual agreement of some kind
  - ⇒ Creditors allow buyers to buy goods or services on credit from them and to pay for them in the future
  - ⇒ The functions of credit: economic function (at macro-level trade and industry); social function (at consumer function); at management level (micro-enterprise level)
- Good reasons for incurring debt

The right reasons are based on logical decisions; where as the wrong reasons are based on emotional decisions

- ⇒ A good bargain which is available today, which would most likely cost double at a later stage
- ⇒ Cost of the item rises to fast to save for
- ⇒ To finance an income generating asset

Wrong reasons for incurring debt

- ⇒ Being taken in by a sales person
- ⇒ Credit encourages buying unnecessary items
- ⇒ Credit allows people to have large an expensive parties
- ⇒ Credit encourages the purchase of expensive clothes
- ⇒ To lift your self-esteem
- ⇒ To impress people
- ⇒ Etc

⇒ A responsible person always endeavors to prepare him or herself for unforeseen circumstances and events

⇒ Allowances and subsidies do make credit less expensive under certain circumstances

⇒ The cost of credit:

⇒ The price paid for credit is called interest.

⇒ Know the difference between the nominal and effective interest rate

⇒ The longer the term of a credit agreement, the lower the interest rate levied

⇒ The costs of credit are called transaction financing costs. Loan rates vary according to the risk the applicant holds for the creditor

⇒ Need v Desire: a need refers to what a person really needs, whereas desire refers to those things a person would like to own

⇒ Credit and saving: the more debt you incur the less money you can save because you have used most of your financial resources to repay the debt. If you were to save more, you would have more money to make cash purchases or to pay off your debts

⇒ Credit and the household budget: prevents them from incurring further debts, since a budget indicates when it is not possible or advisable to incur further debt and pay it off in installments

Advantages of credit

- ⇒ It enables the buyer to maintain a higher standard of living
- ⇒ Good may be bought at a lower price than in 2 or 3 years time because of inflation
- ⇒ A person may purchase goods or services they would normally not be able to afford
- ⇒ Debt may enable a person to earn a higher rate of return on borrowed money that the cost of the borrowed money
- ⇒ Credit allows people to buy goods on sale at a large discount
- ⇒ A credit facility protects people against unforeseen events

Disadvantages of credit

- ⇒ Credit encourages people to buy things they cannot afford
- ⇒ Interest must be paid on borrowed money
- ⇒ Should you lose your income you will not be able to pay off the debt
- ⇒ Excessive credit often results in liquidation
- ⇒ Credit leads to impulse buying
- ⇒ Security is necessary to obtain credit
- ⇒ Etc

The application for credit

- ⇒ Gross annual income; number of dependants; period at present address; career; references; bank account; age; employer etc
- ⇒ These aspects of the credit applicant are called credit standard. Once the applicant has been assessed on the basis of these standards, the institution can providing the credit determines how much credit can be allowed

**Credit policy**

- ⇒ The stipulations of conditions for extending credit
- ⇒ Deciding on an acceptable degree of risk
- ⇒ The gathering of information about the credit applicant in order to establish whether he or she meets the institutions credit standards
- ⇒ An analysis of the clients creditworthiness
- ⇒ The acceptance or refusal of the credit application
- ⇒ Establish the credit applicants legal capacity to enter a credit transaction
- ⇒ Assessing the ability to repay the credit
- ⇒ Check the attitude of the person towards credit
- ⇒ Biographical and demographical information should be supplied as well as income and ability to pay, stability factors, contactability factors etc
- ⇒ the 7 C's of credit: Character, Collateral, Capacity, Capital; Conditions; Credit history
- ⇒ Credit conditions: specify the repayment conditions that are required of all credit clients

**Handling a debt crisis**

- ⇒ A crisis indicates long-term problems that urgently demand attention, after which action plans should be implemented. A crisis often arises as a result of excessive debt
- ⇒ Undisciplined buying habits and mismanagement of money can result in a debt crisis
- ⇒ The creditors should be approached and the situation explained to them

**Surrendering a policy.**

- ⇒ when an investor surrender a policy, it means that they decide to stop paying premiums on a policy, and ask the insurance company to repay the invested payments to him
- ⇒ Reasons for surrendering a policy.
  - The investor may be faced with a debt crisis
  - The investor may be without a job

**Borrowing against a policy**

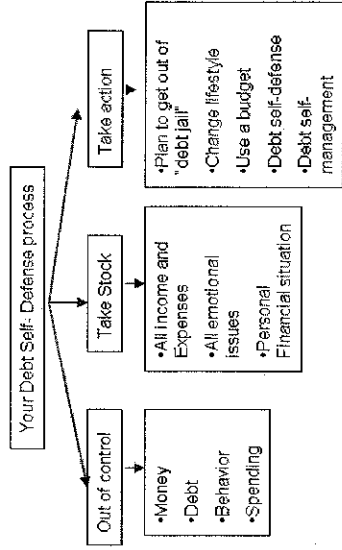
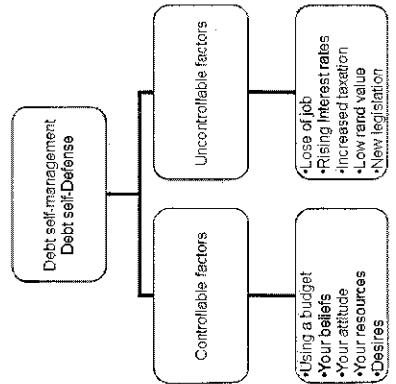
- ⇒ The amount that may be borrowed against a policy may not exceed 90% of the current value of the policy

**Ceding a policy**

- ⇒ Means that the policyholder passed the rights to the policy proceeds to a natural or legal person
- ⇒ The cession may be temporary where the policy holder cedes a policy to a bank in order to obtain a loan. When the loan is repaid, the bank cancels the ceded policy and hands it back to the policyholder
- ⇒ In the case of the death of the policyholder, the proceeds of the policy are paid to the bank
- ⇒ It is also possible to cede a policy permanently as a gift, part of an ANC or part of a divorce settlement.
- ⇒ It is not possible to cede a policy within 2 years prior to liquidation, insolvency or sequestration

**Debt planning:** refers to the judicious and purposeful incurring of debts for needs and goals

**Debt controls:** means watching your cash inflows and cash outflows



**Lifestyle rehabilitation: Attitude; Beliefs and Behaviour**

**Debt and legal Remedies**

**Offer of settlement**

- ⇒ Unconditional: You may offer your creditors any amount of money, either as a lump sum or in instalments. Such an offer of settlement is made in the form of a letter. The creditor must react in writing.
- ⇒ Conditional: the condition means that the offer is made for the full and final settlement of all claims against you. The creditor is advised that is the attached cheque is cashed, you will take it that all your debts have been paid and your conditions have been accepted. Settlement is the best method to reduce the creditor's risk of non-payment

**Selecting certain creditors**

- ⇒ Pick certain creditors above others and to pay them first
- ⇒ Give priority to urgent debt, as opposed to less urgent

**Voluntary distribution**

- ⇒ A settlement agreement with all your creditors
- ⇒ You choose a trustworthy person you undertake the distribution amongst creditors on your behalf.
- ⇒ You pay a monthly amount to this person. The distribution is normally done on a pro rata basis according to the amount available for payment

**Administration order**

- ⇒ Is a court order, and is available to a debtor with less than R50 000 in debts.
- ⇒ An application for an administration order is lodged in the magistrates court in the area where the applicant lives
- ⇒ Your application is then considered.
- ⇒ Twin influence of an administration order: it protects you against creditors who may not take legal action against you; and you may contract no further debt

**Friendly or voluntary sequestration**

- ⇒ Sequestration applies to persons with debts of more than R50 000
- ⇒ A 'friendly' creditor is asked to lodge an application for sequestration in their name. It must be proven that you do owe money, that you are insolvent or have committed an act of insolvency and that creditors will get back a proportion of their money
- ⇒ Sequestration: Voluntary v Compulsory
- ⇒ To allow your creditors to have you declared insolvent or to have yourself declared insolvent voluntarily, an act which is also referred to as voluntary sequestration
- ⇒ Sequestration and liquidation: a partnership or trust is sequestrated and a company or CC is liquidated

- ⇒ Voluntary sequestration is preferred, however should you not do it yourself, rather wait for your creditors to takes the necessary action, there is the possibility that they will not succeed in their court order.
- ⇒ In the absence of compulsory sequestration, your debt simply increase further, and your financial situation is aggravated and endures for longer

- ⇒ Voluntary sequestration enables you to conclude an undesirable financial and personal episode and it allows you to begin a new, disciplined life as far as personal money matters are concerned
- ⇒ An application for voluntary sequestration is made to the high court - certain financial information must be disclosed
- ⇒ A notice must be placed in the government gazette as well as in a local district newspaper
- ⇒ The court will grant the application for the surrender of the estate if the correct steps have been followed, if the estate is in fact insolvent, if the cost of sequestration can be covered and if sequestration will benefit the creditors
- ⇒ Consequences of sequestration:
  - Proprietary legal consequences:
  - The possessions of a person who is declared insolvent vests in the master, and thereafter the in the curator of the insolvent estate
  - After the curator has gathered together the assets of the person, has liquidated such assets and has paid the relevant creditors, he or she is discharged for his or her position and the insolvent is referred to as a rehabilitated insolvent.
  - Excluded from the insolvent estate:
  - Policies taken out more than 3 years prior to the insolvency
  - Policies in respect of the life of a spouse taken out prior to the marriage, unless the other spouse has paid the premiums
  - Policies taken out by a spouse which have been ceded to the other spouse
  - Policies taken out by a spouse in favour of the other spouse
  - Should there be no ANC any amount above R30 000 falls into the insolvent estate
  - S21 of the insolvency act governs sequestration in the case of a marriage out of community of property- the wife must prove that certain assets were her property before the marriage, were acquired in terms of an ANC, were acquired during the marriage, but enjoy preference by law against the claims of creditors; or were acquired from the yield of the aforementioned assets
- ⇒ Personal consequences:
- The un-rehabilitated insolvent's name will appear in the blacklists of credit information bureaux
- An application for rehabilitation either by the un-rehabilitated insolvent or by someone else on his behalf, must be made to the same court that sequestered the estate
- An application for rehabilitation can be made when: creditors have already received 50cents in the rand; whether creditors have received security for such a payment; whether 12 months have elapsed in the case of a first sequestration and no offences have been committed; whether 3 years have elapsed in the case of multiple sequestrations and no offences have been committed; 5 years have elapsed in the case of offences; or after 10 years automatically rehabilitated

### **Banking Services**

#### Fixed deposits:

- ⇒ Interest rates on fixed deposits are published to enable investors to compare the rates of return on investment in both the money and capital markets.
- ⇒ Fixed deposits are money market instruments because the demand for and supply of these instruments functions over the short and medium term
- ⇒ When an investor invests money in a fixed deposit it is tied up for a specific period
- ⇒ Interest rates on fixed deposits vary between financial institutions and are fixed for the investment period. Interest rate is usually determined on the day the deposit is made
- ⇒ Advantages:
  - Relatively small amounts may be invested
  - The fixed deposit can be used as collateral for a deposit towards buying a house
  - The investor should be able to raise a loan from the institution where the deposit is held
  - Money is less tied up than in the case of endowment policy
  - The safety of the capital amount is guaranteed by the institution
  - It provides income that is tax free up to a certain amount
  - The investor can plan more accurately, knowing when exactly the investment amount will be returned
  - The control of the capital amount invested is not entirely out of the investors hands
  - No commission is paid by the investor on the amount invested
  - Interest is paid on the full amount invested

- ⇒ It can serve as an emergency fund where the term is very short
- ⇒ Disadvantages:
  - It does not offer an investment hedged against inflation
  - Inflation erodes the purchasing power of a fixed deposit
  - A fixed interest rate may hamper an investor's return on investment when interest rates are rating
  - An investor may experience a negative return on investment in real terms
- ⇒ The interest an investor receives is taxable and forms part of an investor's taxable income
- ⇒ The capital amount or fixed deposit, will be tax-free at the end of the term of the investment period or when it is called up by the investor

#### Savings accounts

- ⇒ A savings account is a very basic form of investment
- ⇒ It is more in the nature of an emergency fund than unit trust
- ⇒ Is a simple way of earning some income on your money, and guaranteeing the safety of your capital at the same time
- ⇒ A savings account is opened at a bank, and then money is deposited into it, and the required withdrawals are made. The interest on the account is calculated daily.
- ⇒ The money you earn daily is paid into the account monthly, and then becomes part of the capital of your account
- ⇒ Advantages:
  - It provides a balance to your investment and protection planning portfolio
  - It serves as an emergency fund
  - You can systematically build up a nest egg to invest or spend at a later stage
  - You can save money for a specific goal
- ⇒ Disadvantages:
  - There is no capital growth
  - It is not a long-term investment
  - Inflation erodes the purchasing power of your money

#### A Current account (cheque account)

- ⇒ A current account holder can effect all transactions from this account
- ⇒ Interest is paid on money in your cheque account, either on your daily balance or on the minimum monthly balance
- ⇒ costs per transaction/ costs based on minimum balance or a monthly management fee
- ⇒ An overdraft: is a short term borrowing option. It is normally linked to a cheque account
  - Criteria for an overdraft: a cheque account; period as client; credit record; record with credit bureau and repayment capacity
  - Banks some times need collateral like deposits, counter investments, insurance policies or someone who can guarantee payment
- ⇒ Advantages:
  - Money is instantly available
  - Interest is only charged on amounts used
  - You can repay borrowed funds at any time
- ⇒ Disadvantages:
  - You can run into a permanent debt crisis
  - You can get used to debt
  - Debt can rise drastically because of rising interest rates
- ⇒ A non transferable cheque can be paid only to the person to whom it is made out

### **Credit Instruments**

#### Service credit accounts

- ⇒ The kinds of credit associated with the use of telephone accounts, water, rates and taxes, medical etc. and are paid at the end of the month. No costs are involved in this kind of credit

#### Open accounts

- ⇒ Arranged between a dealer and a customer. The customer is debited in the dealer's books with the sum of the sale
- Revolving credit
- ⇒ A customer is granted an open account with a maximum credit limit and a fixed monthly payment.
- Deferred payment
- ⇒ Means that the customer pays for goods or services over a period of 3 to 6 months no interest charged, although the customer accepts the fact that the prices are higher than they would be if paid for by cash

#### Installment Sale Agreements

- ⇒ Used when a consumer requires financing to purchase goods such as a vehicle or furniture
- ⇒ Such financing may be direct (from a bank) or indirect (with the seller who then concludes an agreement with the bank)
- ⇒ Direct transactions- the agreement is concluded on the bank's premises. With an indirect agreement the transaction is concluded on the premises of the seller, who refers it to the bank for evaluation over the phone, fax or in person
- ⇒ The buyer takes possession of the vehicle immediately, although the seller retains property rights until the last installment has been paid
- ⇒ Important to pay the largest deposit possible. This reduces the outstanding debt and the buyer saves on interest charges
- ⇒ The financing rate should be linked to the prime loan rate
- ⇒ Financing by means of a bank overdraft is invariably cheaper than an installment agreement, since interest is paid only on the outstanding amount
- ⇒ With an installment agreement the terms are fixed, with the result that the outstanding debt can only be reduced by means of fixed monthly installments
- ⇒ Credit life insurance should be included in the installment sale agreement.
- ⇒ Legislation prohibits a seller from selling a vehicle "voetstoots" in an installment sale agreement
- Lease Agreement
- ⇒ No deposit is required and the vehicle remains the property of the lessor. The lessee may buy the vehicle at the end of the leasing period at its current value, or return it to the lessor
- ⇒ Maximum benefit is derived in the form of income tax advantages, as the installments are written off for income tax purposes (they are tax-deductible)

#### Personal Loans

- ⇒ Involves an amount that may be borrowed over a specific term and at a specific rate
- ⇒ A bank would be concerned mostly with the borrower's ability to repay the loan. The borrower would also have to provide the bank with security ( a house, a car, a vacant plot, shares etc)

#### Credit Cards

- ⇒ Are issued to clients, who may use them to buy goods and services. Credit cards are offered by both financial institution and those used in retail trade
- ⇒ A credit limit is usually attached to each credit card, which prevents excess spending

#### Advantages:

- no need to carry cash
- credit card insurance ensures that the holder will not suffer loss if stolen
- a budget account may be linked to a credit card
- earns interest on a credit balance

#### Disadvantages:

- Credit cards may encourage people to incur debt
- There is a levy for a lost card
- If the total monthly balance is not paid in full, interest is charged
- ⇒ Types of credit cards: Master/Visa, American Express/ Dinners Club
- ⇒ Types of accounts: straight or budget

#### Petrol Card

- ⇒ Are credit cards that may be used to buy petrol at petrol stations
- ⇒ There are both debit and credit petrol cards
- Home Improvement Loans
- ⇒ An additional loan or a bank overdraft may be used to pay for it. The larger the amount, the greater the advantage of a loan over an overdrawn bank account
- Student Loans

- ⇒ Usually a policy is ceded to a bank as security

#### Lay-by

- ⇒ Means that a consumer buys an article and leaves it in the possession of the seller, because he or she does not have sufficient money to pay the whole amount

#### Pawn Shops

- ⇒ Take possession of goods as security for a loan. Once the loan has been paid off, the goods are returned

#### Debit Card

- ⇒ Purchases are made by means of a debit card are debited to your bank account immediately
- ⇒ Can be PIN coded to access ATM and Electronic banking services
- ⇒ Greatest advantage is that you know exactly what is going on in your account, because there are no pending credit card expenses that have to be processed later

#### The credit contract

- ⇒ There must be consensus between the parties
- ⇒ The parties must be legally competent
- ⇒ It must be physically possible to honour the contract
- ⇒ The contract must be legally enforceable
- ⇒ The required legal formalities must be met

#### Buying and selling a car

- ⇒ A car is not an investment
- ⇒ Aspects regarding buying and selling a car:
  - ⇒ Talk to various people
  - ⇒ A new or used car?
  - ⇒ Buying through a dealer?
  - ⇒ A private sale
  - ⇒ Buying at an auction
  - ⇒ Hints for buyers:
    - Step 1- Have a good look around and talk to lots of people
    - Step 2- Study your contract papers
    - Step 3- Know the cost and plan where you will get the money
  - ⇒ Hints for sellers:
    - Market the car in such a way that will make the car seem to be 'value for money'
    - Do not simply hand the registration papers to potential buyers
    - You will probably recover the cost a valet in the selling price
    - Always negotiate in a civilized manner
    - Keep the car's service record at hand
    - Also keep at hand any proof of recent repairs or improvements
    - The seller must inform the licensing authorities that the vehicle has been sold
    - Make sure that the car and buyer are insured if you allow the other person to test drive it

#### How to finance the sale

- ⇒ Own finance
- ⇒ Family
- ⇒ Bank overdraft
- ⇒ An installment sale agreement
- ⇒ A lease
- ⇒ Rental
- Buying, installment, sale or lease
- ⇒ For individuals, buying on an installment sale agreement is cheaper than leasing
- ⇒ For business, leasing is cheaper than buying or an installment sale agreement

#### E-Shopping

- ⇒ You buy when you have the time



- ⇒ The convenience of the purchases
- ⇒ The absence of people who hassle you at the shop
- ⇒ The availability of international products
- ⇒ Delivery at your doorstep
- ⇒ Costs: Product price; telkom; ISP costs; delivery charges; import duties
- ⇒ Risks: 'safe' delivery; dishonest business

### E-Banking

- ⇒ Is cheaper than doing your banking otherwise
- ⇒ Time-saving; accessible; convenient; secure; safe
- ⇒ Telephone; internet; self-service terminals; cash points are all methods of E-banking

### The micro-lending industry MLI

- ⇒ A large portion of the South African community now has access to credit through the micro-lending industry. This industry is very dynamic and currently supplies loans to approximately 5mil South Africans
- ⇒ The loan agreement- the amount you have to pay plus interest divided by installment period= monthly payment
- ⇒ Know how much you can afford
- ⇒ Compare interest rates
- ⇒ MFRC Micro Finance Regulatory Council

### Study Unit 7: Starting a business: Entrepreneurship

- ⇒ The person who starts his or her own business is known as an entrepreneur
- ⇒ Consider the risk of entrepreneurship against the return on investment; what you can be lost (your possessions, your health); consider your personal strength as well as the time you will need to devote to your business
- ⇒ Idea- Business opportunity- business plan

#### The Business Plan

- ⇒ A business or commercial plan sets out all the activities and other aspects of your business
- ⇒ Advantages include:
  - It compels the entrepreneur to consider the business objectively
  - Research is conducted on numerous aspects of the business to be established
  - Business plans are expressed in writing as well as in financial terms
  - The plan may be submitted to the provider of funds in order to obtain funds with which to finance the activities of the business
  - The entrepreneur is compelled to evaluate his/her managerial abilities and resources
  - Risks, opportunities, threats and strong and weak points are identified
- ⇒ Content of the business plan:
  - Title page; table of contents

- ⇒ Family business/ new business/ existing business/ a franchise
- ⇒ Primary goal of the business- to maximize the prosperity of the owners of the business in the long term
- ⇒ Short, medium and long term capital requirements
- ⇒ Research costs, establishment costs, equipment, inventory, debtors, temporary

### Study unit 8: Buying a Business

Two key questions. What is the reason for selling the business? Exactly what is being bought?

#### Reasons for selling a business:

- ⇒ A business decline
  - ⇒ Obsolete products/services provision
  - ⇒ cash-flow problems
  - ⇒ Poor equipment
  - ⇒ Competition
  - ⇒ Changed buying patterns
  - ⇒ Poor management
  - ⇒ Debtors/creditors
- Reasons why an entrepreneur would want to buy a business
- ⇒ Eliminate competitors
  - ⇒ Determine one's own future
  - ⇒ Manage one's own business
  - ⇒ Earn more money
  - ⇒ Build up a business and sell it at a considerable profit

#### Advantages of buying a business to prospective buyers

- ⇒ A lower risk than when beginning from scratch
- ⇒ A saving in time and effort
- ⇒ The fact that there are already existing suppliers/debtors
- ⇒ Trained personnel
- ⇒ Cheaper equipment

#### Steps when buying an existing business

- ⇒ Evaluate yourself in order to determine whether you will be able to manage your own business
- ⇒ Poor appearance

### Study Unit 9: Buying a Franchise

- ⇒ losses, interruptions and future expansion of the business
- ⇒ Capital structure- ratio between equity capital and borrowed funds
- ⇒ The business plan should address: the amount of equity capital; the capital requirements; the security of the owner as well as annual financial statements

- ⇒ Determine the type of business that will correspond with your financial capacity and your needs
- ⇒ Contact sellers yourself
- ⇒ Analyze the business critically
- ⇒ Determine the possible purchase price
- ⇒ Draw up a business plan and determine the different capital requirement periods
- ⇒ Obtain the necessary finances
- ⇒ Comply with all the legal requirements relating to the forms of business and the registration of the business and the business name
- ⇒ Buy on the basis of a carefully drafted contract of purchase and sale

To determine exactly what is being bought, the entire business's financial performance must be measured and assessed

#### Assessing financial performance

- ⇒ Bank statements, deposit slips, cheque counterfoils and debit or stop orders
- ⇒ Tax returns
- ⇒ A contract of lease
- ⇒ The actual reason for selling
- ⇒ Selling price
- ⇒ VAT
- ⇒ Accounts (telephone, electricity, water, rent)
- ⇒ Rates and taxes
- ⇒ Salary and wages payments
- ⇒ Suppliers
- ⇒ Stocktaking
- ⇒ Debtors
- ⇒ Knowledge of the market
- ⇒ Personnel
- ⇒ Personnel administration and management
- ⇒ The determination of goodwill

**Franchise or agency:** a concession which a franchisor grants to a concessionary or franchisee entitling the latter to use a full franchise/business package. Such a package covers all the elements needed to enable even the unformed to establish the enterprise and to manage it at a profit.

A franchisee is an entrepreneur who has acquired his or her own small business enterprise

**Reasons why an entrepreneur buys a franchise:**

- ⇒ A known product/service
- ⇒ The advantages attaching to an existing business
- ⇒ Preference for a specific product/service
- ⇒ Training by the franchisor

**Steps to assessing a franchise**

- ⇒ Contact FASA
- ⇒ Visit franchisees
- ⇒ Consult existing franchise owners
- ⇒ Study examples of franchise agreements

### Study Unit 10: Estate planning

"Estate" is the collective name for everything a person owns

- ⇒ Estate planning refers to all activities leading to the accumulation of, as well as the management of, assets or possessions.
- ⇒ 3 phases in a person's financial life: building up an estate, preserving the estate and transferring the estate
- ⇒ As regards to transfer, the following objectives are important: the minimization of transfer costs, the protection of assets and the provision of sufficient liquid funds to make transfer possible
- ⇒ The testator/ testatrix or estate owner cannot take care of the transfer of his or her estate after their death
- ⇒ There are 3 approaches to estate planning: no estate planning; elementary estate planning and comprehensive estate planning

**No estate planning**

- ⇒ The person's estate will be distributed in terms of the intestate succession act

**Elementary estate planning**

- ⇒ The estate owner's wishes in respect of the transfer of the estate will appear in the will

**Comprehensive estate planning**

- ⇒ Refers to an estate plan that involves far more than a will
- ⇒ Can be divided into: timely planning (during the life of the estate owner); testamentary planning (in his will) and other planning such as insurance
- ⇒ Requires knowledge of specialized fields such as law, tax, investment, insurance etc.
- ⇒ Professional advice should be sought

**The estate planning process**

**Step 1: Set objectives**

- ⇒ Attention must be given to the objectives a person wishes to achieve
- ⇒ The care of dependant is the most important objective. Other objectives involve the protection and retention of assets

⇒ Identify heirs: the estate owner must decide who is going to inherit the estate

⇒ Decide which heir should inherit: the will must state who gets what

⇒ Decide who should control the assets:

**Step 2: take stock**

- ⇒ A value is attached to the property of the estate
- ⇒ Identify estate property: all property fixed as well as current belonging to the estate owner must be identified.
- ⇒ Fixed assets include buildings and plots. Current assets include jewelry, insurance policies etc.
- ⇒ Rights of use and enjoyment and usufruct are also regarded as property
- ⇒ A right of use (fiduciary right) arises when the estate owner bequeaths possessions to an heir on condition that the possessions go to a second heir after the 1<sup>st</sup> heir's death. The first heir may use the property but may not sell it.
- ⇒ A usufruct gives a person the right to enjoy the fruits of an asset. The property however, belongs to another person.
- ⇒ The estate duty Act excludes certain property for estate duty purposes in view of the fact that the estate owner did not reside inside the Republic of SA; payments to widows by the Railways and Harbors provident fund; trust money held by attorneys; benefits from a pension fund controlled by the minister of social development and the return on certain insurance benefits.

⇒ Establish the value of the estate: estate duty is calculated on the net value of an estate

- The valuation of the property: a registered valuer is normally used to calculate the market value of the estate assets
- Book values or replacement values of estate assets are not taken into account for the purposes of valuation for estate duty
- The valuation of an interest in a property: an interest in property is also transferred. By inheriting the usufruct the son benefits because he now has full use of the property for the rest of his life without the encumbrance of the usufruct
- A formula is used for the calculation of the value of an interest in property. This formula capitalises the annual value of the interest or right over the following: the life expectation of the beneficiary and the term for which the interest or right applies
- The following limited rights are distinguished:
  - A *Fiduciary right*: is the right to use and enjoy the fruits of a property
  - *Usufruct*: in the case of a fiduciary right, a separate bare dominium does not exist, where as in the case of a usufruct, a separate bare dominium does exist
  - *Bare dominium*: means that a property is merely registered in a person's name
  - *An annuity charged upon property*: the calculation is the same as that for a fiduciary right. The values of interests or rights in property are added to the market value of other property (over which the owner has full property rights) in order to calculate the gross value of the total estate.
- *Other annuities*: do not form part of the deceased's estate for estate duty purposes

**Step 3: Establish the estate's liabilities**

- ⇒ All outstanding loans and accounts must be listed and the amounts added up. This amount is subtracted from the gross estate value. Certain rebates are subtracted in order to determine the net value of the estate.
- ⇒ A person's matrimonial property dispensation can greatly affect the value, particularly the net value of the estate.
- ⇒ Allowable deductions: funeral and deathbed expenses; debts owed to persons residing in SA; administration and liquidation costs; donations to churches etc; donations to political parties; the amount equal to the accrual of the surviving; maintenance costs of assets from the date of death to the date of liquidation
- ⇒ Assess estate duty liability. Estate duty is payable on the net value of the estate 20%
- ⇒ Assess other estate costs: the costs of providing security; advertising costs; transfer fees of immovable property; master's fees (payable in all estate with a gross value exceeding R15 000); executor's remuneration
- **Capital Gains Tax**: whether estate duty is payable or not, CGT is applicable to the estate's assets

- ⇒ Analyse the liquidity of assets: an estate should have sufficient funds to cover the estate costs. In the absence of such funds, the assets would have to be converted into cash
- ⇒ **Step 4:** Choose estate-planning techniques
- ⇒ Estate-planning is a method or technique used in an estate plan to solve an estate planning problem, in order to achieve a stated objective
- ⇒ Identify a team of professional planners: income tax, insurance, legal aspects, investments and property experts
- ⇒ Establish available techniques:
  - The trust inter vivos technique:
    - If a trust is formed in a person's lifetime, it is called a trust inter vivos
    - The founder donates certain assets to the trust, while the trustee's manage the assets on behalf of one or more beneficiaries
    - A trust inter vivos is a contractual arrangement between a testator (the founder) and the trustees in favour of a 3<sup>rd</sup> party or parties
    - Its purpose is to transfer certain assets to a trust while still retaining control over the assets. The assets are administered in favour of a 3<sup>rd</sup> party and are not created for the benefit of the founder
  - Legal requirements:
    - The donation agreement must be contained in a written deed of trust
    - The donor and the trustee must have legal capacity
    - A copy of the trust must be submitted to the High Court
    - The trust assets must be legally transferred from the founder to the trustees
    - A transfer of property rights over the assets must take place
    - An obligation must arise to administer the assets on behalf of the beneficiary/s
    - There must be no doubt about the identity of the assets to be transferred
    - The beneficiaries or group of people from whom the beneficiaries can be selected must be clearly described
  - Different uses of a trust:
    - A lack of management and investment experience among beneficiaries is eliminated
    - It solves the problem of assets that are difficult to dispose of
    - Growth of the estate is frozen in this manner
    - Assets can be protected until minors come of age
    - It ensures the transfer of inheritance to successive generations
    - Estate duty benefits are obtained
    - A trust is founded by means of a contract called the deed of trust. The powers and duties of the trustees must be indicated, as well as when and how the trust must be terminated
    - The flexibility of the trust lies in the stipulations of the deed of trust
    - More than one trust is particularly effective in a large estate that runs into several millions and where the estate owner needs to undertake comprehensive estate planning
    - How donations can be made: lending the money to the trust and bequeaths the loan to the trust in his or her will. The trustees do not have to repay the loan to the founder at a later stage.
    - Transferring assets to a trust is expensive
    - Every taxpayer may donate up to the value of R30 000 annually without paying donations tax in the case of fixed assets. Transfer duties are payable by either the receiver or the donor
    - When movable assets are sold, VAT at 14% is payable, over the selling price. When selling fixed assets the seller has to pay transfer duty or VAT
    - Assets are often donated or sold to a trust to reduce estate duty. The trustee must accept the capital at a cost of about 1.5% of the capital plus VAT on the cost. Commission is payable on the income accumulated for the benefit of the trust
    - A trust is considered an offshore trust when it is registered in a "tax haven"
    - Company-based techniques
    - The estate owner establishes a company and ensures that his heirs retain the ordinary shares in the company. The growth in share value increases the value of the heir's estates and not the estate of the owner
    - A company with share capital is necessary for estate planning purposes
    - A private investment company is used mainly to prevent donations tax (where assets are donated to a trust) as well as because a trust is not regarded as a body corporate, but as a natural person

- A Farm: a land bank valuation is based on the production value of the farm, whereas an ordinary valuation is based on supply and demand. For the purposes of estate duty, it would be more profitable to retain the farm in the estate owners name
- It is recommended that a separate company be established for each fixed property. When a property is sold, the transferability is simplified because no transfer duty or transfer costs are payable
- It is preferable to retain listed and unlisted shares in separate companies. A purchaser may only be interested in unlisted shares and withdraw because he or she is not prepared to purchase a company with listed shares as well
- Two types of company scheme:
  - Companies employed in a series: the estate owner determines the value of his or her assets and then sells them to the company. Share capital is issued and the estate owner establishes various companies, each with a share in the other, and controlled by him or her as a result of a majority share holding. These companies possess the company to which the assets are sold. This technique can be improved by combining preference shares and a trust with companies
  - Companies combined with trusts: the estate owner sells assets to a company. The preference shares with their voting rights are issued to him so that control over the company is retained. The ordinary shares belong to a trust established in favour of one or more beneficiaries
- Close corporations: only natural persons and trustees of testamentary trusts may be members of a close corporation. Companies and trustees of a *inter vivos* trust cannot be members of a CC. CC's as a form of business cannot serve the basis of an estate plan
- Testamentary techniques
- A will contains a person's wishes with regard to the disposal of that person's possessions after his or her death
- The will:
  - A testator (m) / testatrix (f) is an estate owner who draws up a will himself or requests an attorney or specialist to do so.
  - A codicil is an addition to an existing will made by the testator. A codicil usually contains amendments, additions and further details that the testator wishes to include in the will.
  - The executor is the person who is appointed in the will to administer the testator's estate
  - In order to be valid, a will must meet the following legal requirements:
    - The testator must sign all the pages of the will
    - The testator must be at least 16
    - Two witnesses must sign every page, and they must be at least 14 years
    - No person signing the will as a witness may benefit from the will or act as executor of the will
    - All these requirements are applicable to a codicil as well
    - In a single will, one person makes his or her wishes known
    - In a joint will, more than one person makes their wishes known
    - A mutual will is one in which testators bestow benefits upon each other.
    - A revocation clause— all previous wills and codicils must be revoked when a new will is being drawn up
  - A will must make provisions for several scenarios— alternative beneficiaries, executors, administrators, trustees and institutions must be designated.
  - The testator must exclude all inheritances from, their heir's matrimonial property regimes
  - A testator must indicate whether he wishes to bequeath encumbered or unencumbered property— a house may be bequeathed with mortgage bond and a: to an heir
  - "Bringing in" is an obligation of the part of an heir or descendant of the estate owner to return all goods ("inherited" during the testator's lifetime) to the executor. This is applicable to such goods when bringing in is included in the will.
  - In the letter of last requests, the testator gives the executor more details about the structure of the will and directs a few last requests to him or her.
  - In the absence of a will the deceased would have died intestate and the rules of intestate will apply (spouse then kids, then brothers or sisters and then grandparents)
  - If the person dies without leaving a will and there are no descendants, the master of the high court will place the funds of the estate into the guardians fund— if no descendants come forward to claim the funds for the next 30 years, these funds will be declared forfeited to the state

- **Testamentary trusts:** arises from the will of a deceased, the legal requirements are similar to that of a trust *inter vivos*. A trust *inter vivos* is created in the lifetime of the founder.
- In the case of a testamentary trust, the stipulations of the deed of trust are deduced drawn up according to the testator's will. The master of the high court compares the stipulations of the will that are applicable to the trust to be set up with the stipulations of the deed of trust.
- With a testamentary trust, usufruct and fideicommissum are used. The deed of trust usually stipulates that assets are bequeathed to certain heirs after the death of the spouse.
- The testator stipulates the duration of the trust in the will. Usually this stipulates that the trust can be terminated once the beneficiaries of capital have been paid out or have received their assets. A testamentary trust may be revoked at any time before the testator's death by merely drawing up another will.
- **Perpetual testamentary trusts:** means that they continue from generation to generation and the capital is not transferred to one or more beneficiaries. Such trusts usually have income beneficiaries and not capital beneficiaries.
- A **usufructuary:** could include the natural proceeds from the farm or the income generated from the farm. Full property rights: bare dominium + usufruct
- **Right of use:** the person who obtains the right use can only meet the requirements of his or her family's needs and excess fruits cannot be sold or rented.
- **Habitatio (occupation):** a husband gives his wife the right to live in a house for the rest of her life. Such a right usually means the holder of the right may let the house.
- **Fideicommissum:** is testamentary bequest to a person on condition that the bequest goes to another person (fideicommissarius) after that person's death. The fiduciaries may not sell or encumber the property with a mortgage bond. Legally it is only possible to nominate 2 fideicommissaria.
- A **donation mortis causa:** means that the testator makes a donation in his will in contemplation of his death. This donation may be revoked at any time before the testator's death.
- A **donation inter vivos:** a testator donates something to a beneficiary during his lifetime. Once the beneficiary or trustee or director accepts the donation, it cannot be revoked
- **Annuities:** a person may donate an annuity to a person or an institution. Two kinds: an annuity charged upon property (the beneficiary is entitled to an annuity arising from the proceeds of the building) this annuity is known and exists, this kind of annuity forms part of the person's estate; and other annuities (refers to an obligation that exists to pay an annuity, irrespective of where it is derived from) this kind of annuity only forms part of a persons estate if it is transferred to another person at his death
- **Massing:** takes place when 2 or more people draw up a joint will. They dispose of their separate and/or joint estate in one will. Any person can draw up a joint will. The joint will takes effect at the death of the first- dying as his or her will- such a will has 2 or more testators. Any of these testators may revoke or amend his or her part of the will without the knowledge of the others.
- Acceptance or adiation means that the executor can administer the estate according to all the stipulations in the will. If the surviving spouse refuses to accept the stipulation of the will in respect of her portion of the estate, it is called repudiation
- Massing can take place only if the surviving spouse accepts the stipulation of the will after death of the testator. Where 2 or more people dispose of their property in a joint will, it is subject to a limited right in favour of the surviving spouse
- In the case of massing additional estate duty on the estate of the first-dying is not payable, estate duty is only payable in respect of his or her assets in the joint estate
- Other techniques
- Investments
- **Insurance:** an estate owner can take out one or more endowment and/or life policies and nominate his or her heirs as beneficiaries of the policies
- **Select the most suitable techniques:** the most suitable techniques are those that will help in the achievement of estate planning objectives. Usually a combination of techniques

⇒ **Step 5:** Implement the estate plan

- ⇒ Draw up the necessary documents; draw up the new will that reflects the last wishes of the estate holder; draw up trust inter vivos documents and stipulations in the trust deed; take out one or more policies bearing the name of the beneficiaries; and put together a share portfolio that will ensure the necessary capital growth in the estate

⇒ **Inform the heirs of the plan**

⇒ **Step 6:** Revise the estate plan

- ⇒ The personal and financial position of the estate owner. Any significant change in the position such positions should be an indication that the estate plan requires attention and amendment

⇒ **Estate planning pitfalls and how to avoid them**

- ⇒ Estate planning is involved when an individuals assets are transferred to heirs during his or her lifetime or after death
- ⇒ Financial Objectives: transfer costs should be minimized; assets should be protected and provision should be made for sufficient funds to transfer your possessions
- ⇒ Pitfall 1: no estate planning- avoid by drawing up a will!
- ⇒ Pitfall 2: insufficient estate planning – as soon as your assets increase in value you should consider doing comprehensive estate planning. This involves more than drawing up a simple will. You may set up a trust and establish a company. Testamentary trusts are the best option. Make sure you have sufficient life cover to pay estate duty.
- ⇒ Pitfall 3: insufficient liquid assets (funds) for transferring the estate- make sure that there are sufficient funds in your estate to wind up the administration process
- ⇒ Pitfall 4: building your estate without doing continuous estate planning- specific strategies to reduce the value of your estate (after your death), particularly if you have to invest or reinvest a package. Examples of strategies:
  - Sell property to your heirs but lend them the money to make the purchase. Bequeath this loan to them in your will.
  - Donate an amount R30 000 every year to each child, and deduct the amount every year from the amount that is bequeathed to each child
  - Never include the accrual system in your antenuptial contract
  - Take out a life policy as soon as you buy a fixed assets
  - Buy further fixed assets in the names of the heirs or trust
  - If you cannot make provisions for estate costs you should convert some of your assets into cash while you can still make decisions

⇒ **Your lifestyle and estate planning**

- ⇒ Your lifestyle determines the type and size of the financial claims you could expect on your estate in the case of death or divorce
- ⇒ Living together: your cohabitation agreement: you live with someone in the same hoe without being legally married; draw up a cohabitation agreement- purely financial agreement between two parties
- ⇒ Customary marriages then and now

Unregistered (then)	Registered (Now)
<ul style="list-style-type: none"> <li>• Children could get married</li> <li>• Families could enforce marriages</li> <li>• The marriage was not recorded on paper</li> <li>• The wife had minor status</li> <li>• Man needed no agreement with his wife for further marriages regarding asset division</li> <li>• No agreement had to be registered</li> <li>• Difficult to get a divorce</li> <li>• Wife could not own property</li> <li>• Only the oldest son from the first marriage could inherit from the father</li> <li>• No marriage contract</li> </ul>	<ul style="list-style-type: none"> <li>• Parties must be older than 18</li> <li>• There must be a meeting of the minds</li> <li>• The marriage must be registered</li> <li>• The wife (wives) have adult status</li> <li>• Man agree with wife (wives) regarding division of assets</li> <li>• Agreements must be registered</li> <li>• Marriage recognised by employers and state</li> <li>• Easy to get divorced</li> <li>• Wife can own property</li> <li>• Estate is divided in accordance with customary marriage contract</li> <li>• Registered marriage contract</li> </ul>

⇒ **Your engagement: Financial implications**  
Comparison between an engagement contract and other contracts

Engagement Contract	Other Contracts
An engagement contract concluded by post comes into	A commercial contract concluded by post comes into

Legal Capacity	effect at the place where and informed of the acceptance of the offer by the addressee Only persons legally capable of being married to one another may become engaged	effect at the place where and at the time when the letter of acceptance is posted In the case of a commercial contract concluded by a minor, only the parent or guardian of the minor need give permission
Withdrawal	In certain circumstances an engagement may be broken off unilaterally on god grounds.	A party may withdraw from a contract only if the other party to the contract is guilty of breach of contract
Specific performance	To claim specific performance would mean that the one party would force the other to marry him or her. In SA specific performance cannot be claimed.	A party is entitled to claim specific performance from the other party
Damages	Calculating damages is sui generis in the sense that the damages awarded are calculated according to positive and negative interest.	The rules for damages is that damages are calculated only according to positive interest

**Validity of an engagement – Consent required**

When Both parents of a minor are still living	Both Parent
When only one parent is still living	The surviving parent
When only one parent has custody of the minor	Only the parent who has custody
When both parent of the minor are deceased	The legal guardian
When the minor is emancipated	Both parents
When the minor was married but is divorced	No permission required
When the minor was married, but spouse deceased	No permission required
When the minor has been declared emancipated in terms of the Emancipation act under 15	No permission required
When the minor is a boy under 18 or a girl under 15	The presidency and parents
When the parents of the minor conclude an engagement on behalf of the later	The minor

- ⇒ **Claim for damages and satisfaction**
  - Action for damages: instituted by the 'innocent party' for compensation for the patrimonial loss they suffered. Patrimonial loss constitutes damages that reduce your estate
  - Action for satisfaction: instituted by the 'innocent party' for compensation for the non-patrimonial loss they suffered. Non-patrimonial loss constitutes damages that do not reduce your estate, but do affect your person or personality.
- ⇒ **Requirements:** the parties must have legal capacity, there must be consensus, and it must be permissible and juristically and factually possible.
- ⇒ **Termination:** matrimony, death, mutual agreement, withdrawal of parental consent, unilateral withdrawal on suitable grounds and breach of contract
- ⇒ **Getting Married**
- ⇒ The legally acknowledge life-long voluntary association between one man and one woman to the exclusion of all other persons
- ⇒ Parties must have legal capacity, consensus, proper sanction and satisfaction of the prescribed formalities

- ⇒ **Persons with no legal capacity:** infants, a minor a Wastrel and a mentally incapacitated person
- ⇒ **Where minors have married without permission, the court may dissolve the marriage or not.** If it is not dissolved the following applies in regard to the marriage regime: if no ANC, community of property pertains. The ANC will be valid if accrual is included
- ⇒ With a view to the long-term prosperity of both parties, two separate estates with the accrual system excluded, and personal financial planning is suggested
- ⇒ The choice of matrimonial property regime is particularly important. taking into account current legislation, financial principles, self protection, protection of the family assets and especially personal financial planning
- ⇒ **Your matrimonial property regime- your ANC**
- ⇒ An ANC should be regarded as purely financial agreement and should be drawn up with divorce in mind, because of the high risk, particularly when the accrual system is included
- ⇒ Personal financial matters are based on 3 aspects: accumulation protection and transfer of assets
- ⇒ The accrual system is included if you marry out of community of property unless you explicitly exclude it beware of the inflexibility of divorce legislation, because your ANC has a direct bearing on your divorce
- ⇒ The purpose of the ANC: to determine what 2 parties possess at the time, how assets will be accumulated for the rest of their lives, and to help the executor with the administration of the estate of a deceased spouse. In the case of a divorce, the ANC will help the legal professional to establish what each party is entitled to
- ⇒ An ANC must be drawn up by a attorney
- ⇒ **Marriage in community of property:** assets and liabilities divided equally and they will jointly own all their assets for the rest of their married live
- ⇒ **Marriage out of community of property with the exclusion of the accrual system:** each spouses possess their own assets and own liabilities
- ⇒ **Married out of community of property with the inclusion of the accrual system:** each spouse must make a list of the items they wish to exclude from the accrual system
- ⇒ Calculation of accrual: net value of estate- initial value- excluded assets= accrual
- ⇒ **Important aspects of the ANC:**
  - A list should be made of each party's possessions with their market value
  - When couples are to be married in community of property divorce proceedings and divisions should be stipulated
  - Stipulate whether future inheritances will form part of the settlement
  - Decide who is to be the legal guardian of the kids
  - Etc
- ⇒ it is very difficult to divide assets and call up investment if you divorce, and even more difficult to determine which assets and investments belong to whom
- ⇒ **Managing your joint finances**
- ⇒ Any debt demands should be watched carefully and followed up
- ⇒ Each spouses income must go into a separate bank account
- ⇒ Spread the payment of household expenses fairly
- ⇒ Make notes of distributions/payments and keep this on record.
- ⇒ Make sure that you know which assets are owned and bought jointly
- ⇒ It is important that each party builds up a good credit record
- ⇒ It is only logical that the spouse owning the property should be responsible for its expenses
- ⇒ Invest in joint goals that will help strengthen the marriage
- ⇒ **Divorce: your divorce settlement:**
- ⇒ Make sure that your spouse will not be allowed to buy on your account
- ⇒ Make sure that your spouse will not be allowed to liquidate your joint investments
- ⇒ Make sure that you arrange that business and financial transactions may occur only under the signature of both spouses
- ⇒ Keep records of all income and expenditure until the divorce is over.
- ⇒ Arrange with your bank that only you can use your credit card
- ⇒ Draw up a new will for yourself
- ⇒ An attorney should just direct the legal process and not represent either party

- ⇒ It is legally permissible to handle the divorce yourselves, as long as you work very accurately and both spouses agree

#### The administration of an estate (winding up)

- ⇒ An estate must be administered as soon and as accurately as possible

#### Solvent deceased estates

- ⇒ A deceased's estate is administered by an executor, who is responsible for executing all tasks during the process of administering the estate, and this takes place under the watch of the master of the high court
- ⇒ Distinguish between estates with a value smaller or larger than R50 000, and between solvent and insolvent estates
- ⇒ Appointing an executor: a letter of executorship from the master after he has received a death notice, the original will, an inventory of assets of the estate, acceptance of executorship in duplicate and proof of surety
- ⇒ Also note: Insolvent estates; Insolvent deceased estates; Insolvent partnerships; The liquidation of CC's and the liquidation of companies

#### Study unit 11: Investment planning

- ⇒ Investment management involves the employment of funds with the purpose of earning an income from them
- ⇒ Assets consist of everything a person can purchase, whether capital, financial or current assets
- ⇒ Productive assets include fixed property and machinery that are purchased to generate an income
- ⇒ Current assets include stock, cash and debtors
- ⇒ Financial assets refer to investments in ordinary shares, preference shares and debentures on the capital market, as well as bank acceptances, treasury bills, negotiable certificates of deposit, project bills and trade bills in the money market
- ⇒ The money market refers to an abstract market where supply and demand for funds over the short term come together
- ⇒ The capital market refers to an abstract market where supply and demand for funds over the long term come together
- ⇒ All financial assets are negotiable. Negotiable is a concept that indicates whether a certain financial asset can be bought or sold
- ⇒ The official list refers to the complete list of all the companies whose stock and shares are traded on the JSE
- ⇒ Institutional investors are bodies such as insurance companies, banks, building societies, pension funds and other companies
- ⇒ An offer refers to an offer to purchase a given listed share or security (debenture) at a specific price
- ⇒ A stockbroker is a member of the JSE, who acts as a trader in stocks or shares
- ⇒ Brokerage refers to the commission a stockbroker receives for buying and selling stocks and shares or for buying unit trusts
- ⇒ A stockbroker's note is the contract letter a stockbroker sends to his client after a transaction has taken place.
- ⇒ Portfolio refers to all financial assets an individual owns, whether listed or unlisted, marketable or unmarketable
- ⇒ Financial assets are issued in the primary market and traded in the secondary market
- ⇒ The primary market is that market in which financial assets are issued for the first time
- ⇒ The secondary market arises after financial assets have been issued for the first time
- ⇒ Savings refers to money a person has at his disposal that he does not spend, and that may be kept at home. The moment the person uses these savings or transfers the money to a savings account or fixed deposit account, it becomes a financial investment (a financial asset)
- ⇒ Investment is the transfer of purchasing to buying power to 3<sup>rd</sup> parties for the purchase of assets aimed at earning an income or a return, taking into account the risk involved. An individual investor will attempt to maximize the return or rate of return for a given risk, or to minimize the risk involved in a specific investment for a given return
- ⇒ Investment trusts are companies that specialize in investing in stocks and shares
- ⇒ Capital investment refers to the employment of funds to buy land, buildings, machinery and equipment in order to earn a return or an income

#### Investment Principles

- ⇒ Risk: the possibility of suffering a loss- the possibility that the actual return on an investment may be lower than the anticipated return
- ⇒ Return: refers to the income or profit on an asset, or the possible loss involved in owning such an asset or investment. An investor would anticipate a higher return on investment with a high risk, and a lower return on an investment with a low risk. Risk and return are positively correlated
- ⇒ Risk is an increasing function of time- the longer the time period, the greater the anticipated risk and the greater the anticipated return on an investment or asset
- ⇒ The price of a share is determined by evaluating the risk-return characteristics. A person's attitude towards risk or risk preference will, consequently, influence his decision to undertake a certain investment.

#### Risk preferences

- ⇒ Risk decisions are subjective by nature

⇒ Risk preference refers to a specific persons attitude towards risk: to what extent a person will be prepared to accept risk or not be prepared to accept risk, and particularly what compensation is required for certain levels of risk

#### Risk indifferent people

⇒ No change in return required for an increase in risk

#### Risk acceptors

⇒ Reduction in return is accept for an increase in risk

#### Risk avoiders

⇒ Want a higher return for a higher risk

⇒ Investors always compare the anticipated rate of return with the anticipated risk of the investment  
 ⇒ An evaluation of the effect of a particular investment will have on the risk and return of your portfolio  
 ⇒ Investors usually try to increase their wealth by increasing the rate of return on investment and lowering the risk

⇒ Financial requirements that investors should meet before investing in shares: sufficient life insurance; insurance; housing; installment sales and consumer credit and sufficient savings

#### Financial prerequisites

⇒ Sufficient life insurance: the scope of life insurance depends on the scope of a person's asset structure, income, health, age, life expectancy, financial obligations and number of next of kin  
 ⇒ Housing: the monthly bond installment lowers the homeowners disposable income to such an extent that there are hardly sufficient funds left for investment in shares  
 ⇒ Installment sales and consumer: installment sales should be small in relation to the household's income, particularly because interest rates on installment sales are so high. Should not exceed 1/5<sup>th</sup> of the households net annual income, and not higher than 20% of the net monthly income  
 ⇒ Sufficient savings: a household must possess sufficient funds to meet the demands of the transaction motive and the precaution or provident motive. Funds should be retained to provide for unforeseen events.

#### Investment pitfalls and how to avoid them

Pitfall 1: Comparing the return of the investment with the purpose

⇒ Never evaluate the investment in a home only in terms of money  
 ⇒ If you rent a house, you are using your own money and you do not take out a bond. This means that your money is particularly expensive, because you do not make use of leverage financing  
 ⇒ If you use only your own money, you will also not be able to rent such a big, expensive house as you would be able to buy. Nor will you always know when the rent will be increased and by how much. You can never be certain that the house you are renting will not be sold, and if it is sold, you may have to move because you cannot enter into a contract with the new owner  
 ⇒ When you rent a home you run the risk of losing your accommodation at any time, but you do not need to pay maintenance, insurance or property tax, and there are no implications for your estate using very little of your own money. You thus receive a higher return on your money  
 ⇒ A house may be used as security for further loans and a paid-up mortgage bond may serve as a lifelong emergency fund

Pitfall 2: Misconceptions about investing in a life policy

⇒ A life policy is an asset  
 ⇒ It is a non-tangible investment that enables you to transfer your largest financial risks to an insurance company  
 ⇒ A life policy may be used in various fields of financial planning  
 ⇒ It is surely the most flexible investment instrument, because it can be used in so many ways. A policyholder may use a life policy to cover 80% of his risk, irrespective of whether he is poor, rich, earning a salary or has an own business

Pitfall 3: underestimating the negative effect of inflation

⇒ The effect of inflation can be countered if an investment produces an after-tax return that is higher than the rate of inflation  
 ⇒ Retired people or those who invest packages when they are near retirement age must allow their investments with capital growth to grow, and postpone using the income from these investments for as long as possible. By doing this they let compound interest work for them

#### Pitfall 4: Having insufficient knowledge of investment

⇒ A basic investment principle is that investments with a higher return are more risky than investments with a lower return  
 ⇒ In the case of unit trusts: a higher return could accompany a lower risk and a lower return could accompany a higher risk

#### Pitfall 5: Being uninformed about the investment criteria

⇒ Investors are not informed about the investment criteria. Compare these criteria with your financial objectives and resources before you choose an investment.  
 ⇒ Choosing a specific investment will be determined by a combination of some of the following investment criteria:

- Income
- Capital growth
- Whether the investment is safe
- Flexibility
- Liquidity
- Taxability of the investment
- Ease of management
- Risk
- Amount
- The term of the investment
- Your marginal tax rate
- Transaction costs
- Timing
- Diversification
- Control
- Knowledge/management requirements
- Inflation
- Your investment objectives

#### More pitfalls

⇒ Many people do not know the difference between investing and gambling. If you invest money for a very short period and there is a possibility that you may lose it, you are actually gambling. The investment term also determines whether you are speculating or investing. When you gamble with your investment, the term is usually very short. When you speculate the term is longer. When you invest the term will be longer still. The most important factor is your objective when making an investment  
 ⇒ It is dangerous to make an investment before you have determined: your personal financial situation; your household risks, and whether you have already made provision for them; your risk profile and your short, medium and long term financial objectives  
 ⇒ People often do not know how to choose a broker  
 ⇒ Often, income tax planning, estate planning and retirement planning are not kept in mind when an investment decision is made.  
 ⇒ The investment decision is made without taking the stage of your life cycle into account  
 ⇒ Often people do to have proper investment strategies  
 ⇒ People often go through life without empowering themselves in the field of personal finance  
 ⇒ People often invest their money without consulting a financial specialist  
 ⇒ People often decide about investments without being aware of the role of these investments in their personal financial planning  
 ⇒ Many people want to make specific investments because their rich friends have done so

- ⇒ Remember, you must protect your income, fight inflation, protect your capital and weigh up the risk and returns against your personal risk profile
- ⇒ Many people make investments without any long-term objectives in mind
- ⇒ Never allow fear to determine the type of investment you make
- ⇒ Do not allow greed to influence your investment strategy
- ⇒ Do not call up all your investment because of mass hysteria in the market

#### Types of brokers

- ⇒ People who market insurance products for insurance companies: representatives; insurance advisors; senior insurance advisors; financial advisors and senior financial advisors
- ⇒ Independent brokers and bank brokers operate outside insurance companies
- ⇒ The Financial Planning Institute FPI, 3 levels of membership: associate, ordinary member and fellow
- ⇒ Bank brokers; independent brokers; Attorneys, Accountants; Journalists and Trust companies can all provide insurance advice

#### Investment strategies for different ages

##### The young years 20-30

- ⇒ An investment with capital growth over the long term, such as an endowment policy is necessary. It is important to accumulate a deposit for a dwelling or to finance the purchase with a 100% bond
- ⇒ Take out a life policy to cover your bond from the same financial institution with the option to use the lump sum after 20 years
- ⇒ Cover your household risks by means of short term insurance and take out disability cover

##### The family years 30-40

- ⇒ Parents should maintain current investments
- ⇒ Try to increase your life coverage and make sure that you and your spouse make use of maximum tax advantages when it comes to contributions to retirement annuities.
- ⇒ Take out endowment policies for the children and invest all additional funds in your mortgage bond

##### The career years 40-50

- ⇒ More attention should be given to investments with capital growth, with a view to retirement. You can move to a smaller dwelling, if necessary
- ⇒ Your bond should be paid during this period

##### The pre-retirement years 50-60

- ⇒ All possible funds ought to be put into investments with capital growth, like property or endowment policies.
- ⇒ Contributions to pension or provident funds, retirement annuities or deferred compensation schemes should be increased

##### The retirement years 60 and over

- ⇒ Avoid risky investments and concentrate on capital growth
- ⇒ Concentrate on the protection of your hard-earned investments
- ⇒ Put some of your money into fixed deposits to earn interest
- ⇒ Guaranteed income and capital plans are recommended investments
- ⇒ Get rid of all debt

#### Investment criteria

##### Income

- ⇒ Not all investors are interested in capital growth, some want a regular fixed income
- ⇒ Potential investors who want a fixed income can invest in participation bonds. The capital is still safe, but the money must be invested on a fixed basis for 5 years
- ⇒ Fixed-interest-bearing securities or trusts offer a fixed income while repayment of the principle sum is guaranteed. Not ideal for the small investor

- ⇒ Unit trusts offer the small investor an investment opportunity, aimed at income. Income trusts
- ⇒ Unit trusts are a long term investment, and people who want money within 3 years are advised to invest in the right unit trust

#### Growth

- ⇒ Is a rise in the value of the investment
- ⇒ It is important that an investment should show capital growth in order to improve the investors cash position after the sale of the investment
- ⇒ The value of the investment should increase annually by at least as much as inflation

#### Safety of capital

- ⇒ Means that the investment must survive for as long as it pleases the investor

#### Flexibility

- ⇒ Investor must find out whether it will be possible to make adjustments to his investment at a later stage

#### Liquidity

- ⇒ Even with short-term securities, the more liquid securities will be chosen, if the investor urgently needs his cash it must be available

#### Taxability

- ⇒ People with a high taxable income will prefer investments that are particularly taxable or that yield tax free returns. High returns are played down against tax-free income

#### Ease of management

- ⇒ From a management point of view, it is advisable to evaluate investments continuously and to decide whether they should be replaced with other or similar investments.
- ⇒ The obligatory investment term will be determined when an investment can be altered
- ⇒ It is recommended that investments are discussed with an expert at least once a year

#### Risk

- ⇒ Refers to the possibility of suffering a loss

#### Return

- ⇒ Risk and return are positively correlated- when risk rises that anticipated return will also rise and visa versa.
- ⇒ A lower risk is associated with a lower anticipated return

#### Term of investment

- ⇒ If the investor may need his money in a year's time, he should not consider an investment with a long term.
- ⇒ An investment in shares requires that funds are invested over a long term, unless the shares are sold. Listed shares are fairly easily negotiable
- ⇒ Where a decline in interest rates is anticipated, it is better to make a fixed investment over a longer period.
- ⇒ Where interest rates are about to rise, the investor loses by making a fixed investment over a long term at a specific interest rate.
- ⇒ The need for money and the anticipated interest rates, therefore, lay an important role in the desirability of a specific investment term for the potential investor

#### Investors tax rate

- ⇒ An investors marginal tax rate will largely determine the kind of investment he chooses

#### Transaction costs

- ⇒ Transaction costs are paid for both the purchase and the sale of financial assets



**Timing**

- ⇒ Shares should be bought at the time the investors regards them as undervalued and sold at a time when they are regarded as overvalued
- ⇒ 'Rand cost averaging'. This means that an amount is invested on a regular basis.
- ⇒ Even if prices vary, the average costs are paid over time, are lower than they would have been in the case of once-only purchases

**Diversification**

- ⇒ Diversification means the spreading of risk over a number of investments with the purpose of lowering the total level of risk. If the risk of an investor's portfolio is already very high, he should rather choose an investment with a lower risk in order to lower the total risk of his portfolio

**Control**

- ⇒ In the case of financial assets, the investor can manage the shares portfolio himself, and undertake the buying and selling of share without the assistance of a stockbroker
- ⇒ Savings accounts or fixed deposits do not require any control on the part of the investor. An investor may, require a stockbroker to manage a shares portfolio
- ⇒ A stockbroker may be asked to take complete control over the portfolio and make all the decisions of buying and selling, or the investor may retain a measure of control

**Knowledge/management requirements**

- ⇒ A stockbroker may, be appointed to manage the portfolio.
- ⇒ Saving money in a savings account or fixed deposit, however, does not require knowledge or expertise

**Protection against inflation**

- ⇒ The pre-tax return on an investment should be higher than the inflation rate
- ⇒ An investment may also have a higher capital growth than the inflation rate.
- ⇒ Protection against inflation means the retention of the buying power of the investor's money
- ⇒ The current inflation rate makes investment on the share market essential
- ⇒ Today, an after-tax return that is higher than the inflation rate is unthinkable. Potential investors are therefore referred to the importance of the before tax investment rate, the inflation rate and particularly the investors marginal tax rate
- ⇒ Individual households have their own inflation rate, depending on their bonds and/or number of kids
- ⇒ Consumers expenditure index and not the Consumer price index should be used to calculate the actual inflation rate

**The investor's objectives**

- ⇒ The investors investment objectives will largely determine which investment criteria are the most important personally
- ⇒ These investment objectives will determine which investments he will consider and which he will avoid. A potential investors investment objectives will be determined by his: current financial position; age; physical abilities; education level; present career; relationship status; management ability; nature of income etc.
- ⇒ Both existing and potential investors should be aware of the different investment criteria

**Types of financial objectives**

- ⇒ Potential investors have several financial investments to choose from
- ⇒ Types of financial investments: money market investments and capital market investments

**The money market**

- ⇒ Bank acceptance; treasury bills; negotiable certificates of deposit; participation bonds; deposits; project bills; trade bills and money market funds

**Bank acceptances**

- ⇒ A bank acceptance is a bill of exchange issue by a business enterprise in which it undertakes to a pay a stated sum of money after a stated period. This period is usually 3 months

⇒ The bill of exchange is usually accepted by the bank, which means that the bank guarantees payment of the sum of the bill of exchange on maturity

- ⇒ The primary market: bank acceptances are issued by banks
- ⇒ The holders of bank acceptances: is that institution or individual who is entitled to a certain sum of money on a certain date
- ⇒ The secondary market: investors may sell bank acceptances of high quality in the market at any time. Bank acceptances are bought for terms of 3 years, but they may be sold within this period, although the holder will usually lose out, because the return over the short term is lower than over the long term, or because the rate of return has fallen

**Treasury bills**

- ⇒ A treasury bill is issued by the bank and is proof that the estate has borrowed money from a person or institution. The loan term is 3 months
- ⇒ Between R10 000 and R5 000 000, however the minimum amount borrowed is R100 000
- ⇒ The primary market: the SARB issues treasury bills on behalf of the estate. Loan amounts are incurred in descending order until all loan amounts are exhausted. Issued weekly with a tenure of 91 day, and special issues with a tenure of 92 to 365 days
- ⇒ Holder of treasury bills: banks, building societies, insurance companies, pension funds, mining houses, discount houses and individuals
- ⇒ The secondary market: a treasury bill is transferred merely by tendering it, unless the name of the original supplier appears on it, in which case, it must be endorsed

**Negotiable certificates of deposit**

- ⇒ Issued as an indication that funds will be paid on a stated date to the holder of the certificate.
- ⇒ Negotiable certificates of deposit are issued for periods of up to 5 years. If issued for a period of shorter than a year interest is paid at the end of the period. For periods of 1 to 5 years, interest is paid at the end of the period or every 6 months
- ⇒ The primary market: banks and building societies issue such certificates
- ⇒ The secondary market: certificates are transferable merely by tendering unless the depositors name appears on them

**Participation bonds**

- ⇒ The minimum investment amount is R1000 and the term is 5 years
- ⇒ During this period, the funds may be withdrawn, except in the case of the death or liquidation of the investor. After 5 years the money may be withdrawn or reinvested. However, 3 months notice must be given

**Deposits**

- ⇒ Deposits may be made at a bank or building society. Smaller deposits are placed in savings deposits. Fairly large amounts are called deposits on demand. The 'smaller investor' will make use of a savings account
- ⇒ A minimum amount usually has to be left in a savings account. Fixed term and notice deposits have a higher interest rate than a pure savings account
- ⇒ Trade bills, project bills, promissory notes, municipal stock and Land bank bills are all part of the money market. Investments in these instruments require very large sums of money and are not suitable for small investors
- ⇒ Investments in terms of up to 3 years are regarded as part of the money market. When a capital market instrument, with a normal tenure or term of 5 years, is sold after 2 years it becomes part of the money market

**The capital market**

- ⇒ Ordinary shares; preference shares; fixed interest bearing securities; unit trusts; property trusts; listed property companies and derivatives

**Ordinary shares**

- ⇒ An investor would have limited liability if the company was liquidated, which means that he cannot lose more than 100 % of his investment

- ⇒ An investment in ordinary shares implies that the investor puts his money at the disposal of the company for an unlimited period
- ⇒ Shares are transferable and can be traded. Ordinary shareholders may receive dividends after all fixed interest obligations and preference dividends have been paid
- ⇒ Choose companies for investment, which either pay regular dividends or which reinvest dividends-choice between income and capital growth
- ⇒ The risk is great for ordinary shareholders
  - There is no certainty that ordinary shareholders will in fact receive dividends
  - There is no judicial obligation on the company to pay back borrowed money
  - The legal obligation is to first pay interest and preference dividends from the profit
- ⇒ The high risk associated with ordinary share implies that a high return on such investments may be expected
- ⇒ Preference shares
  - ⇒ Have features of both ordinary shares and debentures. They are also called mixed forms
  - ⇒ The risk of preference shares is lower than for ordinary shares
  - ⇒ Preference dividends are paid before dividends are paid on ordinary shares
  - ⇒ Preference shares enjoy preference above ordinary shares, in the case of the company being liquidated
  - ⇒ Preference shareholders do not possess voting rights. Preference dividends are paid out after interest on capital, because preference dividends are paid out of net profit after tax, whereas interest is paid from before-tax income
  - ⇒ Preference shareholders receive a lower return than ordinary shareholders, with a lower risk attached to their investment because of the fixed obligation to pay out dividends
  - ⇒ Preference shareholders do not have voting rights and are not regarded as owners of the company
  - ⇒ Types of preference shares:
    - Fixed-interest shares; variable interest preference shares; cumulative preference shares; participation preference shares; redeemable preference shares and convertible preference shares

#### Fixed-interest-bearing securities

- ⇒ Includes: gilt-edged stock (IOU's issued by the government), semi-gilt-edged-stocks (IOU's issued by government subsidised institutions and debentures (IOU's issued by companies)
- ⇒ Gilt-edged stock: offers a 100% guarantee that all capital plus interest will be paid to the investor in gilt-edged-stocks. Investors know beforehand how much interests they are going to receive
- ⇒ Semi-gilt-edged stock: similar to gilt-edged stocks but the risk is slightly higher. Because of the higher risk, a higher interest rate is paid to investors. The risk and return can be directly linked to the financial situation of the institution
- ⇒ Debentures: a written IOU that a person or an institution receives as proof of money lent to the person or institution. A debenture-holder is actually a creditor who is entitled to his borrowed capital plus interest.
- ⇒ Normally interest is paid at the end of the borrowing period
- ⇒ The risk of IOU's is higher than in the case of gilt-edged or semi-gilt-edged stocks. A higher interest rate is, therefore paid to holders of debentures
- ⇒ Holders of debentures have no voting rights, except where interest payments are in arrears
- ⇒ Types of debentures:
  - Secured debentures- issued with assets as security
  - Unsecured debentures- no preference above other creditors in the event of liquidation
  - Guaranteed debentures- a holding company guarantees the debentures of the subsidiary company
  - Participating debentures- receive annual interest payments and also participate in surplus profits
  - Convertible debentures- holders of debentures convert their debentures to ordinary shares
  - Redeemable debentures- the company may redeem the loan before the maturity date agreed upon

#### Unit trusts

- ⇒ Method whereby fairly small investor can form part of the share market without being directly involved
- ⇒ Unit trusts are large investment portfolios that may include a variety of shares and fixed-interest bearing trusts. These portfolios are diversified, with the result that the risk for the investor or potential buyer is lower, since the law requires that each unit trust keep at least 20 different investments
- ⇒ Capital profit earned when the unit trusts are sold is taxable
- ⇒ The investor can claim repayment of his units at any stage. The price received for the units will be determined by their price at the time of repayment and not when they were bought
- ⇒ Specialists regard regular investments over fairly long periods as the only way of investing in unit trusts. Unit trusts are an ideal investment for the person on the street who uses a monthly income to invest
- ⇒ Advantages of unit trusts: liquidity; well-diversified-hedge against inflation; purchase unit-rate of return against insurance; lower costs
- ⇒ Disadvantages of unit trusts: no guarantees and rates of return, or growth rates, of the various unit trusts vary from year to year
- ⇒ Types of unit trusts:
  - General Unit trusts:
    - Invest in shares over a wide spectrum of sectors on the JSE
    - The risk is spread over a large number of investments
    - Stable medium- and long-term growth is obtained, even though dividend income is fairly low
  - Specialised unit trusts:
    - Only invest in fixed-interest-bearing assets such as gilt-edged securities, semi-gilt-edged securities and debentures. The safety of the investment amount plus interest is ensured
    - Suitable for retired people
    - It is not an investment that beats inflation or that provides capital growth the long-term
  - The choice of unit trusts:
    - Choose an industry or business sector; decide on the type of trust; determine the investment term; decide whether to reinvest dividends or not and choose a broker
    - Be aware of the fact that an investment in a certain type of unit trusts does not mean that funds need to be kept in that trust indefinitely
    - If financial risks increase, funds may be transferred from a general trust to an income trust
    - A broker has more knowledge than an insurance agent about investment unit trusts
    - There are no charges involved in the selling of the trust. An initial charge of 5% of the purchase amount is levied as well as a service charge 1/16 of 1% of the market value of the investors portfolios at the end of the month
- ⇒ Property unit trusts (PUTs)
  - ⇒ Originally created to offer investors the opportunity of investing in fixed property
  - ⇒ Advantages:
    - A small amount of money may be invested
    - Units are bought back relatively quickly if potential investors exist
    - The investment is liquid
    - The investors risk is spread
    - Investment expertise and management are obtained at relatively low charges
    - The handing over of management and administration problems to the company's management
  - ⇒ Disadvantages:
    - The income from dividends is fully taxable in the hands of the investor
    - The normal dividend release is not applicable; and
    - It is not an attractive investment for individual investors with a high marginal tax rate
- ⇒ Derivatives: options
  - ⇒ A financial instrument derived from an underlying assets or stock
  - ⇒ A contract designed to provide for the future delivery of assets
  - ⇒ Used to manage risk used mainly to reduce risk and to trade them
  - ⇒ An option is the right to buy or sell a standard amount of a specific asset on a future date at a price agreed to by the parties on drawing up the contract
  - ⇒ A future is an obligation to buy or sell a standard amount of a specified asset on a future date at a price agreed to by the parties on drawing up the contract

- ⇒ A forward is an obligation to buy or sell a specified asset o a future date at a price agreed to by the parties on drawing up the contract
- ⇒ Difference: is that a future is a standardized package is traded through an exchange, whereas a forward contract may apply to any quantity of an asset, and with any delivery date
- ⇒ Two types a call option and a put option: a call option gives the holder the right to buy the underlying asset from the writer at the exercise price and a put option gives the right to sell the underlying option to the writer at the exercise price
- ⇒ Market value= strike plus premium
- ⇒ Other types of options on stock index's: currency; interest rates; trading options and future contracts

	Call	Put
Buy (hedger)	The right to buy the underlying item at the strike price until the expiration date	The right to sell the underlying item at the strike price until the expiration date
Sell (Speculator)	Selling the right to buy the underlying item from you at the strike price until the expiration date. Known as writing as writing a call	Selling the right to sell the underlying items to you until the expiration date. Known as writing a put

#### Derivatives: Futures

- ⇒ Futures are obligations to buy or sell a specific commodity, share or even a stock index
- ⇒ An agreement to buy or sell a standard quantity and type of commodity/financial asset/ national asset on a specified future date at a price predetermined at the time of entering into the contract
- ⇒ Risk: futures- more than your investment; shares- total investment; options- premium
- ⇒ Underlying assets: future contracts are based on underlying assets, such as commodities, equities, gifts and money market instruments. The value of these underlying assets determines the value of the futures contract
- ⇒ Futures are obligations to buy or sell at a specified date, no matter the extent of the loss

#### Investment approaches

##### The fundamental approach

- ⇒ Consist of 3 main steps:
- ⇒ A macro-economic analysis, which attempts to determine and explain the state of the economy in general
- ⇒ A business sector analysis
- ⇒ An analysis of the individual company

##### Macro-economic analysis

- ⇒ This approach requires knowledge about: economic variables such as: money supply; interest rates; consumer spending and production
- ⇒ Purpose is to determine turning points
- ⇒ This analysis is out of the reach of individual investors

##### Business sector analysis

- ⇒ Aimed at determining growth potential within a business sector. This growth potential determines the investment potential of a certain business sector
- ⇒ Factors to be considered during the analysis: historical trends for sale and profit; the permanent nature of the business sector; the type of product within the business sector; competition and competitors; labour activities; and the extent of government interference.
- ⇒ Business sector analysis must be undertaken in conjunction with the current status of the economy as well as future economic trends
- ⇒ These business sectors should perform better than the general economy, especially in times of economic growth

##### Analysis of the individual company

- ⇒ A business enterprises future dividend and capital return must be determined and weighed against the risk involved in the investment in a specific enterprise
- ⇒ Financial analyses are used in this case. A financial analysis establishes a business enterprises present and future position by analyzing its annual financial statements
- ⇒ The technical Approach
- ⇒ The historical movements of share prices are analysed. Trends and patterns are investigated, in order to find guidelines on possible trends in the share price future. Technical analysis work from the point of view that patterns in share prices are recurrent by nature, because they reflect recurrent changes in investment sentiment
- ⇒ The Dow theory is aimed exclusively at forecasting trends in the share market as a whole
- ⇒ Analysts who use the technical approach attempt to understand the 'psychology of the market'
- ⇒ This approach can never be used in isolation for investments in the share market
- ⇒ Examples: moving average; on balance volume; relative strength index; momentum and relative strength graphs
- ⇒ The fundamental v the technical approach:
- ⇒ The technical approach is more of a guideline for short-term investment- speculation, where the investor utilizes surplus of supply and demand to his own advantage.
- ⇒ The fundamental approach is more suitable for long-term investments
- ⇒ Individual investors do not have the ability to use the technical approach gives an indication of a possible swing or revolution in share prices. The fundamental approach cannot identify turning points but it can identify under and/or overvalued shares

#### The modern portfolio approach

- ⇒ Previous approaches are called traditional approaches. The emphasis is mainly on the price of shares and earnings per share. Return on investment is the most important factor
- ⇒ The modern approach does not look at return only but at the combination of risk and return. Risk is the chance of suffering a loss or a variation in the anticipated return
- ⇒ Investors should keep the risk of their portfolio in mind. They should attempt to put together an effective portfolio. An effective portfolio can be described as:
  - A selection of a variety of investments that maximize return for a certain risk level and minimize the risk involved for a specific return

#### The main functions of the JSE

- ⇒ Provides a place where securities can be marketed
- ⇒ Decides who may become members and who may make use of its facilities
- ⇒ Establishes rules to be adhered to during transactions
- ⇒ Assists with the settlement of disputes about transactions
- ⇒ Distributes information on prices and transactions of securities
- ⇒ Two groups of transactions: investment transactions (main purpose is to invest money to earn income) and speculative transactions (main purpose is to make capital profit)

#### Valuation methods

##### The valuation of ordinary shares

- ⇒ Valuation is the process whereby risk and reward factors are distributed to a share in order to determine its value
- ⇒ 4 methods of determining the value of shares

##### The basic valuation model

- ⇒ Used to determine the value of an investment. This model calculates the present value of the sum of all net cash inflow (dividends) anticipate over the investment term  $V = I/C$
- ⇒ It is not easy to determine anticipated dividends in the case of ordinary shares: there is no certainty that a dividend will be received in a certain year, the size of the anticipated dividend is difficult to determine; circumstances could compel the company to reinvest all retained profit
- ⇒ The intrinsic value of the ordinary shares may be calculated by means of 3 models:
  - The zero growth model (when no growth is forecast for anticipated dividends)
  - The constant growth model (that dividends will grow annually at a constant rate)

- The variable growth model (where the dividend growth rate changes annually)

#### The book value method

- ⇒ The value of a share is the value indicated in the financial statements. This value can never be regarded as the actual market value of a share

#### The liquidation value method

- ⇒ Is the actual amount each ordinary shareholder will receive:
- ⇒ If the assets of the company are sold
- ⇒ After creditors and preference shareholders have been paid
- ⇒ The remaining money is distributed among the ordinary shareholders
- ⇒ More realistic for determining market value, but does not make the earning capacity of the company's assets into consideration

#### The price-earnings multiplier

- ⇒ Used to value a share by multiplying the anticipated earnings per share by the average price-earnings ratio of the relevant business sector
- ⇒ This method is preferred above the book value of the liquidation method, because it is based on future earnings

#### The valuation of preference shares

- ⇒ The same calculation (the basic valuation model) is used to determine the present value of a preference share. The calculation is simplified by:
- ⇒ A preference dividend is paid annually, except in the case of cumulative preference shares; and this dividend is paid even if ordinary shareholder do not receive any dividends
- ⇒ The zero growth model is recommended for the valuation of preference shares

#### The valuation of debentures

- ⇒ The value of debentures is the present value of all annual income (interest) that the investor is entitled to receive from the borrower in terms of the contract
- ⇒ This borrowed amount is called the face value or issue value of the debenture
- ⇒ The company pays annual interest to the holders of debentures according to a declared rate
- ⇒ The basic valuation model for debentures is:
  - $B_0 = I(PVIFA_{k,n}) + M(PVIF_{k,n})$
  - $B_0$  = the market value
  - $I$  = the coupon rate
  - $PVIFA$  = the present value interest factor for the annuity
  - $M$  = issue value
  - $PVIF$  = the present value interest factor for a lump sum
  - $K$  = the discount rate

#### The face value or issue value (par value)

- ⇒ The face value is the value that the borrower promises to pay on the redemption rate, and is independent of market value
- ⇒ Market value here refers to the price at which the debentures will be traded

#### The coupon rate

- ⇒ The interest amount is expressed as a percentage of the face value

#### The rate of return

- ⇒ Is the rate earned on the current market price, and varies as the market fluctuates. If the market price or market value is lower than the face value (par value), the debenture trades at a discount and the rate of return is higher than the coupon rate. If the market value is higher than the face value, the debenture trades at a premium and the rate of return is lower than the coupon rate
- ⇒ The influence that market interest rates exercise varies according to: the redemption term; rates of return and coupon rate

- ⇒ Investors are advised to pay attention to some guidelines and the associated strategies in respect of debentures:

- Guideline 1: for a given change in interest rate, the price of a debenture with a longer period before maturity date varies more than that of a debenture with a shorter redemption period
- Investment strategy- recommended that a debenture with a long redemption period should be bought when a decline in interest rate is anticipated
- Guideline 2, as the redemption date becomes longer, the decline in the market price of a debenture becomes progressively less as a result of an increase in interest rates
- Investment strategy- when market interest rates decline, a debenture should be sold as quickly as possible, because the largest price increases occur within a short period
- Guideline 3: the market price of debentures with a lower coupon rates vary to a greater extent when changes take place in market interest rates than do those of debentures with high coupon rates
- Investment strategy- when a rise in market interest rates is anticipated, debentures with a high coupon rate should be bought. The important factor is the market price and not the interest that will be received
- Guideline 4: the higher the market interest rates, the greater the change in the market price of debentures for a specific change in market interest rates
- Investment strategy- buy debentures when a decline from a high level in market interest rates is anticipated, since this will result in a large increase in the market price

#### Risk

##### Probability and anticipated return

- ⇒ Probabilities may be used to determine the risk attached to a share
- ⇒ A probability distribution:
  - $P \cdot R = P \times R = (R) =$  anticipated rate of return
  - $P =$  probability that a certain return will be realized
  - $R =$  the rate of return
- ⇒ Add up the anticipated rate of return to get the overall probability distribution
- ⇒  $R = PI + DIV / PO \times 100$
- ⇒  $DIV =$  dividends anticipated;  $PI =$  selling price of the share at the end of the term;  $PO =$  expressed as a % of the original investment

##### Standard deviation

- ⇒ The larger the share's standard deviation, the greater the risk.
- ⇒ The standard deviation measure the average deviation of the anticipated return

##### Coefficient of variation CV

- ⇒  $V =$  Standard deviation/ (R)
- ⇒  $(R) =$  anticipated rate of return
- ⇒ The larger the CV of a share, the greater the risk involved

##### Standard deviation v CV

- ⇒ The standard deviation is an absolute criterion of risk- it is only used to calculate the risk involved in a share without taking the anticipated return into account
- ⇒ The CV is a relative criterion of risk- it is used to calculate risk relative to the anticipated return
- ⇒ The smaller the Standard deviation the smaller the risk

#### Buying of shares

##### Factors to be considered

- ⇒ Your investment objective
- ⇒ The type of business sector
- ⇒ The type of business enterprise
- ⇒ The type of share
- ⇒ The right time to buy

- ⇒ The costs involved- basic charge, brokerage and Marketable Tax Securities( only on buying)
- ⇒ The composition of your shares portfolio
- ⇒ An annual revision of your portfolio; and
- ⇒ Your choice of broker

#### Motivation for an Investment in shares

- ⇒ An investor can sell his shares in a fairly short period and convert such investments into cash
- ⇒ The value of shares rises at a faster rate than the inflation rate
- ⇒ A regular income may be received in the form of dividends
- ⇒ Dividends in the hands of investors are tax free at present
- ⇒ Investors interested in capital growth can reinvest their dividends
- ⇒ Direct investment in shares: buying on the JSE
- ⇒ Indirect investment in shares: Unit trusts or property trusts are used

#### Which shares to buy?

- ⇒ Examine the company's growth performance over the past 5 years
- ⇒ The company management must be leaders in the market who set the pace for new developments
- ⇒ Those who seek winning shares must accept that this process requires hard work and is very-time consuming
- ⇒ Investors should attempt to buy shares that will limit possible losses by means of effective portfolio management
- ⇒ Long term investors in shares should buy immediately, whereas speculators should buy shares on which they can make a profit when they sell them

#### Setting up a shares portfolio

- ⇒ Choose shares on the basis of dividend growth rather than short-term capital appreciation
- ⇒ Choose a minimum of 10 shares, in order to spread the risk
- ⇒ The amount invested in each should be more or less equal
- ⇒ The portfolio should remain unchanged for at least 1 year
- ⇒ From the 2<sup>nd</sup> year, the portfolio should be revised annually
- ⇒ A minimum of transactions should take place
- ⇒ Profit should only be taken if the market value of the share is at least 50% higher than the average market value of the portfolio
- ⇒ Shares should only be sold in emergencies
- ⇒ Dividends and interest should be reinvested, preferably in shares already included in the portfolio
- ⇒ The primary purpose of the portfolio should be never to sell a share if at all possible
- ⇒ During reinvestment, the share in the portfolio with the best prospects for long-term dividend growth should be chosen
- ⇒ Access all investments and anticipated results over the long term
- ⇒ Build up your own expertise in order to manage your share portfolio
- ⇒ Do to expect to become wealthy over night
- ⇒ Do not try to manage your own shares portfolio if you are a novice
- ⇒ Do not attempt to manage your own shares portfolio if you do not have sufficient time
- ⇒ Do not try to speculate if you do not have a computer
- ⇒ Do not try to speculate if you do not receive up-to-date, daily information about the closing price of shares
- ⇒ Do not buy shares blindly
- ⇒ Do not borrow money to buy shares
- ⇒ Do not participate in panic selling
- ⇒ Do try to buy only quality shares
- ⇒ Do work hard and spend enough time on research
- ⇒ Do invest in the stronger companies in growth sectors

#### Share prices in newspapers

- ⇒ High- the highest share price for the year

- ⇒ Low- the lowest share price for the year
- ⇒ Last sale- the last sale price paid for a share the previous day
- ⇒ Buy- the last offer made the previous day for buyers
- ⇒ Sell- the last price charged by a seller the previous day
- ⇒ 1v%- the dividend which shareholders were paid as a % of the nominal share value
- ⇒ Dividend return- the dividend return on the actual price the investor pays
- ⇒ Price-earnings ratio- price: earnings
- ⇒ Rise/fall- whether the last selling price is higher or lower than the previous day
- ⇒ Vol- this shows the number of shares sold weekly or monthly

#### The Economic indicators

- ⇒ The gold price: a rise in the gold price results in a rise in government revenue as well as that of the gold mines. More money is consequently available for the economy
- ⇒ The rand/dollar exchange rate:
- ⇒ the bank acceptance rate: when this rate drops and the trend continues, a drop in short term rates can be expected
- ⇒ Capital market rates: a rise in capital market rates is an indicator of a rise in interest rates over the long run
- ⇒ The gold index: is calculated by adding the market price of a number of selected gold shares and determining the average value of the shares
- ⇒ The industrial index: same way as gold index
- ⇒ The consumer price index: inflation rate

#### The economic cycle- your investment cycle

##### Industries and the economic cycle

- ⇒ The South African economy has a direct influence on the return you get on your investment. In particular the specific investment instrument in which you invest your money
- ⇒ Growth industries: e.g. computers. The financial sector and electronics will usually perform well, irrespective of the state of the economy
- ⇒ Defensive industries: the economic cycle has very little effect- food, beverage and financial services industries
- ⇒ Cyclical industries: the economic cycle has the biggest influence on the cyclical industries, which include durable goods such as cars and furniture
- ⇒ Interest rate sensitive industries: are largely affected by expectations of rising or declining interest rates- building and property industry
- ⇒ Rand-Hedging industries: invest in an industry to protect your investment against the depreciation of the value of the rand. Income is usually received as a foreign currency

##### Investments during the different phases of the economic cycle

###### Economic recovery

- ⇒ Short-term interest rates are at a low, invest particularly in commodities (metal and minerals), because of increased demand during the next economic phase

###### Economic upswing

- ⇒ Investors usually sell government securities, shares and property. Short-term interest rates rise, the inflation rate begins to rise too and company profits decrease. New businesses are established and more people are employed

###### Economic downswing

- ⇒ Commodities are sold because of an expected drop in demand. Short term interest rates are very high and government securities are bought, because a drop in short-term interest rates and a recession are expected

###### Recession

- ⇒ A recession causes negative economic growth. Short term interest rates drop and investors buy mostly shares and property

- ⇒ You should know the state of the economy, the current state and which stage in the economic cycle is expected to follow.

⇒ Know the different types of industry and how they react to a specific stages in the economic cycle

#### Investment and life stages

- ⇒ **Youth:** 20-30. Learn financial discipline. Funds should be invested for capital growth. Risky investments are recommended because of your age and number of years before retirement. Invest in property, unit trusts and shares
- ⇒ **The family years:** 30-40. Invest for capital growth with a view to your children's future financial needs
- ⇒ **The career years:** 40-50. Invest for retirement. Investments for capital growth are still recommended
- ⇒ **The years before retirement:** 50-55. Investments for capital growth should now be less risky. Increase your annuities and diversify your investment
- ⇒ **The years of retirement (an afterwards):** 55+. Void risky investments but concentrate on capital growth if your income needs permit it. Pay off your debts and manage your credit. Protect your investments against inflation.

#### Study unit 12: Buying a residence

- ⇒ 2 main risks involved in buying a house:
  - Operating risk- the factors affecting the value of the house are of such a nature that the value of the house may be lower than the investor paid for it
  - Financial risk- the need to borrow money and the numerous obligations and costs involved in buying property

#### Motivation for buying a house

- ⇒ **Self and family orientated needs:** a place to live, the safety of the family; independence and freedom; creativity; adventure; the expansion of knowledge; peace of mind and emotional factors
- ⇒ **Economic factors:** buyer's credit position improves; amortization; appreciation; peace of mind
- ⇒ **Group-oriented needs:** usually revolve around person's position in the community and his or her participation in the community and his or her participation in politics
- ⇒ Having a position in the community implies that the person is a respectable resident; shares in the interests of the community and has a positive attitude about the area
- ⇒ Political participation by a homeowner may lead to participation in the interests of the community and public support
- ⇒ **Other motivations:** they are transferred to another own; the need a larger house; they have bought a new house before the old one has been sold; divorce; the prospects of a more profitable investment and insolvency

#### Valuation of a house

##### Factors that determine the value of the house

- ⇒ **Physical features:** the size and slope of the site should be viewed, and the potential buyer should find out about the municipal services available. Note should be taken of the important features of the house such as size, finish, quality of construction and age
- ⇒ **Location:** particular attention should be paid to the convenience and exposure network
- ⇒ The convenience network is related to such aspects such as proximity of shopping centers, schools, churches, freeways and recreation grounds
- ⇒ The exposure network refers to sensory factors that affect living in a house such as sound, smell and sight
- ⇒ **Institutional factors:** refer to private and public legal circumscriptions – what rights you have as the owner of the property or house
- ⇒ Public legal circumscriptions refers to the control exercised by government in the interest of the public- includes taxes, control measures and expropriation
- ⇒ Over capitalization usually occurs when homeowners like their residential area and decide to build onto the house in view of retiring there, and then shortly afterwards have to transfer and sell for less than the renovation costs

##### Assessing the price of a house

- ⇒ The method of comparable selling
- ⇒ Determines the value or price of a house according to the house or property market

⇒ The method of comparable selling prices is also referred to as the market approach

⇒ The principle of substitution is applicable- a buyer or investor would not be prepared more for a property than the amount for which he could buy a similar property. In comparing the selling price of the 2 houses particular attention should be paid to the factors determining the value, the bona fide status of the sale transaction; the date of the sale; the nature of the sales transaction and what was purchased

⇒ The market value is compared with the investment value of the house. Market value represents the maximum price that should be paid. If the market value is higher than the investment value, the house must be bought at investment value or not at all. If the market value is considerably lower than the investment value, a buyer should not pay more than the market value

#### The income method

#### The cost method

- ⇒ **Cost implications of the registration procedure of deeds if transfer and mortgage bonds**
- ⇒ The registration of deeds is the legal process that puts into effect the objectives of preceding legal actions regarding the registerable immovable property
- ⇒ S 16 of the deeds registries act provides that ownership of property may be transferred from one person to another only by means of a deed of transfer signed and attested by the registrar
- ⇒ A deed of transfer is a document that states the facts of transaction in which property is sold and that the transferee is entitled to the property.
- ⇒ The primary aim of the registration system is to inform the public on the property right as well as the limited real rights over property

#### The role of the conveyancer

- ⇒ The cancellation of an existing mortgage bond on a house and the registration of a new mortgage bond are handled by a conveyancer of the financial institution concerned. The conveyancer is also responsible for lodging the deed of transfer at the deeds office

#### The role of the estate agent

- ⇒ Estate agents must inform both the buyer and the seller of the financial implications of guarantees by the other party, parties with whom these parties have already concluded contracts or are about to conclude contracts, and about financial institutions that have or are about to grant mortgage bonds
- ⇒ A financial institution will guarantee that in the case of a cash sale, the purchase sum will be available in cash on the registration date. Otherwise the institution will guarantee that either the cash deposit or mortgage bond amount will be available or both will be available on the registration date
- ⇒ Guarantees are not issued when a financial institution grants a mortgage loan or when the financial institutions conveyancer is instructed to undertake the registration of the mortgage bond. The guarantee is issued after the conveyancer has sent a copy of the deed of transfer in the name of the buyer to the financial institution conveyancer and provided him with certain information

#### Cost items related to buying a house

- ⇒ **Transfer duty**
- ⇒ **Conveyancing costs:** levied for the transfer of immovable property from one person to another. The amount payable is prescribed by legislation
- ⇒ **Occupational interest:** the buyer pays occupational interest if she occupies the house before transfer has been registered in her name, the owner has to pay municipal rates on the date of transfer, irrespective who is occupying the property at that stage
- ⇒ **Loss of interest on capital:** buyer does not supply the cash before the date of registration so that he earns interest on capital up to that date
- ⇒ **Estate agents commission:** the seller is normally responsible for paying the estate agents commission, unless he buyer acts as principal for the estate agent. The estate agency receive the commission due after the seller has received the purchase price
- ⇒ **Deeds office registration**
- ⇒ **Rates and taxes**
- ⇒ **Rates clearance certificate**
- ⇒ **Valuation costs:** a potential buyer may voluntarily have a house valued in order to determine its market price. These costs are compulsory if a person makes use of a mortgage bond

- ⇒ Moving expenses
  - ⇒ Telephone installation costs
  - ⇒ Water and electricity
  - ⇒ Additional improvements
  - ⇒ Costs relating to a bond
  - ⇒ Deposit: usually 10% of the purchase price
  - ⇒ Bank initiation and administration fee
  - ⇒ Bond installments
  - ⇒ Bond registration costs: consist mainly of the amount paid to the attorney of the financial institution. A notarial bond may also be registered over immovable property
  - ⇒ Inspection fee
  - ⇒ Interim interest: the buyers first installment is often only payable in the following month.
  - ⇒ Registration and the date of payment of the first installment
  - ⇒ Levy commission with regard to mortgage bonds and collateral security: commission on a loan is a negotiated % of the loan amount charged by financial institutions when funds are in short supply
  - ⇒ Homeowners insurance policy: provides protection to the security of the mortgagor
  - ⇒ Decreasing term life insurance policy: is also called a mortgage protection policy. This policy ensures that, in the case of death or permanent disability, the amount owing on a mortgage bond is paid and the next of kin of the deceased will own a house without a mortgage over it
  - ⇒ An endorsement policy may also be taken out instead of a term policy.
- The estate agent**
- ⇒ An estate agent is someone who represents buyers and sellers in order to serve their interests during the conclusion of buying and selling transactions
  - ⇒ To become an estate agent, you have to meet the requirement set by the Estate Agency Affairs Board
  - ⇒ "any person who, for the application of gain, on his own account or in partnership, in any manner beholds himself out as a person who, directly or indirectly advertises that he, on the instruction or on behalf of another person, performs the following acts in respect of immovable property, an interest in immovable property or business undertaking:
    - Sells or purchases
    - Negotiates sellers or purchasers
    - Canvasses sellers or purchasers
    - Undertakes or offers to canvass sellers or purchasers
    - Lets or hires
    - Negotiates to let or hire
    - Canvasses sellers or purchasers
    - Undertakes or offers to canvass lessor or lessees
    - Collects or receives any moneys payable on account of a lease"

### **Estate Agency Affairs Board EAAB**

- ⇒ The aim of the board is to promote and maintain the professional integrity of estate agents
- ⇒ 2 aspects connected with this aim: to protect the public in their dealings with estate agents by ensuring that persons subject to certain disqualifications do not practice as estate agents and to safeguard the money entrusted to estate agents by the public; to regulate the affairs and activities of estate agents by defining their rights and responsibilities clearly by means of a code of conduct
- ⇒ An estate agents Fidelity fund was established to reimburse persons who suffer pecuniary loss as a result of theft by an estate agent of certain money or property entrusted to him, or failure by an estate agent to open and keep a trust account
- ⇒ A person wishing to claim against the fidelity fund must prove that the estate agent who was responsible for the financial loss complies with the definition of an estate agent
- ⇒ An estate agency must take out fidelity insurance in respect of every person employed by the agency irrespective of his capacity
- ⇒ An estate agency protects itself in its capacity as an employer against theft by its employees

### **Position of trust: relationship between estate agent and principle**

- ⇒ Unless otherwise agreed, an estate agent is under no obligation to: conduct negotiations for the purchase; ensure that the agreement of sale is finalised and executed; establish a valid agreement of sale; canvass buyers; or introduce a buyer when the opportunity presents itself
- ⇒ The obligation of good faith is based on the position of trust existing between the estate agent and his principal. This obligation places the responsibility on the estate agent to:
  - To serve the interests of his principal
  - To ensure that his own interests are not in conflict with his obligations
  - Not to make any secret profit
  - Not to be negligent
  - To carry out the power of attorney personally, and
  - To maintain professional and ethical standards
  - To avoid conflicts of interest
- ⇒ A voidable clause does not exclude liability for false statements
- ⇒ Negligent statements are statements that no reasonable estate agent would make under similar circumstances
- ⇒ A buyer cannot hold an estate agent liable for contractual damages, as no contract or mandate exists between them (unless the estate agent acts on behalf of the buyer)
- ⇒ Whether an estate agent would be liable for damages as a result of not disclosing certain information: was the agent under an obligation to disclose certain information? Did the estate agent fail to take reasonable steps in order to determine the true state of affairs?
- ⇒ Intermediaries are go-betweens who do not buy and sell goods for their own account- their sole aim is to bring manufacturers and retailers together
  - Brokers are not sales orientated to the same extent as commercial agents. Their service is more limited and they are normally used on account of their specialist knowledge and experience. A broker only rings the buyer and marketer of goods and services together
  - A commercial agent is a person, such as estate agents, who receives commission as a primary source of income

### **Service rendered by estate agents**

#### **Primary services**

- ⇒ Finding a buyer for, or seller of, immovable property or an interest in immovable property
- ⇒ Finding a lease for, or lessor of, immovable property or an interest in immovable property; and
- ⇒ Finding a buyer for, or seller of, or lease for, or lessor of, a business concern
- ⇒ An estate agents function is to canvass a potential buyer, introduce the buyer to the canvassed property, supply information on the property in order that he may decide whether to purchase or not, assist the potential buyer in drawing up the offer to a seller should he decide to purchase, arrange financing, present the offer to the seller and advise the potential buyer about the acceptance or non-acceptance thereof

#### **Secondary services**

- ⇒ Support primary services
- ⇒ Determining the market value of the property
- ⇒ Advising on property investments
- ⇒ Advising on raising finances
- ⇒ Advising on property development

#### **Roles estate agents play**

- ⇒ Rendering a services to meet the requirements of buyers and sellers, following up these services and keeping both parties informed
- ⇒ Encouraging both parties to accept current market trends in a positive way, by informing them on a factual basis
- ⇒ Convincing both parties to accept that their actions are in the interest of both parties
- ⇒ Leading the buyer and the seller to an agreement on the strength of their advice
- ⇒ Building a good reputation by means of references and testimonials from satisfied buyers, sellers and previous employers
- ⇒ Estate agents are also required to carry out this 10 point plan:
  1. Develop thorough knowledge of all activities related to their area of work
  2. Keep records of all purchase transactions irrespective of who was responsible for the transaction

3. Always provide potential buyers and sellers with a reliable market analysis
  4. Have knowledge of codes of conduct and codes of ethics
  5. Provide effective guidance when entering into the agreement of sale by informing the parties on the meaning of various clauses
  6. Ensure that properties are listed at market related prices
  7. Learn how to relate the requirements of sellers and buyers to their financial position
  8. Develop the ability to determine the real buying and selling motives
  9. Make both parties feel that their interests are being served on an equal basis
  10. Obtain the maximum information regarding properties from other sources
- ⇒ 5 factors that determine the marketability of a house: area; condition; price; terms and the seller's motive
- ⇒ 4 steps to help sellers reach their goals: identify the seller problem; understand the seller's problem; identify the problem and solve the problem
- ⇒ An estate agent 'qualifies' a buyer by asking the right questions: buyers preferences, motives, time and financial constraints, family requirements etc.

#### Commission

- ⇒ The party on whose behalf the estate agent acts is liable for the payment of the commission. The payment of commission is determined contractually by the parties
- ⇒ An estate agent is entitled to commission when the services rendered to a buyer or seller actually lead to the conclusion of an agreement of sale between the parties
- ⇒ When the seller acts as principal, the service the estate agent must render is the presentation of a buyer who is ready, willing and able to buy. The buyer must be contractually capable and financially capable before he can qualify as a buyer. The event is the conclusion of a binding agreement between the buyer and the seller. Commission is payable from the proceeds of the purchase price. The same applies when the buyer acts as a principal except the buyer need not be financially capable of buying after the estate agent has found a property that meets the buyer's requirements. The buyer is liable for the payment of the estate agents commission irrespective of whether he is financially capable of buying

#### The contract

- ⇒ Is an agreement that indicates that the persons concluding it intend binding themselves to certain obligations
- ⇒ An obligation is a legal relationship between 2 or more persons, according to which one is entitled to a performance, while the other is bound to a performance
- ⇒ A mandate is established between an estate agent and a principal immediately the agent accepts the mandate from the principal to render a specified service to the principal

#### Sole mandate

- ⇒ Is concluded between an estate agent and a seller whereby the seller appoints one estate agent exclusively for a limited period agreed upon to sell a property, thereby excluding other estate agents and himself from the act of selling
- ⇒ It is not worthwhile entering into a sole mandate for too short a period where there is no urgency to sell; where the selling price is unrealistically high under the current market conditions; where there is an over-supply of houses
- ⇒ A sole mandate for relatively long period will not be worthwhile from the seller's point of view where the sale of the house is urgent; where the seller drops an initially high selling price and decides to accept the market prices; and where other estate agents have already exposed the house to the market over a fairly long period
- ⇒ Advantages of a sole mandate:
- an estate agent will make a more concerted effort to convince potential buyers of the value of the seller's house, compared with other houses
  - because of the single communication channel, the seller will know which estate agent is arriving to show his house
  - disputes with other estate agents about commission will be eliminated
  - if all efforts to sell the house are unsuccessful, an estate agent will approach another agent to assist and come to an agreement to share the commission
  - an estate agent will not spread rumors about why a buyer cannot be found for the property

#### An open mandate

- ⇒ does not involve an agreement between an estate agent and a principal; it merely refers to the fact that any agent may sell a seller's house
- ⇒ the seller is liable for paying the agent who sells the house commission

#### A multi-mandate

- ⇒ the listing of a property made available in terms of an agreement with more than one estate agent or various estate agencies

#### Requirements for a legally binding contract

- ⇒ the parties must have contractual capacity; there must be a meeting of the minds between the parties; there must be a state of juridical and physical feasibility and the contract must comply with all formalities
- ⇒ An offer: buyer makes an offer to the seller which invites the seller to respond to a particular suggestion concerning the conclusion of a contract between them
- ⇒ Acceptance: instead of accepting an offer, a seller may make a counteroffer and wait for the buyer's acceptance. If this offer is accepted, a legal contract may be formed between the parties
- ⇒ A buyer or seller may withdraw an offer regarding the purchase or sale of a house before acceptance
- ⇒ An offer may only be accepted by the person to whom it is addressed
- ⇒ An acceptance means that the person who received the offer has expressed his intention and declared his absolute consent to the proposal
- ⇒ Legal feasibility: the contract must not be in conflict with the provisions of legislation or the common law
- ⇒ Physical feasibility: the subject of the contract must be possible
- ⇒ Objective impossibility: natural disaster make performance impossible
- ⇒ Subjective impossibility: of performance exists where it is not impossible for both parties to perform
- ⇒ A contract must be in writing!
- ⇒ The requirements of recording and signing and alienation of deed in writing do not apply to the sale of land by public auction, unless the purchase price or any other money is payable in more than 2 installments over a period of more than 1 year

#### Three requirements of a purchase contract

- ⇒ Both parties must have the intention to purchase and sell, and the buyer must receive the use and enjoyment of and powers of disposal over the subject of the purchase
- ⇒ The property to be sold must be described in the purchase contract in such a way that the buyer knows which house he will be purchasing from the seller
- ⇒ The parties must agree on the purchase price

#### Contractual clauses

- ⇒ Latent defects in the property of which the seller was unaware
- ⇒ Patent defects are defect that would be noticed by the normal actions of a person
- ⇒ Voetstoets- a seller gives the buyer an implied guarantee that the property does not have latent defects
- ⇒ The alienation deeds is a contract which stipulate that a residential plot is being sold and that repayment will take place in more than 2 installments over a period exceeding a year
- ⇒ A condition is suspensive when the commencement of the intended operation of a contract depends on something that must happen in the future or that must not happen
- ⇒ Resolutive condition is the opposite- one the condition has been fulfilled, the existing right or obligation will terminate

#### An option

- ⇒ An offer the purchase or sell property, coupled to an agreement not to revoke this offer for a certain period
- ⇒ Two parts: a general offer to purchase or sell property, which has to comply with the usual requirements for an offer in general; and an agreement to reserve the offer for a specific period of time



- ⇒ An option must clearly stipulate the specific property, the price and information regarding the relevant properties
- ⇒ An option is exercised by the unconditional acceptance of the offer to purchase or to sell
- ⇒ The acceptance must be in writing and signed by both parties concerned, or by the agent who signs with the written permission of one of the parties
- ⇒ If a tenant who signed a lease with the option to purchase, eventually purchases the property, the lessor is responsible for paying the agent's commission

#### Right of first refusal

- ⇒ A person obtains the right from the owner of the property, should the owner wish to sell, to be granted to first opportunity to purchase the property
- ⇒ The holder of a right of first refusal is not obliged to purchase should the opportunity arise. The owner is not obliged to sell the property to the holder, but is merely obliged to give the holder the first opportunity to purchase, should the seller come to such a decision

#### Raising finance for the purchase of a house

- ⇒ Cash; partly cash, balance by means of a mortgage bond; jointly cash, balance in installments; joint property rights and 100% mortgage bonds

#### Partly cash, balance in installments

##### Benefits for the buyer:

- ⇒ The buyer enters the property market with little initial cash
- ⇒ The buyer becomes the owner instead of the lessee
- ⇒ The contract may be adapted with the aid of the seller to suit the financial ability and requirements of the buyer

##### Benefits for the seller:

- ⇒ If the responsibility for the maintenance of the house rests with the buyer
- ⇒ If the buyer cannot continue payment at a later stage, the house will still be registered in the name of the seller
- ⇒ The seller receives a cash deposit when the agreement is concluded- a faster process than in the case of a normal transfer
- ⇒ This sales method lends itself to tax benefits

##### Requirements:

- ⇒ A minimum of 2 installments are required
- ⇒ A cash deposit has to be paid
- ⇒ An interest rate must be indicated
- ⇒ The date of conclusion must be indicated

#### Long-term financing instruments

- ⇒ A financial instrument is a written contract which states the relationship between a provider of funds and a borrower of funds
- ⇒ Financial instruments for financing immovable property: a mortgage bond and a contract for the alienation of land in installments

#### A mortgage bond

- ⇒ Is a legal action through which property is pledged in order to obtain a loan
- ⇒ A conveyancer is someone who is authorized in terms of the deeds registries act to draw up deeds of transfer and mortgage bonds in the province in which the deeds office is situated
- ⇒ A deeds office is the government office where mortgage deeds and deeds of transfer are registered
- ⇒ A mortgage deed is a document stating the legal act between the mortgagor and the mortgagee.
- ⇒ A mortgage is the right which one person has in and over another person's property and which serves as security for the mortgagor's obligation towards the mortgagee. The right is secured by a mortgage deed on the debtors immovable property by the mortgagor
- ⇒ The effects of a real right in the mortgaged property are the isolation the property as the subject of attachment in the event of default of payment, as well as the granting of a preferential right in the event of the buyer or seller becoming insolvent

#### Types of mortgage bond:

- ⇒ A first bond: contains all the features of a mortgage bond as well as those of a special bond, since a specific property is mortgaged
- ⇒ A covering bond: secures a debt to be incurred at a future date, contrary to the normal bonds which serve as security for funds borrowed before or after registration of the mortgage deed
- ⇒ Endowment policy option: a bond is linked to an endowment policy. The monthly installment redeems only the interest, while the capital sum is used to take out an endowment policy in the name of the insured
- ⇒ Unit trust linked bond: the capital expenditure portion of the premiums is linked to a unit trust
- ⇒ The access choice: with this bond, the mortgagor has the opportunity to use the paid-off amount at any stage

#### A contract for the alienation of land in installments

- ⇒ Alienate means sell, exchange or donate
- ⇒ An alienation deed is the written agreement embodying the alienation contract
- ⇒ Land, for the purposes of contract for the sale of land in installments, involves land used or intended to be used for dwelling purposes only, and does not include agricultural land or land kept in trust by the minister for the state for any person
- ⇒ The sale of land in installments has the following benefits for the seller:
  - The land can be repossessed fairly easy and quickly if the buyer defaults
  - Transactions can be finalised relatively quickly because delays in financing for the buyers are to a great extent eliminated
  - Un-proclaimed even can be sold
- ⇒ A buyer gains the following benefits:
  - Occupation of and control over the property may be obtained in the absence of an initial cash repayment of the purchase sum
  - The buyer can build up sufficient capital to enable him to apply for a mortgage.

#### Sources of long-term financing

- ⇒ Deposit-taking institutions
- ⇒ Mutual building societies- may grant housing, business or a general advance
- ⇒ Insurance companies
- ⇒ Pension and provident funds
- ⇒ Participation bond schemes
- ⇒ Employer
- ⇒ Seller
- ⇒ Family
- ⇒ State housing subsidy schemes

#### Practical steps: home buying

- ⇒ How much can I afford?
- ⇒ How much do I qualify for? (30% installments of your joint annual income)
- ⇒ Your household budget
- ⇒ House-hunting
- ⇒ Calculating all the cost items
- ⇒ The offer to purchase
- ⇒ Choosing a home loan: decide on a bank; method of payment
- ⇒ Apply for a home loan- via a estate agent or attorney; financial institution or internet
- ⇒ The processing of the application: bank- attorney- attorney-bank
- ⇒ The legal work
- ⇒ Payment of deposit and other legal cost
- ⇒ The deeds office
- ⇒ Attorney advises bank
- ⇒ You are the new home owner!
- ⇒ Build or buy?
- ⇒ Protection against defects in a new house: the National Home Builders Registration Council

- ⇒ Renovating
- ⇒ Security
- ⇒ Squatting
- ⇒ different ways to home ownership
- ⇒ paying off your bond
- ⇒ living together- draw up a cohabitation agreement
- ⇒ Divorce- and the house...

**Practical steps: Selling your house**

- ⇒ Your costs
- ⇒ The estate agents
- ⇒ The selling price
- ⇒ Preparing your house: interior and exterior
- ⇒ Show days
- ⇒ Receiving an offer to purchase
- ⇒ Appointing a transferring attorney
- ⇒ The cancelling attorney: cancels the existing mortgage bond
- ⇒ Final costs: commission and cancellation fee

**Practical steps: moving house**

- ⇒ Supply purchaser with your new residential details
- ⇒ Inform creditors
- ⇒ disconnect telephone
- ⇒ negotiate water and electricity bill with the purchaser
- ⇒ inform your garden service
- ⇒ inform the post office
- ⇒ arrange with your short-term insurer to cover the risks involved in the moving day
- ⇒ inform friends and relatives

**Study Unit 14: Offshore Investments**

Why do we have exchange control?

- ⇒ To prevent large amounts of capital from flowing out of the country as a result of factors such as: local political shocks; and changes in legislation
- ⇒ Exchange control amounts to government control over the buying and selling of foreign currencies
- ⇒ The abolition of exchange control
- ⇒ South Africans may, among others:
  - ⇒ Invest R750 000 per person above the age of 18 years overseas countries
  - ⇒ Open a South African foreign bank account and use a foreign country of their choice
  - ⇒ Open a foreign exchange bank account
  - ⇒ Buy property overseas
  - ⇒ Invest in various overseas financial assets
  - ⇒ South Africans must pay their taxes before they can invest in foreign countries
- ⇒ **Advantages of the abolition of exchange control:**
  - ⇒ Investors will be able to invest in various overseas products.
  - ⇒ The risk of limiting our investments to South Africa will increase. By investing in foreign countries we will be able to increase our returns and lower our risks. We will be able to reduce our risks in international terms and apply international diversification

Why invest offshore?

- ⇒ Protection against fluctuation of a single currency and market
- ⇒ Thousands of new investment opportunities
- ⇒ The expertise of offshore fund managers who know the foreign markets
- ⇒ A balanced portfolio
- ⇒ The possibility of increasing the return of your portfolio on an after-tax basis
- ⇒ **People who should invest offshore:**
  - ⇒ All investors- 10-20 % of their investment
  - ⇒ Wealthier people- up to 50% of their assets
  - ⇒ Those who are considering emigrating
  - ⇒ People with children who may later want to emigrate or work in overseas countries and/or who want to send their children overseas
  - ⇒ People whose income is sufficient to live on after they have invested part of their retirement packages offshore
- ⇒ Make provisions for rand hedging and we should diversify our investments internationally
- ⇒ Low productivity and high real wages are placing pressure on our inflation rate
- ⇒ The risk and terms of an exchange account are lower than those of an offshore investment in shares

Low Risk and Return

- Local/International exchange account (call money, fixed deposits)
  - Policies
  - Linked unit trust products
  - Local Unit trusts
  - Structured funds
  - Offshore property trusts
  - Fixed property
  - Containers
  - Offshore unit trusts
  - Offshore share portfolios
- High risk and return

**International Diversifications**

- ⇒ You invest in different countries
- ⇒ You invest in different offshore investment products in different industries or sectors
- ⇒ Your investments are internationalized
- ⇒ Your total investment risk is lowered and the returns on your investment are higher over the long term
- ⇒ You protect your self against a decrease in your real wealth
- ⇒ Your international risk is smaller and your international wealth increases
- ⇒ Do not place more than 1% of your investment in emerging countries- if funds are withdrawn as a result of a economic or political situation then the government will raise interest rates, which has far reaching financial implications; such as: higher mortgage bond interest; higher credit card rates; lower profits for businesses; lower share prices; lower unit trust values; more unemployment; people sell investments at a loss etc.
- ⇒ An advantage of offshore investments is the greater choice of investment products this offers investors

**Types of offshore investor**

- ⇒ The primary reason is mostly protection of current assets, rather than making money.
- ⇒ Investors are taking advantage of the anomalies that exist between the financial and tax regimes of the different nations of the world

**Research before investing in foreign countries**

- ⇒ You want to invest your money in such a way that you will be financially independent after your retirement
- ⇒ Consult various sources of information about offshore investments
- ⇒ Consult various brokers and experts
- ⇒ Make sure you know why you want to invest in a foreign country
- ⇒ Determine your risk profile
- ⇒ Find out whether your investment objectives fit in with your retirement objectives
- ⇒ Decide which product, currency and country to invest in
- ⇒ Avoid swindlers and be realistic.
- ⇒ Find out whether you have to obtain the approval of the reserve bank for your investment
- ⇒ Make sure you know which forms to complete for the reserve bank and your own bank, and what additional proof they require
- ⇒ What is the political, stability; religion; strength of the currency; tax situation of the country you intend on investing in?
- ⇒ Identify the economic cycles of overseas countries and invest in countries when the cycle is favourable for the growth of your investment
- ⇒ Evaluate the investment risk of specific overseas countries
- ⇒ Find out about the inflation rates and interest rates of the various countries

**Offshore investment pitfalls**

- ⇒ If the investor has no knowledge of the investment trap in South Africa, the broader picture and other pitfalls will be missed as well. A knowledge of the local investment pitfalls must be regarded as a prerequisite for offshore investments

**Money Laundering**

- ⇒ Whereby illicit money becomes part of the system and is invested in legal products with financial systems
- How much should I invest offshore?**
- ⇒ The average investor should not invest more than 20% of a portfolio offshore. A wealthy investor may invest up to 50% of a portfolio
- In which country should I invest?**
- ⇒ The USA, United Kingdom and Western Europe offer long-term benefits.
  - ⇒ The Isle of man and the Channel Islands of Guernsey and Jersey are tax havens

**Investment guidelines- your international investment strategy**

- ⇒ Decide how much money you have to invest
- ⇒ Are you going to invest a lump sum or monthly?
- ⇒ Whether to invest locally or internationally
- ⇒ Choose one or more investment products
- ⇒ Invest in a certain type of the chosen product
- ⇒ Invest in more than one of the chosen type of product
- ⇒ Your investment choice must meet your needs for income or capital growth
- ⇒ Choose safe countries for your investment
- ⇒ Make sure that you understand the investment risk
- ⇒ Always keep your investment objectives in mind

**How do South African companies handle offshore investments?**

- ⇒ Some companies opened in overseas countries
- ⇒ Others formed partnerships with overseas countries
- ⇒ Alliances where formed between local and overseas institutions with local institutions acting as agents for their counterparts
- ⇒ Types of offshore fund: global or international funds; sector funds; government securities, money market funds and currency funds

**What are the costs of investing in a foreign country?**

- ⇒ The cost of an offshore investment will always be higher than the costs of South African investments
- ⇒ Benefits of an investment should be compared with the cost
- ⇒ Initial cost, service charge; compulsory charge; cost of reinvesting the income

**Factors which determine the return on offshore investments:**

- ⇒ The type of investment will determine the return on your investment
- ⇒ Over the long term shares seem to beat cash, government securities and fixed property
- ⇒ The weight of the type of investment should be determined
- ⇒ Decide on the type of economy you want to invest in- developed countries or emerging markets
- ⇒ Decide on the on the specific currency in a specific country

**AN international currency exchange guide:**

- ⇒ An exchange rate is simply the ratio at which one currency can be exchanged for another at a given time
- ⇒ Factors influencing and determining the exchange rate: Inflation; trade figures; flow of capital; interest rates; investment abroad; productivity; savings; bank intervention; confidence in a country; war; crime etc.

**Tax on offshore investments**

- ⇒ Tax systems and the basis of income tax calculations differ from country to country
- ⇒ Not all countries have entered into an agreement that eliminate double taxation
- ⇒ Interest earned overseas- interest will be taxable unless it is received by an offshore trust in a tax haven
- ⇒ Interest on a local foreign exchange account- interest will be taxable
- ⇒ The exchange rate profit that results when the offshore investment is converted into rands -taxable income from the leasing of buildings- rent is taxable unless it is received by an offshore trust is a tax haven
- ⇒ Income from the leasing of a container- rent is taxable unless it is received by an offshore trust is a tax haven
- ⇒ Dividends from unit trusts and shares are taxable
- ⇒ Capital growth- taxable
- ⇒ Capital Profit- taxable unless it is received by an offshore trust is a tax haven
- ⇒ Main tax categories: income tax; capital gains tax; estate duty and withholding tax (tax on income from an investment by a non-resident)
- ⇒ Taxability of a South Africans offshore investments.

- ⇒ capital gains tax is applicable to local as well as foreign assets (not in a trust, unless controlled from South Africa or permanently in an offshore financial center as part of an offshore investment because of residence based tax, all income derived from a foreign source is taxable, all income derived from a foreign source is taxable although dividends earned in South Africa remain tax free, dividends from a foreign source are taxable (certain exemptions exist)
- ⇒ withholding tax paid abroad is tax deductible in South Africa

Capital Gains Tax

- ⇒ CGT applies to all assets/investments owned by South Africans
- ⇒ The introduction of CGT resulted in a reduction in the estate duty rate and the donations tax rate. Where CGT is paid on the disposal of an asset in a foreign country, a credit is granted by the South African tax authorities so as to prevent duplicating CGT payment
- ⇒ Disposal or deemed disposal includes basically any action or event that affects your assets. Some action that are excluded: where assets serve as security for debt; obtaining debt financing; obtaining shares in a company; a change in trustees and the distribution of trust assets to a beneficiary already entitled to them
- ⇒ Personal assets that are excluded: car, furniture, household appliances, a boat, an aircraft, investments, financial products, remuneration
- ⇒ Profits that are excluded:
- ⇒ Lump sums from local or foreign retirement funds
- ⇒ Long-term insurance policies where the person entitled to the proceeds is the owners; his spouse, dependant, beneficiary or where the policy has been ceded
- ⇒ Business insurance policies on the life of another
- ⇒ Pension fund policies
- ⇒ Provident fund policies
- ⇒ Retirement annuity fund policies
- ⇒ Any compensation for injuries or illness
- ⇒ Money from legal gambling competitions
- ⇒ Profits from conversion of foreign currency
- ⇒ Proceeds from short-term insurance policy
- ⇒ Donations to public benefit organizations

3 methods for determining the base cost of an asset in order to calculate the capital gain:

- ⇒ The market-value method- used when the proceeds are greater than expenses or expenditure cannot be determined
- ⇒ The time-apportionment method- used when the proceeds are greater than the expenditure or proceeds are less than expenditure and the owner did not determine the market value on 1 December 2001
- ⇒ The 20% rule- proceeds are greater than expenditure or expenditure cannot be determined
- ⇒ When the proceeds are less than expenditure both the market value and the time apportionment methods must be used. The lower of the 2 values will be used to determine that base cost of the asset
- ⇒ Effect certain allowable deductions from the valuation amount: improvements made, valuation costs, cost of professionals involved, brokerage costs, transfer duty, conveyancing fees, advertising costs etc.
- ⇒ The following may not be claimed as deductions: financing costs, rates and taxes and maintenance

The global investment process

- ⇒ Complete and submit a "declaration of good will"
- ⇒ Complete the South African Reserve bank form
- ⇒ Complete form MP1423
- ⇒ Complete the investment application form
- ⇒ Hand in the documentation

Offshore investment alternatives

Policies

- ⇒ It is possible to contribute to retirement annuities and endowment policies via offshore investments.
- ⇒ The usual income tax deductions for annuities will apply
- ⇒ Life policies: Both Life and disability coverage can be obtained abroad. The risk is higher because the business that market these are registered in offshore financial centers in those countries
- ⇒ A life policy can be used to pay debts and meet other obligations after your death
- ⇒ The premiums of a life policy issued from an offshore financial centre ( tax haven) will be lower and the return higher than a South African life policy- the main reason would be the taxability of the returns of the policy in the hands of insurance companies in South Africa
- ⇒ Endowment policies: you should receive a higher return because of the lower or no income tax, and the capital gain. Such policies include: market linked policies; with profit guaranteed policies and geared guarantee policies

Unit trusts (mutual funds)

- ⇒ 3 categories from which the investor can choose:
  1. You may invest in South African unit trusts that are investing in South African shares
  2. You may invest in South African unit trusts that invest in offshore assets- you do not need any form of approval from the reserve bank to invest in these onshore unit trusts. The main reason is that these investments must be returned to South African and do not form part of the annual investment you are allowed to take out of the country to invest permanently overseas
  3. You may invest directly in offshore unit trust as part of the R750 000 per person that may be invested permanently overseas. You have to obtain the approval of the reserve bank for this type of unit trust investment. These unit trust investments are known as offshore investments, because the money does not have to be returned to South Africa and does not have to go through the reserve bank

Index trusts are better for cautious investors- the return is good and the risk is low.

A specialist trust is a unit trust that invests in shares in a specific industry. The risk is higher, but so are the returns

Shares

- ⇒ It is possible to invest in shares overseas through South African shares listed on the JSE. This type of share earns mainly through overseas business
- ⇒ Possible to invest in export shares
- ⇒ Advantage of shares is that your investment is more flexible- you can buy and sell shares at any time.
- ⇒ Disadvantages include lack of security for your capital and the Restrictions placed by the South African market on diversification. risk and Returns are high
- ⇒ Part of these shares may be used to make contributions to retirement annuities, endowment policies, preservation funds and provident fund. You are allowed the usual income tax deductions, even though the contributions to the retirement annuity form part of your offshore investment
- ⇒ These overseas funds hold a higher risk that other types of investment- your objectives, and the return, should always be kept in mind

Tank Containers

- ⇒ A container is made of steel and is used to transport all sorts of products
- ⇒ An individual or group of people buys a container and leases it overseas to earn an income
- ⇒ This type of investment is meant for wealthy investors, particularly those who are about to retire and need income from an investment
- ⇒ The Commissioner of inland revenue and the Reserve bank have both approved this type of investment
- ⇒ Most important benefits: tax savings; investments are protected against inflation; protection against the weak rand and the beneficiary of an estate may inherit in a different country
- ⇒ Investment in containers can be combined with Annuities, unit trusts and managed investment accounts
- ⇒ The demand for containers is expected to grow immensely because traditional methods of transport are being abolished

- ⇒ Use borrowed money to finance part of the investment. Because the loan is made in order to earn an income, the interest is tax deductible. The purchase price is also written off after 5 years in the form of depreciation
  - ⇒ The investors pays income tax on the income earned; it forms part of the investors gross income
  - ⇒ When a container is sold there will be a tax refund on amount received at the date of sale. VAT is payable when the tax is bought but may be refunded within 2 months of being claimed
  - ⇒ The investor receives a copy of the certified certificate of ownership from the reserve bank. Each container has 3 numbers: an ID number; a trade number and an international number of certification
  - ⇒ Income is paid out quarterly in arrears
  - ⇒ The container may only be sold to South African investors
  - ⇒ The investor may never be held responsible for anything regarding the use of the container
  - ⇒ In foreign countries, leasing agents will manage your investment. In South Africa, the investor will appoint an agent when the container is bought
  - ⇒ The return is determined by the measure of occupation/usage of the container pool
  - ⇒ You should invest for 5 to 10 years in containers to get the maximum tax benefit and protection for your rand.
- Yachts**
- ⇒ Investment is yachts function in the same way as investments in containers and investors receive a free week per year on the yacht

#### **Krugerrands**

- ⇒ Are good rand protectors and can be bought in the primary market at the South African Mint and in the Secondary market from banks, brokers and the public.
- ⇒ The lower the value of the rand exchange rate, the higher the value of your Krugerrands
- ⇒ Risks: theft, no capital growth or income from interest from certain periods, and the cost of keeping the Krugerrands safe in the bank

#### **Fixed Property**

- ⇒ You can invest directly by buying property, or by investing in a property trust. You can also invest in a timeshare that can be exchanged internationally
- ⇒ A syndicate investment may spread the investment risk through diversification
- ⇒ The main reason for the advantage of such an investment is the possible future use thereof
- ⇒ make sure you have knowledge of: the investment amount required; the deposit you will need in a foreign country; the tax position; other cost-items involved

#### **Bonds**

- ⇒ the primary goals should be income and guaranteed capital
- ⇒ interest rates are far lower abroad than in South Africa

#### **A business in a foreign country**

- ⇒ if you receive income from an overseas business that is making trade profit, that profit will not be taxable in South Africa but in the other country; offshore businesses that earn an income from investments are excluded; this income will be taxed in South Africa

#### **An offshore trust**

- ⇒ a trust is an independent entity that is used for estate planning, in particular;
- ⇒ The person who establishes the trust places assets in the trust to limit their capital growth in his own estate. Estate duty is saved this way
- ⇒ The founder of the trust retains control over the assets but loses the right of ownership to the trust.
- ⇒ There are also tax benefits
- ⇒ An offshore trust is one that is registered in one of the "tax friendly" country (Jersey, the Isle of man, Monaco the Bahamas)

#### **A Business Trust**

- ⇒ Establish a business trust if you want to: Start a business in SA; start an export business; buy or establish a business in a foreign country or manage overseas investments via a trust

- ⇒ When a business trusts and companies are linked, there are many benefits for the person who establishes them ( save on income tax and estate duty)

#### **An investment trust (asset protection trust)**

- ⇒ A tax-friendly country or tax haven is the ideal place to establish an offshore investment trust
- ⇒ An investment trust is particularly suited to people who already have capital overseas
- ⇒ Take special note over the measure of control you will retain over the capital

#### **Banking overseas**

- ⇒ Useful for making foreign payments
- ⇒ Can open locally or abroad
- ⇒ You can invest your money either as call money or as a fixed deposit
- ⇒ Decide in which overseas currency you want to keep your money
- ⇒ This investment may only be made at an overseas bank and not in property or shares
- ⇒ You will receive the same interest rate as the currency of the offshore bank; the greatest advantage comes when you want to convert the money back into rands
- ⇒ It is also possible to open a foreign exchange bank account to protect yourself against a falling rand
- ⇒ A foreign bank account in an offshore centre offers far greater confidentiality, as well as more income and estate planning advantages
- ⇒ if the bank account is an offshore financial centre, you should not pay tax on interest
- ⇒ The US, UK, German and Swiss banks offer the greatest stability and security
- ⇒ If you do have sufficient financial means to open a foreign bank account spread your business across various banks, countries and currencies; do research about the stability of the bank; study the banking regulations of various countries and banks; watch the media and avoid unstable countries with undemocratic government and nationalization policies

#### **Offshore investor protection**

- ⇒ The Financial Services Board FSB required the registration of all unit trust funds if they are marketed in South Africa. The protection of investors in foreign countries receives special attention
- ⇒ The protection must be the same as for local investment properties
- ⇒ The FSB does not protect against all offshore products

#### **Your estate**

- ⇒ For the purpose of estate planning, you may make an offshore investment in your own name or that of a company of trust
  - ⇒ If you intend to realize the investment at a later stage, the best decision is probably then to retain them is your own name, if they will go your heirs at a later stage, either during your lifetime or after your death, it may be better to invest them in the name of a company of trust
  - ⇒ A company is mostly used for the purpose of perpetual succession, that is for continued trading
  - ⇒ It is very important that 50% of the company should be in foreign ownership, or else the tax authorities will regard it as a controlled foreign entity managed from South Africa. This would result in you having to pay income tax in South Africa
  - ⇒ You may not grant interest free loans to an offshore trust. Neither may you, as you may in South Africa, donate an annual amount of R30 000 to an offshore trust
  - ⇒ To ensure that your offshore trust and your offshore assets/investments are not regarded as foreign controlled entities ensure that: South Africans do not have a right to more than 50% of the trust benefits; South Africans do not control more than 50
  - ⇒ 5 of the trust by making up more than 50% of the trustees and that South Africans are not entitled to more than 50% of the trust income
  - ⇒ Apart from income tax advantages (no income tax is payable in certain offshore centers) an offshore trust offers estate protection of foreign assets and the same trust advantages as a South African trust
- Types of offshore trust**
- ⇒ In the case of an offshore trust, legislation in certain countries requires a protector. This protector ensures that the wishes of the founder are carried out.

- ⇒ The protector also protects the trust fund and may even dismiss trustees at his or her discretion
- ⇒ 2 types of offshore trust: testamentary trusts ( established after a person's death) and *inter vivos* trusts ( established while a person is still alive)
- ⇒ Taxation of a trust depends upon:
  - The legal jurisdiction of the trust
  - The legal jurisdiction of the country
  - The domicile of the settler
  - The domicile of the trustees
  - The domicile of the beneficiaries

Duration of the trust

- ⇒ Only a special/charitable trust can exist or be created in perpetuity
- ⇒ In England a trust can be set up for 80 years, or for a period that may be extended for up to 21 years after the death of the last survivor of all the descendants who were alive when the trust was created- the "royal lives period"
- ⇒ Jersey and Guernsey allow a maximum of 100 years
- ⇒ The period for which income may accumulate in trusts without being paid to the beneficiaries is 21 years or the term of the settler's life in England; Jersey and Guernsey allow for 100 years and Ireland allows the royal lives period

Choosing a jurisdiction

- ⇒ You may choose different jurisdiction for different aspects of your trust such as : the trust deed itself, the validity of the trust deed, how the trust is administered and trust assets located in different countries
- ⇒ The settler or the protector may be permitted to alter the jurisdictions applicable to various aspects of the trust in terms of the trust deed- however there must be a court capable so as to amend various aspects of the trust. There should also be a court capable of guiding the administration of the trust

The protector

- May be afforded the power to:
- ⇒ Approve the fees/expenses of trustees
  - ⇒ Change the trustees
  - ⇒ Monitor the way the trust is being run
  - ⇒ Stop a proposed investment
  - ⇒ Stop the distribution of money to a beneficiary and stop an addition of a beneficiary or the removal of one

Trusts in civil law countries

- ⇒ Ownership is an abstract concept
- ⇒ Two people cannot be co-owners of the same property
- ⇒ The power to bequeath assets by the owner is more limited than in common law countries
- ⇒ The meaning of a contract is much wider in civil law and includes 3<sup>rd</sup> parties
- ⇒ Assets may be transferred to 3<sup>rd</sup> parties who have not yet been declared beneficiaries
- ⇒ Probates may easily take place, or a trust may not be recognized
- ⇒ Stick to common law countries

An offshore will

- ⇒ The purpose of any will is to help the executor of an estate to administer it after the death of the testator/ testatrix
- ⇒ Study the legislation of the foreign country or countries concerned to determine which situation would best satisfy your needs in regard to disposal, and at the lowest cost
- ⇒ In the absence of an offshore will, the executor must first apply abroad to gain rights as a foreign executor
- ⇒ There should be a separate will for each foreign jurisdiction
- ⇒ An offshore will makes it easier to trace the estates assets and to administer the estate

Estate duty

- ⇒ A South Africans estate is made up of all of his assets/investments no matter where in the world they are
- ⇒ The following assets are excluded: assets that were acquired before the person became a SA citizen; assets inherited from a foreign resident; assets donated by a foreign resident
- ⇒ Where no double taxation agreement exists, a person will first have to pay foreign estate duty and then be entitled to rebate in South Africa
- ⇒ A non-resident does not pay estate duty in South Africa on assets in other countries
- ⇒ A non-resident does not pay donations tax on his South African assets, which means that estate duty is also avoided

Donations

- ⇒ The beneficiaries of a trust and/or the trust may be held responsible for paying income tax. This depends on: the rights of the beneficiaries of the trust; the discretionary powers of the trustees; whether the income is divided among the trust, the beneficiaries and the trustees, and whether income is retained by the trust
- ⇒ The taxability of income from overseas sources has been changed drastically by legislation
- ⇒ Do not form an offshore trust via a donation or loan if you are also a beneficiary of the trust

**Study Unit 15: Protection planning**

- If you have a job and receive a salary, the greatest risks are:
- ⇒ A lack of knowledge of PFP and management
  - ⇒ To much debt, and to little cash flow for your livelihood and investments
  - ⇒ Receiving a retrenchment or retirement package and applying or investing it badly
  - ⇒ A basic human need is to protect ourselves and our possessions
  - ⇒ Risks create certain financial needs
  - ⇒ The should be only one approach to financial planning- self-protection

Household risks

- ⇒ Loss of income
- ⇒ Loss of property
- ⇒ Personal liability
- ⇒ Business risks
- ⇒ Estate duty
- ⇒ Cost of winding up your estate
- ⇒ To many debts because of 'living it up'
- ⇒ Inflation
- ⇒ Income tax
- ⇒ Frequent changes in legislation
- ⇒ Interest rate changes
- ⇒ Market risks
- ⇒ Financial risks
- ⇒ Fluctuations in exchange rate
- ⇒ National risks
- ⇒ Health risks

Needs and risks

- ⇒ Financial needs are made up mainly of income and capital needs.
- ⇒ Income needs exist or develop during your lifetime, as well as in cases of unemployment, disability or disease.
- ⇒ Capital needs exist or develop primarily after your death, in the form of mortgage debts, estate duty and the cost of winding up your estate
- ⇒ Your financial needs could be: temporary, permanent, future, increasing, decreasing or constant

Types of risk

- ⇒ Financial and non-financial
- ⇒ In the insurance industry, the risk for which insurance is provided is restricted to financial losses.
- ⇒ Such losses are called financial risks
- ⇒ A non-financial risks or loss is the emotional loss involved in the demise of a loved one
- ⇒ Financial risks can be subdivided into speculative and pure risks

- **Speculative risks:** where either a profit or a loss may occur (investment in shares)
- **Pure risks:** there is no possibility of profit or benefit only loss (a fire burns house)
- **Fundamental and specific risks:** Fundamental risks have an impersonal source, such as war and specific risks have a personal origin, and insurance provides protection against them

**Classification of pure risks- the subject of Insurance**

- ⇒ **Personal Risk:** related to the loss of a life or an income as a result of: untimely death, physical disability, age or unemployment
- ⇒ **Property risk:** related to the possible loss of property- direct and indirect loss
- ⇒ **Liability risk:** the risk of being held liable for damage to another persons property

**Risk management**

- ⇒ **Step 1: The identification of risk**
- ⇒ If you are not aware of a certain risk, you cannot take precautions against a possible loss

⇒ **Step 2: The evaluation of risk**

- ⇒ Financial implications and sub sequential loss are determined for each type of risk.
- ⇒ An evaluation of financial risk is calculated as follows: the intensity and degree of potential loss is calculated; and the frequency of a loss is determined
- ⇒ Risk is classified as bearable, unbearable or unimportant
- ⇒ Group 1- should be avoided
- ⇒ It is possible to make provision your self for Group 2 & 3
- ⇒ risks, insurance isn't necessary
- ⇒ Group 4 risks should be shifted to an insurance company

G	Frequency	Intensity	Evaluation
1	High	High	Unbearable
2	High	Low	Bearable
3	Low	Low	Unimportant
4	Low	High	Unbearable

⇒ **Step 3: Methods of handling risk**

- ⇒ Loss prevention and control; risk avoidance;
- ⇒ retention and transfer
- ⇒ Loss prevention or control is an activity aimed at limiting or lessening the intensity or degree of a loss
- ⇒ **Retention-** since the frequency of theft is low, a person may decide to carry the associated risk himself
- ⇒ In reality, risk cannot be shifted or transferred to someone else. However the consequences of risk can be transferred. The risk remains with the owner of the property

Intensity Degree	Frequency	
	High	Low
high	Retention	Loss Prevention
Low	Transfer	Avoidance

⇒ **Step 4: Implementation and re-evaluation**

- ⇒ The programmes or methods chosen and implemented must be re-evaluated from time to time to ensure that they are still able to prevent specific losses and to adapt to changing circumstances

**Needs and Insurance**

- ⇒ An income need relates to the monthly salary a person would require were he or she to become disabled and unable to work.
- ⇒ A capital need, on the other hand, indicates the need for capital that would arise after a person's death in order to redeem his or her mortgage bond
- ⇒ A need is temporary when it is time-bound. A permanent need will arise after a person's death, when estate duty becomes payable. Although the re is uncertainty about the period, there is certainty about the event
- ⇒ In the case of a future need, parents could begin saving to cover the cost of their children's future education.
- ⇒ The extent of the need could increase as a result of the declining purchasing power of money the value of fixed property could rise, which would at the same time increase the need for capital to pay estate duty.
- ⇒ A reducing need arises when the outstanding amount on a home loan decreases as monthly payments are made
- ⇒ A constant need means that the financial obligation remains the same

- ⇒ These needs can be dealt with separately or in combination
- ⇒ All these needs must be quantified to be of any use. All the provisions made for needs after death must be available at the death of the person concerned
- ⇒ The existing provisions are weighed up against the needs in order to determine the shortfall or surplus
- ⇒ Important to compare the features of a specific product with your specific needs

**Long-Term Insurance**

- ⇒ Means insurance for a period longer than a year. Long-term insurance provides for insurance as an investment; and as protection against risks as a result of death or disability

⇒ **Types of long-term insurance:**

- Endowment policies
  - Single premium
    - Term insurance
      - Funeral assurance
      - Medial assurance
    - Universal policies
      - Credit/debit life assurance
  - Second-hand policies
    - Life assurance
      - Disability assurance
- ⇒ Insurance as a long-term investment instrument was developed with the following goals in mind: to provide policyholders with different kinds of indemnity; and to provide members with a savings plan aimed at retirement
- ⇒ There is also guaranteed growth rate for the investment, and sometimes a growth rate for a specific fund

**Endowment policies**

- ⇒ Endowment insurance is probably the most common long-term insurance vehicle
- ⇒ The best uses are to provide capital at retirement and to supplement the provision for retirement
- ⇒ Pay special attention to the taxability of the proceeds of an endowment policy, the cession of a policy as well as the surrender value of a property
- ⇒ Investors contribute on a monthly basis to this investment and receive a lump sum (or income) tax free after 5 years. Life cover could be added to the endowment policy.
- ⇒ The investor chooses a specific investment portfolio. There are 3 types: a more stable conservative portfolio; a market related portfolio or a share link risky portfolio
- ⇒ The first 2 portfolios guarantee the safety of the capital amount

**Single-premium endowment policies**

- ⇒ Possible to invest a single premium (lump sum) in an endowment policy on condition that, to be tax free, such an investment may not be surrendered for a period of at least 5 years. After a 5 year period, monthly cash withdrawals are tax-free
- ⇒ In the case of monthly cash withdrawals:
  - Interest for the 5 year period will be added to the capital amount
  - Interest and capital are divided into equal amounts over a period of 5 years
  - Payments received have to be declared on the investor's income form, because the interest component is taxable
  - The capital portion of the payment is tax-free
  - After 5 years the lump sum will be tax free
  - Income received after the 5 years will also be tax-free
  - Capital growth is thus tax free
  - Income received after the 5 years does not have to appear on the investors income tax form

**Second-Hand policies**

- ⇒ Policyholders often borrowed against their policies in order to fulfill needs and desires or to handle debt crises. These loans are interest free
- ⇒ Many potential investors would like to invest in an insurance policy, but do not want to wait 5 years for tax-free returns. This is the demand for the product. This product is known as a second hand policy
- ⇒ A potential investor could invest a lump sum in a second-hand policy. The investor would buy the policy from the insurance company and the price would be: the gross value of the policy after the 5 year period plus 3% to 7% on the value of the policy

- ⇒ **Advantages to the investor**
  - The surrender value of the policy is tax-free at any time of the investment period
  - All income from the policy is tax-free
  - The investor receives tax-free cash bonuses or income per month
  - An increase in income is possible
  - The term of the policy can be increased or decreased
  - It is a relatively safe investment
  - It is the ideal investment for investors in a high tax bracket
- ⇒ **Disadvantages to the investor:**
  - Second-hand policies are not readily available
  - The cost of obtaining such an investment is relatively high

**Life assurance**

- ⇒ Is a asset
- ⇒ A policy is, at the same time, an intangible investment that enables a person to transfer his or her greatest financial risks to an insurance company
- ⇒ The primary goal of every individual's personal financial affairs is to achieve financial independence after retirement. A life policy can help achieve this goal as no other investment can
- ⇒ **Career planning:**
  - ⇒ Any life policy has a surrender value after 3 years and this endowment value is tax free after 5 years
  - ⇒ A private household may even be bankrupted as a result of one or more of the following:
    - The untimely death of a key person who cannot be replaced in a partnership or company
    - Debts that a partner may incur on behalf of the partnership without the knowledge of the other partners
    - An owner, a partner or director becoming disabled and unable to work; or
    - Key persons retiring
- ⇒ **Credit planning:**
  - ⇒ If the policyholder survives paying off the car and/or house, the life policy could be used for estate duty and even as a legacy. A life policy can serve as security
- ⇒ **Investment planning:**
  - ⇒ A life policy represents the first investment that a person ought to make

Investment Criteria	Life Policy
Risk	Low
Return	Acceptable
Amount invested	Very low (per month)/age factor 3 years for surrender value. After 3 years it can be 'made' into an endowment policy
Term	It is left to an insurance company
Ease of management	None, an agent can inform you
Knowledge required	100% safe- it is guaranteed
Safety of capital	Very good capital growth
Capital Growth	Very liquid after 3 years. May be redeemed after 2 years
Liquidity	Return is tax free after 5 years
Taxability	Very flexible- content can be adjusted
Flexibility	Relatively low
Transaction costs	Does not play a role- the best time is always to take out a policy immediately, while enjoying good health
Time calculation	The risk of a portfolio may be lowered by taking out a policy
Diversification	Premiums may be increased by up to 20% annually to make provision for inflation
protection against inflation	Inflation

- ⇒ **Retirement planning:**
  - ⇒ A life policy can be used to make provision for retirement. An individual can ask for the policy to be paid out.
  - ⇒ The hedge against inflation and the capital growth that a life policy can offer to serve to make it particularly suitable as a possible provision for retirement
- ⇒ **Protection planning:**

- ⇒ Life policy can help against: personal, property and business risk, as well as Responsibility for estate duty/CGT and transfer duty
- ⇒ **Estate planning:**
  - ⇒ A life policy can be used to good advantage to pay estate duty and all other estate administration costs
- ⇒ If you do not have sufficient life cover, take out a life policy before you experience ill health, in which case your monthly premium will be very high, provided of course that you can still obtain a life policy
- ⇒ Life insurance can also be included in your endowment policy or retirement annuity
- ⇒ **Whole-life assurance:** can be taken out to protect you against the financial consequences of death or disability. This type of insurance stretches over the whole life of the insured. Whole life insurance does not have loan or surrender value and pays out only at death or disability

**Term insurance**

- ⇒ You can take out term insurance to protect against the financial consequences of death or disability
  - ⇒ Term insurance does not have loan or surrender value
  - ⇒ **Features:** Cover is provided for a fixed term/ The cover may constant or reducing/ only required at death or disability/ does not provide cash
  - ⇒ **Needs:** The need must be temporary/ it must be constant or increasing/ cash not required during the period/ need only arises at death or disability
- Universal policies**
- ⇒ An endowment policy is combined with both life and disability cover
  - ⇒ It has the same characteristics as an endowment policy and a life policy
  - ⇒ Investment + life insurance + disability insurance

**Credit/debt life assurance**

- ⇒ Offers coverage for present debts. If a person dies incurring certain debts, the debts are repaid with the amount provided by the credit life assurance
- ⇒ Credit life assurance includes both life and disability coverage
- ⇒ Also called decreasing-term life assurance. Because the coverage amount decreases with the debt period. Decreasing term life assurance is much cheaper than term insurance

**Disability assurance**

- ⇒ Can be taken out to provide for loss of income, and does not include medical expenses or medical cover.
- ⇒ Disability insurance protects the family from loss of income if the breadwinner suffers a prolonged period of illness or becomes occupationally disabled. In the case of occupational disability, the need for income is usually much greater than in the case of the breadwinners death
- ⇒ 3 considerations when purchasing disability insurance
  1. Determine the level of income that will be received in the event of occupational disability. Most policies over-between 1/4 and 2/3 of a person's normal income.
  2. Determine under which circumstances the policy will pay out. Before taking out a policy ask the following questions:
    - When is the person regarded as occupationally disabled?
    - Are benefits paid out if you can't work at all or only if you can't work at your present job?
    - For how long does the policy holder have to be disabled before they'll start to receive benefits
    - Is there a limit attached to the total benefits which will be received during the policy holder's lifetime?
    - Are benefits paid to the surviving spouse in the event of the policyholder's death?
  3. determine the costs of the policy the extent of the cover determines the premium amount

**New generation products**

- ⇒ these products may be combined for maximum returns or capital growth, or for spreading local or international risks (total risks)

**Funeral Assurance**

- ⇒ A funeral policy is taken out to cover or to help to cover funeral costs



- ⇒ Before a funeral policy pays out an indemnity document, death certificate and form filed in by the next of kin should be presented
- ⇒ The cost involved in the funeral policy will vary on the basis of: the insured's age, the number of insured persons and the type of policy required
- ⇒ Funeral costs may be covered in various ways: from existing investments; a life policy; a funeral policy; through your group benefits
- ⇒ Clearly state whether you wish to be buried or cremated

#### Medical Insurance

- ⇒ The financial risks involved in medical expenses may be handled in various ways: by cash; public health care; insurance company or financial institution or a medical aid scheme
- ⇒ A combination of 1 or more of these strategies is another possibility
- ⇒ The cover is taken out in addition to a medical aid fund, and is meant to help cover additional medical and related costs
- ⇒ A hospital policy requires that members pay a monthly premium. The benefits received are based on the size of the monthly premium and not on the specific amount in medical expenses
- ⇒ Irrespective of the amount paid out by the policy holders medical aid fund, the hospital policy pays out a cash sum
- ⇒ Amounts received from a hospital policy are tax-free
- ⇒ A basic policy consists of a hospital benefit and a recovery benefit
- ⇒ The whole family can be covered. Optional operation benefits may exist
- ⇒ there is no limit on the number of times a member of the family can be admitted to hospital
- ⇒ Guidelines when purchasing medical aid:
  - Most medical policies offer a 10 to 14 day period to decide whether the policy is acceptable or not
  - Note the policy's renewability, directions concerning cancellation, the waiting period, as well as which medical conditions are excluded
  - Make sure that the policy will cover you world wide
  - Find out whether the policy will still be available to other members of the family at a lower tariff after your death
  - Not all policies cover children once they have achieved independence
  - Find out whether the policy covers medical conditions existing at the time the policy commences
  - Make sure that medical expenses will be covered every time they occur, irrespective of the number of times a year
  - Purchase a policy offering comprehensive cover
- ⇒ Top up medical aid: can be taken in addition to your medical aid fund. Is a type of insurance and not a medical aid fund
- ⇒ Medical aid scheme: it is possible to belong to a medical aid fund if you do not belong to such a fund through your work relationship
- ⇒ Managed care: means that medical aid schemes try to arrange their relationship with hospitals, doctors and pharmacists in such a way as to keep medical costs as low as possible
- ⇒ Life Offices Association: represents the long term insurance industry and attempts to protect its interest
- ⇒ The names of people at high risk are entered into a computer and no insurer will give them insurance. For this reason, it is important to obtain the necessary life insurance as early as possible, before some medical condition or accident makes this impossible
- ⇒ Those who cannot obtain life insurance at all should apply for a pure endowment policy

#### Short-term insurance

- ⇒ Is insurance taken out to meet short term needs
- ⇒ Home owner's insurance
  - ⇒ Protects a house or building against risks like damage or destruction by fire
- ⇒ Household insurance
  - ⇒ Covers the contents of a dwelling
- ⇒ Motor vehicle insurance
  - ⇒ Comprehensive insurance( your car, another car, fire, theft); third party insurance (fire, they and other car) or third party insurance only (other car only)

- ⇒ You may claim from both your short-term insurance company and the Road Accident Fund

#### Travel Insurance

- ⇒ Self-Insurance – Emergency fund
  - ⇒ Money is invested so that the accumulated amount will be available in a crisis situation
  - ⇒ The aim of such a fund is to make provision for possible future loss
  - ⇒ Assumptions of a successful emergency fund:
    - A financial disaster such as car theft or accident will never occur to you
    - It is unlikely that more than one disaster will occur within a short period
    - No disaster will occur in the first 10 years
    - You will pay small claims yourself and won't use the fund
  - ⇒ Reasons why people establish an emergency fund: under economic pressure; the household budget does not balance; premiums are too high; they are unemployed; etc
  - ⇒ Types of emergency funds:
    - ⇒ people could cancel all their short-term insurance and deposit the premiums in an emergency fund they could self-insure part of their property
    - ⇒ a mutual fund with friends or family- joint premiums and compound interest will increase the amount in the fund
  - ⇒ Disadvantages of an emergency fund
    - The interest is taxable
    - The value of the fund is eroded by inflation
    - After tax interest in the emergency fund will prevent rapid growth
    - Should a house be destroyed in the first year you may be sequestered but still have to pay the mortgage bond
    - You will have to save for almost a decade to replace the furniture of an average household
    - Two or three accidents can occur in the same year
    - This kind of fund causes stress
    - Within a day of being established an emergency fund will have to be large enough to cover the loss of a car, a house and furniture
    - Monthly payments into an emergency fund need to be increased every year to keep up with inflation

#### Business insurance

- ⇒ Risk management- the process of addressing needs that may arise in the future of a business enterprise
- ⇒ Buy-and-sell agreements
  - ⇒ The purpose is to ensure the continuity of the business and to build up a reserve fund for unforeseen circumstances
  - ⇒ All the partners and shareholders of the business enter into a buy-and-sell agreement. This agreement obliges them to sell their share in the business enterprise to the remaining partners or shareholders in the event of their death. The remaining shareholders or partners are also obliged to buy the deceased's share
  - ⇒ Partners and shareholders rarely have sufficient funds available to buy the deceased's share
  - ⇒ A life policy in the lives of all the partners, directors and shareholders would be the solution. In that way a cash reserve could be built up with which the surviving partners could buy the deceased's share. A separate life policy may be taken out on the lives of all the partners
- ⇒ advantages:
  - it ensures that the business can continue doing business.
  - no goodwill is lost
  - in ensures the continuation of creditworthiness
  - it is not necessary to discharge employees
  - the surviving partners do not suffer financial damage

#### Partnership insurance

- ⇒ Primary purpose is to provide sufficient capital to the other partners to enable them to buy the deceased's share in the partnership in the event of the death of one of the partners

- ⇒ Partnership insurance covers risks, and the needs that may arise by providing the necessary capital to the surviving partners
- ⇒ The proceeds from the policy would eliminate the needs for the surviving partners to take out loans.
- ⇒ To sell their interests or other assets or to employ unacceptable partners because of a lack of funds
- ⇒ Joint insurance policy: is taken out on the lives of 2 partners. The policy pays up and ends at the death of the 1<sup>st</sup> of the 2 partners
- ⇒ Single life policy: a partner may take out a policy on his own life and cede it to his partnership. The surviving partners will have to pay the premiums of the life policy, however the proceeds of the policy will be regarded as capital and the policy holders will not be liable for income tax. These premiums are not deductible for income tax purposes
- ⇒ Life-of-another policy: used where 3 partners are in partnership. Partners A and B take out a life policy on the life of C. B and C take out a policy on the life of A. A and C take out a policy on the life of B etc.

#### Proprietary Limited Company

- ⇒ May have only one shareholder
- ⇒ The shareholders own shares in the company, may vote at general meetings and may elect the board of directors.
- ⇒ The shareholders of a proprietary limited company are often family members or a group closely involved in running the business
- ⇒ Conflict may arise between the surviving shareholders: the shareholders wish to see future growth, while the heirs want immediate income; to the shareholders salaries are of primary invoices and dividends are secondary, while the heirs want dividends; An heir may sell their shares to a stranger even a competitor
- ⇒ To prevent all these negative consequences may be to buy the deceased's shares through a buy-and-sell agreement, supported by a life insurance policy. The purpose of this business insurance policy is to provide sufficient funds at the time of a shareholders death to enable the survivors to buy his shares

#### Close corporations

- ⇒ A CC may take out insurance policies on the lives of its members who have an interest in the corporation, in order to buy a members interest at his death or disability at a later stage.
- ⇒ Because of the taxability of the proceeds it is not recommended that a CC take out policies on its member's lives to finance buy-and-sell agreements. Members should rather take out separate policies on each others lives

#### Professional incorporated companies

- ⇒ The shareholders of a professional incorporated company may also take out insurance policies e.g. pensions and provident funds
- ⇒ Professional people normally do not have a right to pass their shares to their heirs. The shares have to be sold to the surviving shareholders or a qualified outsider

#### Policies on the lives of employees

- ⇒ To provide a benefit for the employer or the company or to provide a benefit for both the employer and employee
- ⇒ Policies in favour of the employer:
- ⇒ Key person insurance- employees who contribute greatly towards profitability. The untimely death of such a key person
- ⇒ By taking out key person insurance, thereby utilizing bridging funds from the key person insurance policy in order to ensure the business enterprise's continuity; cover losses over the adjustment period; pay for the recruitment and training of a substitute; ensure continuous creditworthiness; and guarantee continued dividends
- ⇒ Insurance to cover a specific liability
  - To insure a bank overdraft- insurance policies are often taken out on the life of a key director in order to consolidate the loan capital of the business enterprise

- To cover a personal guarantee- in order to prevent a situation where the director's personal assets have to be used at the time of his debts to honour the guarantee, he may transfer the burden to an insurance company by having the company take out a policy
- To cover a shareholder's loan account- a low-cost term policy may be taken out on the shareholders life for twice the required amount
- To cover a mortgage loan- a company with a mortgage loan on a property may insure the managing director's life for the outstanding amount, so that the property is unburdened should the director dies unexpectedly
- To provide a cash reserve- a life or an endowment policy may be taken out. Such an insurance policy would enable the company to build up a cash reserve that would become available at the untimely death of the director or when the policy expires
- ⇒ Policies in favour of the employee:
- ⇒ Deferred compensation- is normally used when a highly paid employee will not benefit from a salary increase because of tax implications. An agreement is made that the company will pay the proceeds of the policy to the employee at retirement or his heirs in the event of an untimely death. The main objective of this insurance policy is to over additional incentive schemes to key employees and retain their services till they retire
- ⇒ Advantages of deferred compensation:
  - Additional tax benefits to the employee at his retirement
  - The employer may deduct a certain percentage of the premiums from his taxable income
  - Employees conditions of employment are improved and their loyalty retained
- ⇒ Policies in favour of both the employee and employer:
- ⇒ Employers may take out a life or an endowment policy on the life of the employee: to obtain the benefit for the company, should the employee dies before his retirement; and to provide the employee with a benefit should he live till retirement
- ⇒ A service contract in which the 2 purposes of the policy is set out, would be entered into with the employee

#### Short-term insurance policies

- ⇒ Provide cover over the short term
- ⇒ Most short term insurance companies provide for: building insurance; business interruptions; accounts receivable; theft; money lost or damaged; dishonesty; goods damaged or lost in transit from transport vehicles; all risk for loss or damage of property anywhere in the world by any events which are not specifically excluded; employer liability
- ⇒ The main purpose of insurance is to avoid financial loss as a result of someone's death
- ⇒ The purpose of short-term insurance is to afford the business person protection against a wide variety of specifically defined risks

### Study Unit 17: Retirement Planning

#### The importance of retirement planning

- ⇒ Financial independence- the ability and freedom to make financial decisions
- ⇒ Reasons why only 6% of the population are able to provide for retirement: *Retirement pitfalls*
  - Lack of knowledge about the importance of early personal financial and retirement planning
  - The absence of investments which lead to capital growth in the long term
  - The tendency some people have to spend all their money because they want certain possessions, which decrease in value
  - The absence of planning according to objectives that have to be achieved sometime in the future
  - The erroneous impression that you can earn a good living for the rest of your working life, which will ensure a good standard of living after retirement
  - Uncertainty of the future causes people with a negative attitude to be wary of investing their money- they believe its better to enjoy the money while they still can
  - People regard retirement as an event to be tackled after retirement, not before
- ⇒ Factors affecting your standard of living after retirement:
  - The number of homes possessed and lived in over the years- transfer duty costs which had to be paid each time
  - The number of times estate agents commission had to be paid

- The number of job or career changes, associated with loss of contributions by employers or because of the taxability of the lump sum
  - The number of children at university/ weddings etc.
  - The number of years during which a person has contributed towards a pension fund
  - The amount set aside for other retirement provisions
  - Whether both husband and wife contributed to provision for retirement
- ⇒ Parents and children should be taught to manage their personal finances for the following reasons:
- It will have a positive effect on the financial conduct of young people
  - Young people will strive for financial independence and will receive the guidance they need
  - Young people will assume responsibility for their own finances
  - They will know more about financial matters and be able to survive financially
- ⇒ Young people should know about the uncertain financial future that awaits them
- ⇒ A lifetime should be explained in terms of the life cycle and the planning required in the different life stages.
- ⇒ Career choices and investments that need to be made should be pointed out. The importance of early planning should be stressed
- ⇒ Information should be given about the importance of further studies and about choosing a career as an employee or an entrepreneur

**The income gap after retirement**

- ⇒ This shortfall must be replenished by means of effective retirement planning in the form of investments, if the person wishes to maintain the same standard of living as he or she did before retirement
- ⇒ Timely investments, with the necessary capital growth, can prevent this income from declining – such investment should be started between 20-30 years old

**The retirement planning process**

- ⇒ Objectives may include:
- To maintain the same standard of living as before retirement
  - To make a mortgage investment valued at R1mil
  - To pay off all mortgage bonds
  - To buy an expensive car/boat
- ⇒ Investment objectives are the same objectives as Step 1
- ⇒ Various investment avenues for retirement purposes- these are compared and evaluated according to the following investment criteria:
- Income
  - Capital growth
  - Safety of the investment

- Flexibility
- Liquidity
- Taxability
- Ease of management
- Risk
- Return
- Investment amount
- Investor's tax position/status
- Transaction costs
- Timing
- Diversity of investors portfolio
- Control
- Knowledge or management requirement
- Protection against inflation
- Investors objectives

**Methods of providing for retirement**

- ⇒ You should invest with a view to capital growth in the long term
- ⇒ Investments must also constantly be used to make provision for household financial risks and taxes that will have to be paid after your death
- ⇒ Ways of achieving capital growth over and above your employers retirement fund, before, during and after retirement:
- Retirement annuities; unit trusts; linked products; umbrella products; immovable property; shares; investment trusts; unlisted companies and hard assets
- ⇒ Ways of supplementing income over and above your employers retirement fund, before, during and after retirement:
- Retirement annuities; a money market fund; linked products; umbrella products; a lump sum endowment policy; a lump sum annuity; second-hand policies; rent income; shares; fixed-interest-bearing securities; participation bonds; unlisted companies; hard assets; a savings account; fixed deposits; property unit trusts; *property bank accounts*

**A defined benefit pension fund**

- ⇒ The Pension Fund act 24 of 1956
- ⇒ Goals of the act: the provision of annuities for employees and previous employees at retirement; the provision of annuities for the dependants of these employees; and other benefits to the above mention persons
- ⇒ 2 types of pensions plans:
- ⇒ Insured plan: a pension fund and an insurer reach an agreement whereby the insurer pays out all the benefits in the case of retirement, disability or death
- ⇒ Self-administered funds: the employer administers this type of fund.
- ⇒ Investments are made over the entire range of investment products, not only insurance
- ⇒ Important to distinguish between a defined contribution pension fund and a defined benefit pension fund

**Characteristics of a defined benefit pension fund**

- ⇒ The fund must have a large number of members to be effective
- ⇒ ideal for large organizations and businesses
- ⇒ the size of the fund is determined by the age of the employees, their salaries and years of membership
- ⇒ It is ideal for the remaining members where staff turnover is high
- ⇒ monthly contributions by employees are tax deductible
- ⇒ years of service may be bought
- ⇒ where additional years of service have been bought, the outstanding amounts, up to R1800 per year, can be deducted from income tax
- ⇒ it is wise to make additional contributions
- ⇒ there is no flexible retirement and estate planning

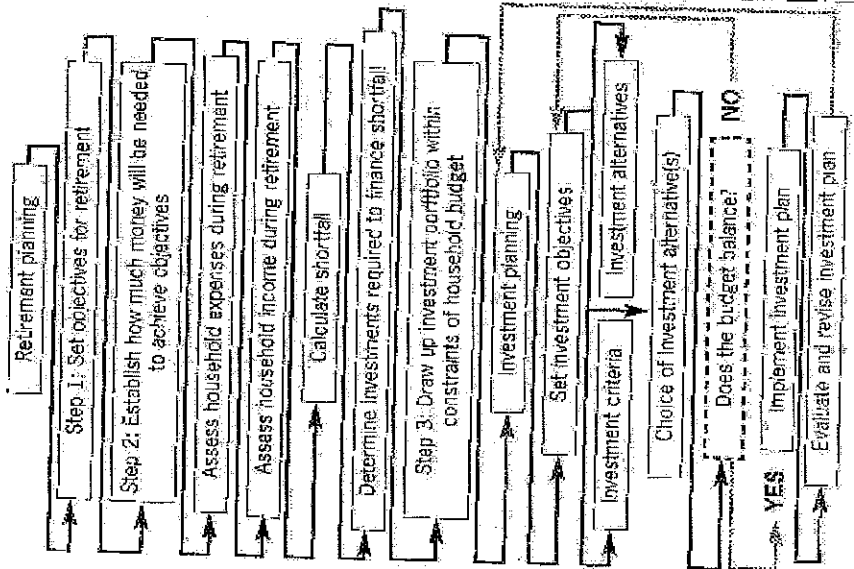


FIGURE 14.6 Steps to be taken in retirement planning

- ⇒ the primary objective of a pension fund is to provide a pension at retirement
- ⇒ trustees are free to increase retirement benefits after retirement, based on the performance of the insurers
- ⇒ contributions to the fund are paid from pre-tax money and, therefore your taxable income will be lower
- ⇒ Ceding your pension: it is not possible for a member of a pension fund to cede or pledge any pension fund benefits. It is possible for a creditor to claim these benefits while the member is still contributing to the fund
- ⇒ Insolvency: if a member has already received the lump sum part of the pension benefits, this amount will form part of the member's insolvent estate. The pension payable monthly to the members or member's dependants cannot form part of the insolvent estate
- ⇒ The employer may deduct the following from a members benefits:
  - Amounts payable to the employer with regard to a home loan
  - Warranties with regard to a home loan in favour of other persons
  - Any amount payable to an employer as a result of fraud and/or theft; and
  - Arrear contributions to a medical funds
- ⇒ Estate duty: no pension (or annuities) will ever form part of a person's estate for purposes of estate duty, unless it ceases to exist after the person's death. Income tax is payable on pension
- ⇒ Group Life Benefits: the group life benefits are regarded as pension benefits. Life cover is provided to members without any proof of health. Estate duty is payable on group life benefits as they are classified as normal insurance benefits
- ⇒ Functioning of defined benefit pension fund:
  - ⇒ Members contributions form a fixed % of remuneration for the retirement funding service
  - ⇒ The employer's contribution varies according to actuarial advice. The employer's contribution covers costs as well as death and disability benefits. The employer is responsible for member's benefits.
  - ⇒ Benefits are promised and defined according to a formula based on the members years of services and average final salary
  - ⇒ Monthly pension = 2.2% of the average final salary x years of service / 12
  - ⇒ Investment performance does not have such a significant effect on retirement benefits
  - ⇒ The investment risk rests with the employer
  - ⇒ At retirement the member receives 1/3 of the retirement benefit as a lump sum

Advantages: pension fund members

- ⇒ Monthly contributions are tax deductible
- ⇒ The pension is protected against the insolvency of the member
- ⇒ Life and disability cover are included at a low cost
- ⇒ The investment risk is not yours, because your employer still has to pay you your pension irrespective of the investment return
- ⇒ Even if you take early retirement because of ill health you will receive a pension calculated on what you should have received at retirement age

Disadvantages: Pension fund members

- ⇒ Employees lose the employers contribution as well as growth when they resign
- ⇒ 2/3 of retirement benefits must be taken in inflexible pension
- ⇒ Employees are not protected against their own indiscretion, because they can take their pension lump sum and squander it before retirement age
- ⇒ Monthly pensions do not keep up with inflation

Similarities between defined benefit pension funds, defined contribution pension funds and defined contribution provident funds

- ⇒ Membership requires and employee-employer relationship
- ⇒ Benefits cannot be ceded
- ⇒ With insolvency, benefits are dealt with in the same way
- ⇒ All forms of important provisions for retirement
- ⇒ Estate duty is payable on the lump sum after the death of the member
- ⇒ Benefits are handled the same in cases of divorce
- ⇒ Pensions benefits do not form part of the estate for the purposes of estate duty

- ⇒ Life and disability benefits are included for a in the membership for a low cost

A defined contribution pension fund

- ⇒ Clearly emphasis contribution
- ⇒ The major differences between a defined contribution fund and a defined benefit fund are:
  - Difference in the fixed contributions that you and your employer make to the fund every month - the amount is predetermined as a % of your salary
  - The employer does not guarantee the amount of your pension

Advantages of a defined contribution pension fund

- ⇒ If the fund does well you get the benefits
- ⇒ It is possible to receive more than in the case of a fixed benefit pension fund
- ⇒ There is a greater choice of funds in which to invest, because you have a say and may choose your portion yourself
- ⇒ Contributions are tax deductible

Disadvantages of a defined contribution pension fund

- ⇒ If the fund does badly, you will lose. You may even receive far less than expected depending on the timing of your retirement and the performance of the investment
- ⇒ Should you be forced to retire early because of poor health, you do not receive a pension on the basis of what you would have received at retirement age.

A defined contribution PROVIDENT fund

- ⇒ An employer-employee relationship is a prerequisite for provident fund members
- ⇒ 2 types: insured and self-administered

Defined benefit pension fund	Defined contribution provident fund
<ol style="list-style-type: none"> <li>1. Retirement benefits based on final salary and membership years</li> <li>2. Employer bears the risk</li> <li>3. Favours older fund members</li> <li>4. Members do not get back what they invested in the fund</li> <li>5. Referee receives one-third as lump sum</li> <li>6. Relation (ratio) between lump sum and pension is fixed (one-third: two-thirds)</li> <li>7. Higher administration costs because of more actual calculations</li> <li>8. To be efficient the fund requires a large number of members</li> <li>9. Ideal for large organisations</li> <li>10. The size/strength of the fund is determined by the age of the employees and their salaries</li> <li>11. Ideal for remaining members where the staff turnover is high</li> </ol>	<ol style="list-style-type: none"> <li>1. Retirement benefits based on total contributions made by member plus growth</li> <li>2. Employer bears the risk</li> <li>3. Favours younger fund members</li> <li>4. Members get back what they invested</li> <li>5. Referee receives 100% of benefits as lump sum (or less if member prefers)</li> <li>6. Member receives lump sum only</li> <li>7. Lower administration costs (no salary changes, years of service, highest salary per period)</li> <li>8. The fund requires a relatively small membership</li> <li>9. Small and new organisations or businesses can use this fund</li> <li>10. The size of the fund is determined by monthly contributions</li> <li>11. Staff turnover does not influence the benefits of remaining members</li> </ol>

Defined contribution pension fund v Defined contribution provident fund

Defined contribution Pension Fund	Defined contribution provident fund
Limited tax deductibility of monthly contributions	Contributions are not tax deductible
At retirement you should take at least 2/3's of you benefits in the form of pension	at retirement you can take 100% of your benefits in the form of a lump sum - you do not have to take any part thereof in the form of pension

Characteristics and functioning of a defined contribution provident fund

- ⇒ Monthly contributions to the fund are, fixed and determined as soon as you start working there % of salary
- ⇒ Retirement benefits are based on the total contribution a member has made to the fund, plus growth Employees bear the risk
- ⇒ Younger members of the fund benefit more
- ⇒ Members get back their contributions to the fund
- ⇒ At retirement the member take 100% of the total retirement benefit as a lump sum
- ⇒ Small or new organizations and businesses may use the fund
- ⇒ The size of the fund is determined by the monthly contributions made by members
- ⇒ Staff turnover does not have an effect on the benefits of the remaining members
- ⇒ Monthly contributions by employees are not tax deductible, employers contribution is.
- ⇒ Lump sums of up to R120 000 or R4 500 x years of service are tax-free
- ⇒ Very flexible retirement and estate planning is possible because members have control over the benefits
- ⇒ It is not possible to buy years of service
- ⇒ With relatively low real salary increases a defined contributions fund is effective, because benefits are not calculated on the final salary
- ⇒ The primary objective of the provident fund is to provide a lump sum at retirement
- ⇒ After the member has received the lump sum, the member has nothing to do with the fund
- ⇒ It is still possible to qualify for a state pension where benefits have been taken in the form of a lump sum

#### Advantages of provident funds

- ⇒ A member can also take all the relevant benefits in the form of a single lump sum
- ⇒ Members are in control of the entire amount of their benefits
- ⇒ Flexible retirement and estate planning is possible
- ⇒ Members can make additional contributions in order to increase their retirement provisions

#### Disadvantages of provident funds

- ⇒ Highest risk of the 3 funds
- ⇒ Lump sum benefits may be squandered
- ⇒ The rules of the fund do not allow members to buy back years of service
- ⇒ Contributions made by members are not tax deductible
- ⇒ Lump sums received are taxable in total in any event
- ⇒ The investment risk rests with the employee or member

#### Retirement annuities

- ⇒ An annuity is a series of payments or investments that are made in equal installments
- ⇒ A retirement annuity is a tax-friendly way of making provision for retirement
- ⇒ If you have an approved 4 year degree you may take out a PPS annuity (Professional Provident Society of South Africa). The return on this annuity is higher than that of other annuities because of the lower risk of the members
- ⇒ The PPS annuity is an ordinary annuity and functions in the same way as other annuities. The only difference is that extra tax-free dividends are paid out in cash for each share you own the retirement annuity's option must be exercised when you are between 70 and 55 years old- the investor must take 1/3 of his investment in lump sum and reinvest it and the other 2/3's must be used to buy a compulsory annuity

Investing the lump sum: The lump sum should be used to pay of the current bond or other debt if interest rates are high. For the purposes of capital growth, an endowment policy, unit trusts or a share portfolio may be chosen, based on the investors risk profile *voluntary annuity or income funds*

Annuities and emigration: The living annuity offers an opportunity to increase the amount of money that can be transferred out of the country

Use of retirement annuities for different categories of investor: The main purpose of retirement annuities is additional provision for retirement

Retirement annuities and Insolvency: Retirement annuities do not form part of a person's estate and are protected against the claims of creditors

Retirement annuities and estate duty: Income received from a retirement annuity (after his death) does not form part of the investors estate

Beneficiaries: A contributor to a retirement annuity may appoint a beneficiary to whom the proceeds must be paid

#### Employers and retirement annuities

- ⇒ Only the individual member may take out a retirement annuity. The following applies if an employer increases the employees salary on the condition that such an annuity be bought: the increase forms part of the employees normal income and the employee is entitled to claim tax deductions for contributing to the annuity

#### Retirement annuities and divorce settlements

- ⇒ They are included in divorce settlement where the spouses are married in community of property and out of community of property with inclusion of the accrual system

#### Retirement annuities and life coverage

- ⇒ Life cover may be added to a retirement annuity, in which case the annuity contributions remain tax deductible. A major disadvantage is that the life cover insurance influences the maximum tax-free amount

#### Compulsory versus voluntary annuities

- ⇒ When the purchase of annuities is required by law it is called a compulsory annuity. Income from a compulsory annuity is taxed in full
- ⇒ In the case of a voluntary annuity- the income is divided into income and capital. Tax is payable on the income portion and not on the capital

#### Preservation Funds

- ⇒ A preservation fund is a type of retirement fund in which retirement benefits from a pension or provident fund are kept
- ⇒ With a preservation fund, money may be withdrawn only once before retirement
- ⇒ The transfer of a retirement package from a pensions fund or a provident fund to a preservation fund is tax-free. If money is transferred from a pension fund to a preservation provident fund there are tax implications
- ⇒ An advantage of a preservation fund is that the employer's years of membership of the employer's fund can be transferred to the preservation fund. The years of membership are still taken into account when the tax-free lump sum is calculated

#### Deferred Compensation schemes

- ⇒ Companies offer such a plan to benefit senior or selected staff. The purpose is to reduce their tax liability on an annual basis and, at the same time, to purchase an endowment policy for them
- ⇒ The policy belongs to the employer. An agreement is entered into between the employer and the employee, in which the policy is ceded to the employee under certain conditions.
- ⇒ The employee receives a lump sum when he or she resigns or retires, of which a certain portion is tax-free.
- ⇒ The advantage is that this tax-free portion does not form part of the maximum tax-free benefits stipulated by law for purposes of retirement.
- ⇒ The policy has life cover as well as maturity level
- ⇒ The lump sum forms part of your estate after your death

#### Advantages of a deferred compensation scheme

- ⇒ *Income tax advantages:* return on benefit is taxed separately from all other returns or policies

- ⇒ *Additional provisions*: because of the tax benefits the employee has more money for retirement
  - ⇒ *Improved working conditions*: employees are more loyal and perform better
  - ⇒ *Protection for dependants*: the scheme can be used to benefit dependants should the employee die before retirement
  - ⇒ *Flexible contributions*: contributions can be increased or decreased to suit the pocket
- Perks tax: deferred compensation is not subject to perks taxation because it provides retirement benefits to employees

#### The agreement between employer and employee

- ⇒ An employer takes out a policy on the life of an employee. At the same time an agreement is concluded between the employer and the employee that makes provision for the following:
  - Payment of the proceeds of the policy at a certain age or at the employee's death, resignation, termination of employment or disability
  - Cession of the policy to the employee
  - The rights of the employee in the case the employer is declared insolvent
  - Payment of annuities instead of a lump sum

**Death: lump sum and annuities:** The lump sum accrues to his estate a, unless it accrues directly to dependants or beneficiaries, the employer becomes liable for income tax payments on the lump sum

**Estate duty:** Payable unless the policy proceeds accrue directly to a dependant according to the agreement

**Cession of the policy:** If it is possible for an employee to cede a policy to an employee before the actual date of maturity. The cession takes places at the discounted value of future proceeds and offers the employee a lower taxable amount

**Tax implications for employees:** The proceeds of the policy are exempt from income tax up to and including an amount of R3000

#### Insolvency

- ⇒ The insolvency of the employee will have no influence on the validity of the value of the policy
- ⇒ The policy is the property of the employer
- ⇒ A problem exists in the case of the employee being declared insolvent. Employee have no protection and will lose their expected proceeds in this event, unless alternative arrangements have been made

#### Unit trusts

- ⇒ Unit trusts offers a high capital growth and may be realised quickly because they are very liquid
- ⇒ Unit trusts can be divided into 3 categories: general trusts; specialist trusts and income trusts
- ⇒ General trusts and specialist trusts are aimed at capital growth, while income trusts provide regular income for investors
- ⇒ Money market funds provide an income for investors, while their capital is protected. Money market funds have the lowest risk of all unit trusts
- ⇒ Methods to buy unit trusts:
  - Completing application forms supplied by a broker or an institution
  - Filling in magazine and newspaper ads
  - E-mail
  - Websites and internet
  - Dialling the toll free numbers of customer care services
- ⇒ Unit trusts offer high capital growth, particularly when the investment is kept for more than 3 years
- ⇒ They also protect the investor against inflation. Unit trusts are very liquid. The total investment may be called up within 10 days, if the investor needs the money urgently

- ⇒ It is possible to link an investment in unit trusts with a life policy, a endowment policy or a retirement annuity- called a unit trust-linked investment
- ⇒ Short term- money market and income
- ⇒ Medium term- prime stock and specialist
- ⇒ Long term- managed shares
- ⇒ If you have relatively little knowledge of unit trusts, you should either not be involved at all managing your unit trust portfolio, or you involvement should be very limited
- ⇒ Tax is paid on the income received from income trusts and money market funds

#### Knowing your risk profile

- ⇒ Risk adverse investors should invest in low-risk unit trusts (or no unit trusts at all)
  - ⇒ Risk indifferent (neutral) investors should invest in medium-risk unit trusts
  - ⇒ Risk-takers (seekers) should invest in high-risk unit trusts (or shares)
- #### An investment technique
- ⇒ Investors should divide trusts into 4 categories, in view of the different reactions of shares in these categories to market conditions
    - ⇒ Cash and capital market funds; value funds; growth funds and special opportunity funds
    - ⇒ Cash and capital market funds are very sensitive to changes in interest rate. These funds invest in money market instruments and offer a low risk to investors
    - ⇒ Value funds concentrate on the prime shares of the JSE.
    - ⇒ Growth funds invest in smaller, prime shares
    - ⇒ Special opportunity funds offer high-risk investments in unit trusts

#### Unit trust switches

- ⇒ Guidelines on switching between unit trusts:
  - Timing is important
  - Losses may be incurred
  - Switching entails the selling of units from one fund and then buying units from another
  - The real cost is determined by looking at the market value of the unit trusts before and after the switch
- ⇒ Market timing when switching between unit trusts:
  - Keep your money in equity unit trusts when the stock market is surging
  - Switch to high-income funds when the stock market peaks
  - Past performance is used to predict future performance
  - Serious investors choose a buy-and-hold strategy (buy low and sell high)
  - The volatility of the unit trusts industry is the cause of market-timing services
  - Market timing combines the fundamental and technical approach
  - It is almost impossible to predict the turning points in share prices over the medium and long term
  - Rand-cost averaging (diversification over time) is one way of solving the timing problem
  - In the case of rand-cost averaging the average cost of the units will always be lower than the average market price
  - Investors are advised to take a long-term view for the entire economic cycle

#### Money market funds

- ⇒ Money market fund is a unit trust that serves as a short-term investment industry. The objective is to provide a current income to investors.
- ⇒ A money market fund invests the joint investment of a large member of investors in the money market. He capital is safe because it is invested in government and other public securities, treasury bills, debentures, bank deposits and other permissible money market instruments with a term of longer than 12 months

- ⇒ For what situation is it suitable: If you require total liquidity, if you're looking for a risk free investment; if you want an income from you investment
- ⇒ Money market funds versus other unit trusts:
- ⇒ Although certain unit trusts offer an income, capital growth is the primary objective of others. Money market funds are aimed at protecting capital and offering a high income at the same time.
- ⇒ Unit trusts invest in the shares of listed companies, whereas money market funds invest in money market instruments. The risk involved in money market funds is much lower than in unit trusts
- ⇒ The income from both is fully taxable. Interest is paid every 6 months | unit trusts and every month in money market funds. Both are very liquid
- ⇒ Money market funds versus fixed deposits:
- ⇒ The interest rates of money market funds fluctuate, whereas those of fixed deposits do not.
- ⇒ In money market funds, the investment may be obtained within a day.
- ⇒ The money in fixed deposits may be withdrawn only after a fixed term
- ⇒ Money market funds are, therefore more liquid.
- ⇒ In both cases, the interests or income is fully taxable. The interest's rates of money market funds are higher than those of fixed deposits. This risk is lower in money market funds than in fixed deposits.
- ⇒ Benefits of money market funds:
- ⇒ The money in fixed deposits may be withdrawn only after a fixed term.
- ⇒ Money market funds are, therefore more liquid.
- ⇒ In both cases, the interest rates of money market funds are higher than those of fixed deposits. The risk is lower in money market funds than in fixed deposits
- ⇒ Small investors may invest in them
- ⇒ Investments are very liquid
- ⇒ They yield a higher return than other short-term investments than offer an income
- ⇒ They are more diversified than other, similar investments
- ⇒ The competition they generate will lead to better investments
- ⇒ The investors capital is very safe
- ⇒ They are suitable for people who want to avoid risks
- ⇒ They provide a high return in inflationary conditions
- ⇒ No commission is payable
- ⇒ Disadvantages of money market funds:
- ⇒ No fixed returns are guaranteed
- ⇒ Potential investors do not have the benefit of a South African track record
- ⇒ Fund managers are still 'inexperienced'

### Unit trust linked products

- ⇒ Are those in which trusts are linked to retirement annuities, living annuities, preservation funds, guaranteed income plans and guaranteed capital plans
- ⇒ These products allow the investor to switch from one unit trust to another. You may invest monthly in unit trusts-linked products, or invest a lump sum in unit trusts
- ⇒ Advantages:
  - These products are particularly suitable for investing a lump sum package
  - They offer the benefits of unit trusts plus the benefits of other products
  - It is cheaper to switch between unit trusts
  - The investor's needs concerning risk and return are better satisfied, particularly in changing market conditions
  - Relatively small amounts may be invested
  - An investment may be gradually phased in to lower the risk

- Information about your investment is easily obtained and all aspects of your investment are transparent
- Your money is kept safely in a trust
- Administration during the investment process is very simple for the investor
- A computer system provides immediate information about your investment
- ⇒ Disadvantages:
  - If your needs change, you will not be able to cancel the unit trust link free of charge and reinvest the money in another product
  - If you choose the wrong unit trust portfolio, the average return of your linked investment may be considerably lower
  - Investors do not always want to hold their offshore investments in the same product as their local investments
  - Linked-product companies charge annual management fees, which will increase your total costs
- Umbrella products (split investments)
- ⇒ Linked products, wrap funds, funds-of-funds and multi-manager
- ⇒ The main purpose of split investments is to offer you, as the investor, the greatest possible choice and freedom
- ⇒ Linked products: the umbrella products may be retirement annuities, living annuities and preservation funds. The cost of switching from one linked product to another are far less than were unit trusts are managed by various companies
- ⇒ Wrap funds: provide large scale diversification (spreading the investment risk) by investing in various sectors or industries
- ⇒ Fund-of-funds:
- ⇒ Should not have to many underlying unit trusts because then you may as well invest in an index fund
- ⇒ An international fund-of-funds is very useful because you can invest in specific countries
- ⇒ Makes you choice easier, because you do not have to pick the funds yourself
- ⇒ Fund-of-funds is not only for wealthy investors
- ⇒ It gives you access to a wide spread of investments
- ⇒ Offer you greater diversification, even though you are investing in a single fund
- ⇒ May present you with over-diversification
- ⇒ Do not have a fixed investment period
- ⇒ Multi-manager: an investment strategy where a 'multiple manager' does the following on behalf of the investor:
  - ⇒ Decides how must should be invested in different asset classes
  - ⇒ Decides how much should be invested in the different sectors of an asset class
  - ⇒ Selects asset managers/ management companies
  - ⇒ Monitors the performance of the asset class and sector
  - ⇒ Monitors the specific instructions given to the asset manager

### Insurance products

- ⇒ Goals of insurance as a long-term investment: to provide policyholders with different kinds of indemnity; and to provide members with a savings plan aimed at retirement
- ⇒ Categories of need individuals experience:
  - Income in the case of death before retirement
  - Income in the case of disability before retirement
  - Income at retirement
  - Capital in the case of death before retirement

### Capital at retirement

#### Endowment policies

- ⇒ Can be used to supplement pension benefits
- ⇒ Is a combination of life insurance and investment, and has several applications:
- ⇒ To provide capital at retirement; to buy a pension; to supplement a pension and to provide cover for dependants during the policy term
- ⇒ **Advantages:**
- ⇒ Income tax advantages ( tax-free after 5 years), can be ceded, can be surrendered after 3 years and flexibility (life cover can be added)

#### Lump sum investments in insurance products

- ⇒ A **lump sum endowment policy**: investment options should be chosen when you take out a lump sum endowment policy;
- ⇒ The amount may be invested for 5 years after which cash withdrawals are made every month.
- ⇒ These withdrawals are tax-free
- ⇒ To invest the lump sum for 5 years but to make the monthly withdrawals for 60 months. The amount of the monthly withdrawal is divided equally between capital and income. The income is taxable, while the capital is tax-free
- ⇒ **Second-hand policies**
- ⇒ A **lump sum retirement annuity (voluntary annuity)**: the income and capital of a voluntary annuity are handed in the same way as the second option of a lump sum endowment policy

#### The securities exchange

- ⇒ Can invest in share via a stockbroker, a bank or a full-service broker
- ⇒ You may speculate with shares in the short term or make a long-term investment
- ⇒ As a company grows shares are issued to the public
- ⇒ **Unit trust**: is an open trust (or fund) in which you may buy units and later sell these units back to the trust. A unit consists of securities and shares
- ⇒ **Securities**: are financial assets issued by the government, state-aided institutions and larger municipalities and companies. Your capital grows and you also receive dividends
- ⇒ **Are shares more risky than unit trusts?** Yes but shares offer a higher return. Different unit trusts also mean higher or lower risks for the investor depending on the companies in whose share the trust has invested
- ⇒ **Investment in shares**: direct ( you buy shares that are listed on the securities exchange) or indirect ( a unit trust)
- ⇒ **Why invest in shares?**
  - You can make a relatively large profit in a relatively short period
  - You can sell your shares after a relatively short period if you want cash in your pocket
  - The value of most shares grows over the long term, so the return on your investment will be higher than the inflation rate
  - You receive income in the form of dividends
  - At present no tax is payable on dividends
  - A positive growth rate can be obtained over the long term
  - Capital may be increased quickly
- ⇒ **Difference between investment and speculation:**
  - **Investment**: shares are bought as a long-term investment. The purpose is long-term capital growth
  - **Speculation**: the shares are bought and sold to make a profit. The speculator invests his money in the short-term and is not interested in capital growth

- ⇒ If you are buying you have to pay broker's fees and marketable securities tax. When you are selling you only have to pay brokers fees

#### There are 2 approaches to determine the value of shares:

- ⇒ The fundamental approach consists of 3 steps: a macro-economical analysis that determines and explains the course of the general economy, and then the selection of an industry and finally an analysis of the individual business in a specific branch of an industry
- ⇒ The technical approach analyses the historical movement of share prices
- ⇒ **Newspaper terminology:**
  - **H**: highest price of a share the previous day (in cents)
  - **L**: the lowest price of a share the previous day
  - **Co**: Company name
  - **Last**: Closing price the previous day
  - **Buy**: price at which the buyers wanted to buy
  - **Sell**: the price at which sellers wanted to sell
  - **DY**: dividend yield
  - **Earnings Per share**: total net profit of the company divided by the total number of shares issued by the company
  - **PE**: price earning ratio- dividing the price of the share by the earnings per share. The higher the PE the higher the expectation that the specific share will perform for many years to come
  - **+/-**: the movement of the day
  - **DV**: day's volume
  - **Money market**: market for short-term funds
  - **Capital market**: market for long-term funds
  - **Bank acceptance rate**: a short-term investment instrument in which individuals and companies may invest. They are bought from a bank that guarantees a certain interest rate or rate of return; the amounts are very large
  - **Consumer price index**: the inflation rate
  - **Blue Chips**: are shares in the strongest companies with the best performance record
  - **Black chips**: Companies under "black control" on the JSE
  - **Bull market**: a buying phase during which the price of shares are continuously rising
  - **Bear market**: a tendency for share prices to fall
  - **Sentiment**: the sentiments of dealers in expectations of or following certain events or announcements concerning for e.g. interest rates
  - **Gold index**: the total movement of selected gold shares
  - **Industrial index**: the total movement of selected industrial shares
  - **Dow Jones Industrial Index**: the industrial index of the American stock exchange
  - **Nikkei**: the total index of the Japanese stock exchange

#### Investment trusts

- ⇒ An investment trust is a company that invests in the shares of other companies. Investment have investments in both listed and unlisted companies as well as mines
- ⇒ Investment trusts are unpopular in South Africa because of the low prices at which shares are traded.
- ⇒ Investors invest directly in these shares in order to trade in them

#### Fixed-interest-bearing Securities

- ⇒ Securities are various financial vehicles that the state, state-aided bodies and municipalities use to obtain capital over the long term
- ⇒ With fixed-interest bearing securities, investors are promised a given predetermined return
- ⇒ Gilt-edged stocks: stocks issued by the sata



- MNF303-8
- ⇒ Semi-gilt-edged stocks: debentures issued by state aided bodies
  - ⇒ Debentures: debentures issued by companies consisting of: debentures with or without cover of assets as security; guaranteed debentures; profit-sharing debentures and convertible debentures
  - ⇒ Preference shares are also fixed-interest-bearing securities and are a mixture of ordinary shares and debt. Preference shares are shares bearing a fixed annual rate of dividend, with a prior right over all ordinary shares in the distribution of dividends from annual profits

#### Unlisted shares

- ⇒ It is very risky to invest in unlisted shares
- ⇒ The reason is primarily because an investment in unlisted companies is not protected by the companies act
- ⇒ Investors should avoid any investments that are not in shares
- ⇒ It is advisable to ask for the prospectus of any shares issued. The Companies act requires that every prospectus should give details of the unlisted company

#### Hard assets

- ⇒ Have intrinsic value (monetary value) as well as aesthetic value. Aesthetic value refers to the collectors value that the assets has for the owner (the returns on such investments are taxed)
- ⇒ Diamonds; postage stamps; works of art; gold; antiques; old coins and silver
- ⇒ Advantages of investing in hard assets:
  - Aesthetic value: for the owner
  - Transportation: they are light and do not take up much space
  - Acceptability: these assets are accepted internationally.

#### ⇒ Disadvantages of investing in hard assets:

- Theft
- Loss
- Cost of insurance
- Specialist advice
- Possibilities of selling: not always possible to sell these assets in a short period of time

#### A lifestyle approach towards retirement

- ⇒ These lifestyle investments that are required to serve your goals in life

#### Financial Discipline

- ⇒ Do things that force you to pay attention to personal financial planning
- ⇒ Discuss your finances with an expert twice a year
- ⇒ Join an investment club that will give you information about financial developments, and the opportunity to discuss and evaluate them

#### Other retirement planning issues

##### Changing jobs

- ⇒ Make sure that you get the necessary tax advice in order to avoid paying unnecessary tax, or to defer tax, and to prevent money that you have just received tax-free from being taxable again
- ⇒ Your money may only be transferred from a pension fund to a pension preservation fund, and from a provident fund to a provident preservation fund
- ⇒ The greatest advantages of a preservation fund are that you get the opportunity to think about what you want to do with your life and your money, and that service years are transferred from your retirement fund

#### Your group life benefits

- ⇒ As soon as you retire, you lose all group life benefits, consisting in both life and disability cover
- ⇒ If you remain a member of your employer's group life scheme, either before or after retirement, you must do this. The reason is the much lower premiums you will have to pay in comparison with the same coverage elsewhere

#### Taxation

- ⇒ After retirement, the rebates are greater, with medical deductions for those who do not belong to a medical aid fund
- ⇒ Fixed benefit funds, fixed contribution funds, fixed contribution provident funds and retirement annuities

#### Tax-free amount of lump sums for pension, provident and retirement annuity funds

- ⇒ Overall maximum tax-free lump sum from the 3 funds: Z=Y+E-D
- ⇒ Z= tax free amount
- ⇒ E= disallowed contributions to approved funds
- ⇒ D= any tax-free lump sums received in previous years
- ⇒ Y= N/10 x HAAS
- ⇒ Y= amount to be determined
- ⇒ N= Number completed years of membership of the fund
- ⇒ HAAS= highest average annual salary
- ⇒ Y is limited to the greater of R120 000 or R45000 x N

#### Tax treatment of a monthly pension

- ⇒ The pension is taxable like any other income. Tax payable will depend on the amount of the total taxable income, because the latter will determine the marginal tax rate

#### Some income tax avoidance guidelines

- ⇒ If you have contributed more towards retirement annuities than may be deducted annually by law, you may claim these amounts from future income
- ⇒ You can bring these excessive contributions into account when calculating your taxable lump sum on retirement
- ⇒ Remember the R30 000 tax free amount from a deferred compensation scheme
- ⇒ If you have enough retirement funds, you must take the greatest lump sum you are entitled to
- ⇒ Always protect the (maximum) number of years you have contributed towards a retirement fund, so as to receive the maximum tax-free amount

#### Capital Gains tax

- ⇒ Keep the required documentation of everything CGT may apply to

#### Psychological preparation for retirement

- ⇒ When you retire you should find new anchors or new systems to give your life structure. Because your existing support systems have fallen away, you have to replace them
- ⇒ Most retired people are not prepared to accept new ways or ideas of doing things
- ⇒ A retired persons mental health depends on a willingness to accept changes
- ⇒ In order to retain emotional and mental health and to prevent mental confusion: remain intellectually active, positive and rational; keep in contact with the active world; keep control over personal affairs and ensure an income, remain flexible; go on holiday or travel regularly; be creative; take up a

hobby; avoid stressful situations; pay attention to your personal appearance; retain your self-confidence; speak positively - it stimulates your health

### Where to live after retirement?

- ⇒ In your own home: advantage: its value increases at more or less the same rate as inflation, it is a hedge against inflation; it can always be sold at a later date at a capital profit. Money can also be borrowed with the house as security
- ⇒ A town house: is controlled and marketed under the Sectional titles act 95 of 1986
- ⇒ A retirement scheme: sectional titles and share-block schemes are often built in the form of retirement villages or retirement schemes. Certain schemes allow retired couples to buy a lifelong interest in a unit. After the person's death the unit is passed to the scheme and can be sold again
- Advantages:
  - Emphasis is on security
  - There are no maintenance costs
- Disadvantages:
  - Poor management of the scheme can cause investors to lose their money
  - Monthly levies can be high
  - There may be lack of medical facilities
  - Parking is limited
  - Pets are not allowed
- ⇒ In the country or by the sea:
  - Advantages:
    - The purchase price of the house is lower
    - Municipal costs are lower
    - Maintenance costs are lower
  - Disadvantages:
    - Medical facilities are not always readily available
    - The absence of sports facilities, cultural activities, public transport etc.
    - The risk of theft and even attack on your life is greater
- ⇒ Home of senior citizens or frail-care centre: provide occupants with accommodation at a fairly low cost, inexpensive meals, medical care, recreational facilities and spiritual counselling
- ⇒ Frail-care centres also provide physical aid and support to those who can no longer walk, bath themselves and so on

### A job after retirement

- ⇒ Clarify your motives before starting a new job
- ⇒ Consider your potential, your needs, your desires and overall health
- ⇒ It is important that you consider your personal strengths and weaknesses before starting a new job
- ⇒ Carefully evaluate your level of education, training, work experience, interests, skills and knowledge
- ⇒ Compare the above personal analysis with the specific nature of a job
- ⇒ Important that you calculate your retirement income deficit RID
- ⇒ Keep your priorities straight
- ⇒ Employee v Employer: the advantages of working as an employee include: job security, less risk, less stress and responsibility, and receiving pay while ill
- ⇒ The disadvantages of being an employee: an oversupply of labour- difficult to find a job, fierce competition from younger people
- ⇒ if you intend to work as an employer, you have the advantage of being able to pursue real interests, with the flexibility to do what you feel like, when you feel like it, as well as being able to involve your whole family.

Disadvantages include the risk of losing all your assets, high stress levels, which could cause deterioration in health, and the greater effort that is required to earn a living from your own business. Time management and planning are essential

⇒ Buying a business: it is always advisable to see a business consultant before you put up your retirement money into what may be an unprofitable venture

### Financial strategies at and after retirement

- ⇒ When to retire: at what age and in which month of the financial year
- ⇒ It is also important that any pension benefits, provident fund, retirement annuity and deferred compensation scheme should be received on different dates. The purpose is to keep tax liability as low as possible. If the benefits or lump sums and/or instalments are received simultaneously, the tax liability will be much than if these benefits were received separately
- ⇒ Inflation halves the purchasing power of money every 5 to 10 years. you would then have to earn 2 to 4 times as much money after retirement than before retirement in order to be able to maintain the same standard of living as at present
- ⇒ Tax free investments: the purpose of tax-free investments is to lower your tax liability. It is possible to convert existing taxable investments to tax-free investments in order to save on tax
- ⇒ Increase your pension: buy back years of service form your employers pension fund and/or make voluntary additional monthly or annual contributions to your pension
- ⇒ In the case of buying back pension from an employer, you increase your years of service and, consequently also your pension benefits after retirement.
- ⇒ In the case of making additional contributions, you increase your investment in the pension fund and, consequently your ultimate pension benefits
- ⇒ Pay off your debts!
- ⇒ Ensure sufficient liquidity especially for emergencies
- ⇒ Buy annuities: if you have a tax problem, buy more annuities in order to reduce your tax liability
- ⇒ Invest in the short term
- ⇒ Participation bonds: their money is invested in fixed savings for 5 years, but the safety of the investment is guaranteed
- ⇒ Diversified investments: spread the risk

### Civil servants

- ⇒ Should not place retirement funds in a preservation fund, because tax-exempt benefits will be lost.
- ⇒ Preservations funds do not accept member contributions, but only transfer benefits
- ⇒ Civil servants benefits are consolidated to be member contributions for tax purposes and not transfer benefits
- ⇒ distinguish between: younger than 55 years; older than 55 years with at least 10 years of pensionable service; between 50 and 65 with at least 10 years of pensionable service; people younger or older than 55 with less than 10 years of pensionable service left

### Retirement planning for domestics

- ⇒ if no savings exist, the employer may assist the domestic worker in one or more of the following ways:
- ⇒ Take out an affordable insurance policy for the worker, in the workers name, the employer can pay the premiums or share them with the employer
- ⇒ open a savings account at a bank
- ⇒ Invest in a trust on a monthly basis.
- ⇒ A life policy can be taken out on the life of the employer. Cede the policy to the worker or relatives in the case of the workers death

⇒ The least any employer can do is inform such a worker of the importance of saving for retirements; ask somebody else to do the informing; assist in planning such an investment

