# to take care of before you die

■ If Fate is unkind to you and you die tomorrow, your best legacy to your dependants is their knowing not only that they are financially secure, but that your estate can be wound up quickly and cleanly.

MOST SOUTH AFRICANS WILL DIE before they are 50. Most will probably die without a will. Most with dependants will die leaving their dependants to face financial hardship.

Many of those who leave their dependants facing a financially insecure future will do so because they simply failed to plan and take action.

And the reason they do not plan and take action is because they simply do not believe they are one of the people who will die before the age of 50, or 60, or 65 from anything from a road accident to a serious disease.

Most people do not believe the old adage, namely, there are two certainties in life: tax and death. While most people nowadays acknowledge that, with the increased efficiency of the tax collectors, tax cannot be escaped, they still think they can escape the Grim Reaper, at least until an advanced age.

And death and tax are not two separate entities – they are inextricably linked.

PERSONAL FINANCE has put together a list of 10 things you should take care of now in case you die prematurely (working on the assumption that most of us do not know that date). Following this list will help to ensure that your dependants will not be left desperately looking for someone else on whom they can depend.

It all falls under the broad heading of estate planning. Be aware that estate planning is not only about having a will; it entails a lot more.

## 1 Your will

THE MOST OBVIOUS AND IMPORTANT OBJECTIVE in planning your estate for when you are no longer around is having a will. A will makes provision primarily for who gets to own your assets after you die and the guardianship of your minor children. A will helps to ensure that your wishes are clearly documented and protected by law. Regardless of the size of your estate (your assets less what you owe), preparing a will can help to prevent the State, in effect, from deciding who will inherit your assets.

If you die intestate (without a will), it is possible

ILLUSTRATIONS: COLIN DANIEL

that people you don't want or expect to inherit will receive a portion of your estate, while those you think will receive your assets may get a smaller share.

You also need to ensure that your will is properly drawn up and as such is executable. If not it could well be decided that you died intestate.

In a recent High Court judgment, Judge JA Leach said: "It is a never-ending source of amazement that so many people rely on untrained advisers when preparing their wills, one of the most important documents they are ever likely to sign."

In an effort to reverse the situation described by the judge, the Fiduciary Institute of South Africa (Fisa) has been struggling for some years to get South Africans to prepare wills, and when they do, to ensure the will is put together by a qualified professional.

A do-it-yourself will bought from your local bookstore is not always the answer. There are lots of little things that can catch the unwary – such as beneficiaries of a will not being allowed to sign the will as witnesses.

**ANGELIQUE VISSER:** 'Fisa experts are at hand'

Angelique Visser, chairperson of Fisa, says an expert will guide you in important matters you will need to consider, such as what to take into account when you nominate an executor to carry out your wishes, who should act as a guardian for dependants such as children, and how the financial needs of your dependants can be protected.

A good place to start in finding expert assistance is Fisa. Its members must meet rigid minimum standards of fiduciary competence and they must show integrity and honesty. The necessary administration systems must be in place to provide a professional service.

You can contact a Fisa practitioner in your area by sending an email to secretariat@fidsa.org.za. For more information about Fisa, go to www.fidsa.org.za

**Tip:** Keep a copy of your will and important documents relating to your will – such as a living will, life assurance policies and a list of your assets, such as unit trust investments and shares – in one file that is accessible in the event of your death.

>>

## 2 Testamentary trust

IF YOU HAVE DEPENDANTS, WHO CAN RANGE from minor children to elderly parents suffering from dementia, your will must take account of how they will be cared for financially, particularly in the case of both you and your partner dying simultaneously – for example, in a motor vehicle accident.

A minor child cannot inherit cash from you and decide on how to spend it. If you have not established in your will how assets will be managed on behalf of a minor child, the money will be handed over to the Guardian's Fund, which is administered by the Registrar of the High Court.

A testamentary trust is established in terms of your will. In most cases a testamentary trust is considered to be a "special trust" by the tax authorities, which means it is more leniently taxed than an ordinary trust. It is taxed on the same basis as an ordinary taxpayer (a natural person).

A special trust can also be created in the form of a living (inter vivos) trust before death for the benefit of a person who suffers from a mental illness or serious physical disability that prevents them from earning sufficient income for their own maintenance.

A special trust, be it a testamentary or a living trust, is reclassified as an ordinary trust and loses its tax benefits when the youngest beneficiary turns 21, unless a beneficiary suffers from a serious mental condition or physical disability.

A special trust's income tax rate is based on a sliding scale, starting at 18 percent and moving to a maximum of 40 percent, as happens for an ordinary person. Only 33 percent of a special trust's capital gains are included in its taxable income. A special trust can also claim the capital gains tax (CGT) primary residence exemption and the annual exclusion, which are usually reserved for natural persons.

The income tax rate for an ordinary trust is fixed at a flat rate of 40 percent while 66 percent of its capital gains are included in its taxable income. It does not qualify for the primary or secondary rebates, exemptions on interest and dividends, the CGT primary residence exemption or the CGT annual exclusion.

In other words, the taxman does not like ordinary trusts but fully appreciates the use of special trusts to handle the affairs of those who may otherwise not be able to do so.

The choice for you is whether to use a trust if you have minor children who qualify for a special trust or to hand over the cash to your nominated guardian to manage and use as and when required in caring financially for your children.

If you decide on a testamentary trust, you will also need to decide on the trustees. You must take great care. You could consider having a trusted relative as a trustee to keep watch, while appointing a professional to ensure the proper administration of the trust and investment of the assets.

Advantages of a testamentary trust include:

- Assets can be protected for generations to come; and
- It can protect the interests of beneficiaries such as minor children, a disabled child or a spouse with a degenerative disease, such as Alzheimer's.

## 3 Living will

MANY PEOPLE DON'T REALISE THAT ESTATE planning includes preparing documents such as living wills, which make provision for delicate situations such as when you should be taken off life support and allowing your organs to be donated at death.

While a living will is not a legal document, it is one of the kindest things you can do for both yourself and your loved ones, because by speaking for you when you can't, it can save them from unnecessary stress and can save you from prolonged pain and suffering.

It can also have a significant impact on your finances, because keeping yourself alive on expensive life support devices reduces the potential for financial security for your dependants.

There is an increasing need to know how family members want to be treated in these "death-in-life" situations, because modern medicine and techniques have advanced enormously, enabling medical practitioners to sustain life that would otherwise not continue.

A living will provides guidance to your family in the final stretch of an illness or if you have suffered a severe injury from which you have no hope of recovery and which is causing you a great deal of pain. A living will tells your family whether you want them to take every measure they can to try to keep you alive for a few more days, or another week or month, or simply turn off the switch.

A living will does not mean:

- You are instructing doctors not to treat you in cases in which you could recover from an illness; or
- You are instructing doctors and nurses to abandon you when you are dying. Your doctor is still obliged to do all that he or she can to keep you comfortable and free of pain.

## 4 Death taxes

DEATH IS A TAXABLE EVENT. YOU NEED TO BE aware of the impact of death duties on your estate. The taxes could reduce the amount you leave to your dependants. These taxes also need to be taken into

account when you assess how much life assurance you need (see point 10 on **page 18**).

Your estate is subject to: estate duty, which is a tax on all your assets less your liabilities; CGT, which is a tax on gains in the value of your assets; and income tax, on whatever income is generated by the estate.

■ **Estate duty.** This is applied at a rate of 20 percent to your net assets, with the following exemptions:

❑ No estate duty is levied on assets bequeathed to a life partner, in terms of section 4(q) of the Income Tax Act; and

❑ The first R3.5 million of your net assets is excluded from estate duty.

■ **Capital gains tax.** CGT applies to the increase in the value of your assets from the date of purchase (the base price cost) to the value at the date of your death. The top effective rate is 13.32 percent.

The following exemptions apply:

❑ No CGT applies to assets bequeathed to a life partner. However, CGT will apply using the original base cost that applied in your hands when the inheriting partner dies.

❑ The first R300 000 in capital gains is excluded.

❑ The first R2 million in the gain in value of a primary residence is excluded.

It is best to get advice on how to structure your estate to get the best solution. For example, it may be best not to leave all your assets to your life partner but to pass on, say, your home to your children, to take advantage of both the estate duty and CGT exemptions, while giving your spouse a life right to the abode.

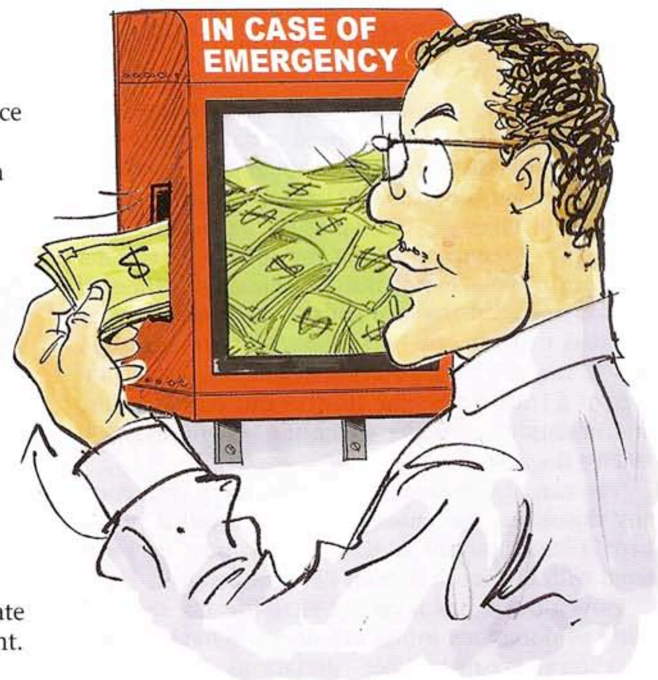
When your partner dies, the same exemptions will apply again. So instead of receiving the exemptions only once, you can double them to the advantage of your beneficiaries.

There is also an annual CGT exemption of R30 000 that can be used to reduce your commitment at death. For example, say you have a portfolio of unit trust funds that has been increasing in value. Every year you could sell and repurchase the number of units providing the R30 000 gain to reset the original base value of these units to a new base value.

Obviously, you should not do this if your estate will be valued at less than the exemption threshold. You also need to take account of the costs of resetting the base value.

## 5 Emergency fund

AN EMERGENCY FUND IS VITAL FOR BOTH WHEN you are alive and in the event of your death. Prior to death an emergency fund is required for life's unexpected events, which can range from your refrigerator packing up to the loss of income from causes ranging from a bad accident to retrenchment.




When you die, cash is needed to keep your family going and to pay for things such as funeral expenses. Your executor may face two problems in maintaining sufficient cash flow to meet these requirements:

■ If your money is locked up in illiquid assets that will be tied up in your estate, such as unit trust funds and your home, your executor may be forced to sell assets at an inopportune time, such as when there is an investment market downturn; and

■ Many payments may take some time to come through. For example, it could take some months before the benefits of any retirement savings are paid out, particularly if the distribution decided on by your fund trustees is challenged (see point nine on **page 18**).

Most financial advisers suggest you keep a cash emergency fund equal to three months' income. The money can be kept in a money market account, where it is normally accessible within 24 hours. Remember to give a partner withdrawal rights.

## 6 Donations

ONE OF THE EASIEST WAYS TO REDUCE ONE'S taxable estate is to gift assets to friends or relatives each year within the donations tax exclusion limits. This is a convenient way not only to reduce the taxes your estate may have to pay after you're gone, but also to see whether your beneficiaries are capable of using your assets wisely.

However, the taxman does not allow you >>

>> simply to give away your assets to escape paying taxes. You are allowed to donate R100 000 a year to anyone without the money being taxed. If you go beyond the R100 000 limit, any further donation will be taxed in your hands at 20 percent.

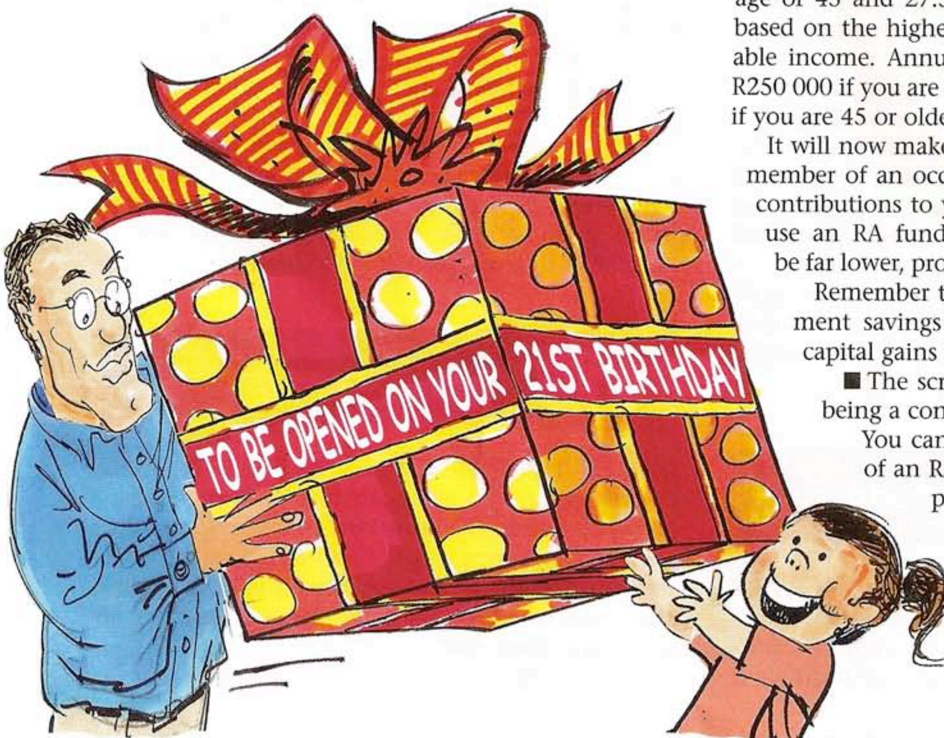
This tax exemption allows you to steadily transfer cash out of your hands into the hands of others. If you do not want the recipients to have access to the donated cash, it can be transferred into a trust to which they can be named as beneficiaries. The advantage of a trust is that the trustees can decide a time and/or conditions under which the beneficiaries will receive the assets.

You can also make and claim as a tax deduction any donations you make to what are called public benefit organisations (PBOs), which must be registered with the South African Revenue Service.

Government has accepted that the tax deductibility of donations influences donor behaviour, and it allows tax-deductible donations to limited categories of PBOs. The list includes those involved in welfare and humanitarianism; health care; land and housing; education and development; religion, belief or philosophy; culture; conservation, the environment and animal welfare; research and consumer rights; and sport.

Your favoured organisation will be able to tell you if it is registered as a PBO.

According to the website of accounting company KPMG, as from March 2009, in order to expand the potential pool of donors, accelerate the tax benefit to employees and reduce the number of refunds on assessment, employers can take into account donations made by employees for employees' tax purposes. Employers are required to obtain the receipts, which must comply with the requirements of the Income Tax Act, at least annually. The deduction is capped at five percent of the remuneration after certain deductions are taken into account.




## 7 Retirement savings tax advantages

ONE OF THE JOYS OF RETIREMENT FUND SAVINGS is that they come with great tax incentives while you are alive as well as after death. This applies to both occupational retirement funds and retirement annuity (RA) funds in the build-up stage as well as in the pension stage.

A number of changes to the way retirement funds are taxed have added significantly to the way in which both occupational pension funds and RAs can be used for financial planning.

The two most significant changes have been:

- Changes in the tax-free deduction limits on retirement fund contributions from next year.

Currently you can deduct from your taxable income contributions of up to 7.5 percent of your retirement-funding income to an occupational pension fund and up to 15 percent of your non-retirement-funding income to an RA.

(Retirement-funding or pensionable income is your basic pay. It normally excludes allowances such as commissions, annual bonuses and travel allowances, all of which can be used in calculating contributions to a RA.)

From March 1 next year, deductions for individuals will be set at 22.5 percent if you are under the age of 45 and 27.5 percent if you are 45 or older, based on the higher of employment income or taxable income. Annual deductions will be limited to R250 000 if you are under the age of 45 and R300 000 if you are 45 or older.

It will now make sense in most cases, if you are a member of an occupational fund, to increase your contributions to your retirement fund rather than use an RA fund because the costs are likely to be far lower, providing a potentially better return.

Remember that investment returns on retirement savings are not subject to income tax, capital gains tax or dividends tax.

- The scrapping of the age limit of 69 on being a contributing member of a RA.

You can now be a contributing member of an RA for as long as you wish. This is particularly useful if you have been a member of an occupational retirement fund, because you cannot continue as a contributing member of an occupational fund after retirement.

The big thing in the context of this article, however, is that savings in retirement vehicles can be used to reduce estate duty. This applies to savings in an occupational pension fund, an RA fund and even an investment-linked living annuity (illa), from which you may be drawing a pension in retirement.

Tiny Carroll, an estate planner at Sanlam's Glacier division, explains that when you die the full proceeds (benefit) of an occupational retirement fund (pension or provident), preservation fund or RA fund, or income from an illa, may be taken by your beneficiaries as a lump sum or as an annuity (monthly amount) or a combination of these.

The Estate Duty Act excludes retirement benefit lump sums and annuities from the estate of a deceased person. This covers all tax-incentivised retirement savings, be they in an occupational fund, a preservation fund or an RA fund. As a result, every rand contributed to an RA fund is removed from your estate.

Carroll says the beneficiary will be taxed on the retirement fund benefit as follows:

- An annuity (pension) added to the gross taxable income of the annuitant (beneficiary) is taxed as part of the annuitant's income at his or her marginal rate of income tax. The annuity can either be:
  - An illa, from which the beneficiary will be required to draw down between 2.5 and 17.5 percent of the capital amount annually; or
  - A guaranteed life assurance pension, which will pay a monthly guaranteed amount for the life of the beneficiary.
- A lump sum is taxed in terms of the lump-sum scales for retirement fund benefits, according to the deceased member's tax rate that applies on the day before death (see lump-sum tables, right).

It makes sense for a beneficiary to take the first R315 000 tax-free portion as a lump sum, depending on its availability. It also makes sense in most cases to take the remaining amount as an annuity because of the tax benefits on retirement savings.

At first sight, when you look at the table showing the advantages of taking the full allowable lump sum, it may seem an advantage for your beneficiaries to do this if they are on the top marginal rate of 40 percent, because the top lump-sum rate is 36 percent. But this may not necessarily be the case.

You need to take into account that if an annuity income is selected by your beneficiaries there are the following advantages:

- The annuity is taxed at their marginal rate of tax, which may be lower than 36 percent;
- The more beneficiaries and the lower their marginal rates, the more effective the tax benefits become; and
- Tax is deferred, because there is no income tax, CGT or dividends tax on the investment returns of retirement savings, including annuities. This means your beneficiary earns returns on money that would otherwise have been paid in tax. The less the beneficiary draws as an annuity, the greater the amount of deferred tax.

However, each case will be different, depending on the marginal tax rate of the beneficiary, the draw-down rate (if an illa is used) and the capital value.

Carroll says RAs can also be used in another way to limit estate duty. Although you cannot deduct from your taxable income any amount paid over the tax-free deduction limits, there is no prohibition on paying in extra. The one time this can work is when you have a shorter life expectancy and >>

## Benefits of an RA

HERE IS AN EXAMPLE OF HOW TAX ON RETIREMENT annuity (RA) benefits works.

Mr X contributes R1 million to an RA and dies four years later. The RA's value at death is R1 500 000.

If his beneficiary takes the benefit (and assuming no other fund benefits) as a lump sum, the entire benefit will be free of estate duty. The saving of 20-percent estate duty on R1 500 000 is R300 000, assuming the initial R3.5 million duty exemption has been used. But the amount would be subject to retirement fund lump-sum taxation, the first R315 000 (tax concession) plus the R1 million disallowed contribution being tax-free. The balance of R185 000 would be taxed at 18 percent. The tax payable is R33 300 – a saving of R261 300 if the RA structure was not used.

## Tax on retirement fund lump sums

| Lump sum | Tax |
|---|---|
| R0 to R315 000 | 0% |
| R315 000 to R630 000 | 18% of the amount over R315 000 |
| R630 001 to R945 000 | R56 700 plus 27% of the amount over R630 000 |
| R945 001 and above | R141 750 plus 36% of the amount over R945 000 |

## Advantages of tax concession on lump sums

| Lump sum | Effective tax rate | Tax advantage |
|---|---|---|
| R1 000 000 | 16.1% | 23.9% |
| R1 500 000 | 22.7% | 17.3% |
| R6 000 000 | 33.5% | 6.5% |

Assumption: 40% marginal rate of income tax

Note: The tax concession includes all taxable benefits accrued, including withdrawal benefits taken in earlier years as well as from benefits accrued from other retirement funds. You cannot claim the amounts more than once. SOURCE: GLACIER BY SANLAM

>> you face a large estate duty liability on death.

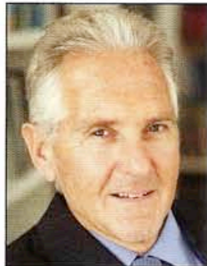
Normally, an RA member should not exceed the tax-free deduction limits for contributions, as there would be no tax advantages. At retirement, you can take your excess contributions as a tax-free lump sum on top of your R315 000 tax-free lump sum, but over the years the value in real (after-inflation) terms will have diminished.

It is better to rather save any additional amounts in a non-tax-incentivised savings vehicle such as a collective investment scheme.

But, Carroll says, if you have a shorter life expectancy and want to do what is called "emergency estate pegging", you can consider paying more into an RA. On death, the full amount is then bequeathed and the over-payments are not included in your dutiable estate. But remember, this structure should be used carefully, taking account of the estate duty exemptions and the effect of inflation on the over-paid amounts.

Carroll says it is important that you inform your beneficiaries that they will have the option of electing an annuity or of commuting the annuity for a lump sum. If the annuity is commuted, the lump-sum benefit will be taxed according to the deceased member's tables – thus allowing the use of any disallowed excess contributions or any part of the R315 000 that has not yet been used.

**TINY CARROLL:** 'Beneficiaries must know what their options are'



**PETER STEPHAN:** 'Contributions to education savings are not tax-deductible'

## 8 The education of your children

THE EDUCATION OF CHILDREN HAS, ACCORDING to the Old Mutual Savings Monitor, become one of the top savings targets of South Africans. The monitor shows that parents are prepared to make tremendous financial sacrifices to ensure a sound education for their offspring, with 51 percent of parents having their children's education as their savings priority.

However, in return, a third of parents expect their children to support them in old age.

The importance of education should also be linked into your planning for the unexpected, whether it is parents ensuring proper provision through life assurance and savings products or grandparents making provision for their grandchildren in assisting with savings and through bequests at death.

Parents should consider setting up special education savings vehicles for their children at birth to which other family members can make contributions (for example, in lieu of birthday presents) and for bequests.

However, you need to take care in the savings vehicles you use. Tax again rears its head.

Peter Stephan, senior policy adviser at the Association for Savings & Investment SA (Asisa), says there can be both CGT and estate duty implications when investing for a child's education in the name of the child or parent.

There are different savings vehicles available, including life insurance investment policies and collective investment schemes.

### ■ Life assurance education policies

Stephan says with an education policy your premiums are not tax-deductible and the investment growth is subject to income tax and CGT, which are paid on your behalf by the life assurance company.

When the proceeds are paid, they are not taxed again in the hands of the beneficiary because they represent an after-tax return. Proceeds of investment policies are also exempt from CGT in your hands.

Stephan says the payment of estate duty depends on how the plan is structured and who dies.

■ If the parent is the owner of the policy, the surrender value of the policy at the date of death of the parent is considered an asset in the parent's estate. If the child dies and the child is the life assured, the proceeds are deemed an asset in the child's estate subject to any concessions in the Estate Duty Act. A life assurance policy has three parties. The first party is the owner of the policy, who has taken out the contract on either his or her own life or that of a person in whom the owner has an "insurable interest". The second party is the assured person on whose life the policy will be paid out. The third party is the beneficiary of the policy. The parties may or may not be the same depending on how the plan is set up.

■ If the child is the owner of the policy and the life assured and the parent just pays the premiums, the proceeds are dutiable in the child's estate. If the parent dies, nothing falls into the parent's estate as he or she does not own the investment and is also not the life insured.

Stephan says the first structure is popular because the parent retains some control and the plan often incorporates risk cover whereby if the parent dies or becomes disabled, the remaining premiums on the plan are funded by the insurer. In the second scenario, when the child reaches 18, he or she could cash in the plan and spend the money on something other than education.

■ **Collective investment schemes**

Stephan says in the case of collective investment schemes, which include unit trust funds and exchange traded funds, the unit holder will be taxed on any distributions by the unit trust company based on the "flow through conduit" principle. Dividend withholding tax at 15 percent will apply to any dividend distributions, and income distributions are taxed as normal income at your marginal rate of tax subject to any interest exemptions. When units are sold, the unit holder will be liable for CGT on any gains subject to any exemptions.

Should the unit holder die, the value of the units at the date of death is an asset in the estate for estate duty purposes. CGT could also apply on death.

Again, Stephan warns, the choice is for the parent to hold the investment in his or her name to ensure the money is used for education, because if it is held in the child's name it could be used for other purposes.

**Important considerations**

Before choosing an investment vehicle, it is important to note the following:

■ You need to be aware of the differences between an education policy and a unit trust investment. These include:

❑ Contractual commitments. A life assurance investment policy is contractual for a minimum of five years, after which it can be extended. If, during the contract period, you halt or reduce the premiums, a penalty can be applied to the saved amount to a maximum of 20 percent. A collective investment scheme, on the other hand, is entirely flexible: you can increase and decrease monthly payments and add lump sums at any stage.

❑ Tax exemptions. With a life assurance policy, CGT and income tax are paid at a specific rate by the life company on behalf of policyholders, but the annual CGT and interest exemptions granted to individuals do not apply. With a collective investment scheme, the conduit principle applies: you pay tax when you receive interest and dividends and CGT on any capital gains, but the taxes are subject to your exemptions of that tax year.

■ Asisa supports a special industry initiative aimed at encouraging education savings called the Fundisa Fund. The main elements are:

❑ An account can be opened in the name of each child. A minimum monthly investment of R40 is required. You can choose to pay R40 or more every month or top up the investment when money becomes available.

❑ Investors in the Fundisa Fund receive the investment returns and can also qualify for a bonus payment. Investors have their investment enhanced by 25 percent a year to a maximum of R600 calculated on the net savings of the previous 12 months for each learner in whose name an account is opened. So if you save R200 a month for 12 months, you will see your R2 400 investment grow by R600 (the annual maximum bonus) to R3 000. The R3 000 will also share in the overall investment return achieved by the fund in the following year, but with the maximum bonus limited to R600 for that year.

❑ The annual bonus is funded by the savings and investment industry and government.

❑ To ensure the money saved in the Fundisa Fund is used to pay for a child's education, the bonus payments (or a portion of them) fall away if the investment is withdrawn. The bonus payments can be claimed only if you pay for the child's education at a government-recognised public institution.

❑ Investors can at any time – in times of a financial crisis, for example – withdraw their savings together with the normal returns on their capital. But they will not receive any of the bonus payments. A partial withdrawal will be reflected in a corresponding reduction in the bonus.

❑ The Fundisa Fund is accessible from Standard Bank, Nedbank Investments and Absa branches. They offer what are called feeder unit trust funds, which pay your savings into the central unit trust fund managed by Stanlib, a low-risk, fixed-interest income fund of funds.

Stephan says Fundisa is a unit trust-based >>

>> plan normally taken out by the parent or guardian as the investment owner with the child as a nominated beneficiary. As such, the normal income tax and estate duty rules for collective investment schemes apply as described above. There are no special tax concessions for Fundisa.

## 9 Beneficiary nominations

NOMINATING SOMEONE (A BENEFICIARY) TO receive your worldly goods is not limited to your will. Two areas where you can, in fact, bypass your will are with your life assurance policies (both risk and investment) and your retirement savings.

### Life assurance policies

With a life assurance policy you have the choice of naming a beneficiary. If you do not nominate a beneficiary, the proceeds of the policy will be included in your estate and will be distributed according to your will.

But there are two big advantages to naming beneficiaries. These are:

- The proceeds are not included in your estate. This means that they are not subject to executor fees, which can be a maximum of 3.5 percent plus VAT.
- A life assurance company can pay out the money within days of a death certificate being submitted. This means that your dependants will not have to wait for what may be many months while your estate is wound up to receive income.

You must ensure that you keep your beneficiary nominations up to date, because if one of your beneficiaries dies, any amount allocated to that beneficiary will be allocated to your estate when you die.

You must also ensure that you check regularly on the named beneficiaries. This is one area where fraud takes place frequently, with other parties, particularly some unprincipled financial advisers, getting themselves named as beneficiaries.

### Retirement savings

Retirement savings, potentially including the proceeds of group life assurance policies, are automatically excluded from inclusion in your estate and your will, but the final decision on how the proceeds are allocated does not lie with you; it lies with the trustees of the retirement fund.

This does not mean that the trustees can ignore you altogether and give the money to a cat home or to themselves. The trustees need your beneficiary nominations to help them to make their decisions. Most importantly, it helps them to identify whom your dependants are likely to be. But your fund trustees are obliged by the Pension Funds Act to establish who your dependants are and the extent of their dependency, and allocate benefits to them on this basis, even if they are not named beneficiaries.

So unlike life assurance policies, where you get to decide the beneficiary, who may or may not be a dependant, the most important consideration in the distribution of retirement fund proceeds at your death is people who have actually been dependent on you.

Trustees often face great challenges in distributing retirement fund proceeds, particularly with one or more parties such as members of extended families or ex-spouses challenging the decision of the trustees.

The Pension Funds Adjudicator has repeatedly determined that the decisions of trustees cannot be challenged if the trustees can show they applied their minds properly to how the proceeds should be distributed, both to whom and how much.

If you have no dependants, your nominated beneficiaries become even more important. If you have not named any beneficiaries, the trustees must transfer the proceeds to your estate to be distributed according to your will.

## 10 Life assurance

REGARDLESS OF YOUR INCOME BRACKET, having adequate risk life assurance coverage is vital in most cases. As mentioned at the beginning, most South Africans die before they reach the age of 50. That's quite a scary statistic! The main reason is Aids and related diseases, but our roads, violent crime and a multitude of other accidents and diseases also claim an inordinate number of lives and leave many people permanently disabled.

It is imperative that you buy risk life assurance if you have dependants but do not have sufficient savings to provide for them should you become disabled or die prematurely. Life assurance that provides benefits on death will ensure that your dependants can maintain their standard of living. And it is even more important to have assurance against being left disabled by either an illness or an unexpected event.

Apart from not encumbering yourself with debt, risk life assurance should be number one on your list of financial priorities.

Despite the risks that each of us faces every day, research undertaken on behalf of Asisa by True South Actuaries & Consultants in 2008 and again in 2010 showed that the vast majority of South Africans are under-insured against death and disability.

Most South African families will be forced to cut their monthly spending by about a third on the death or disability of a breadwinner, Peter Dempsey, deputy chief executive of Asisa, says.

This lack of risk assurance generally means that most breadwinners are prepared to condemn

themselves and/or their dependants to a life of poverty if the unexpected happens.

The research has found that the average South African income earner is under-assured by 62 percent for death and 60 percent for disability; or by R600 000 in the event of death and by R900 000 in the event of disability.

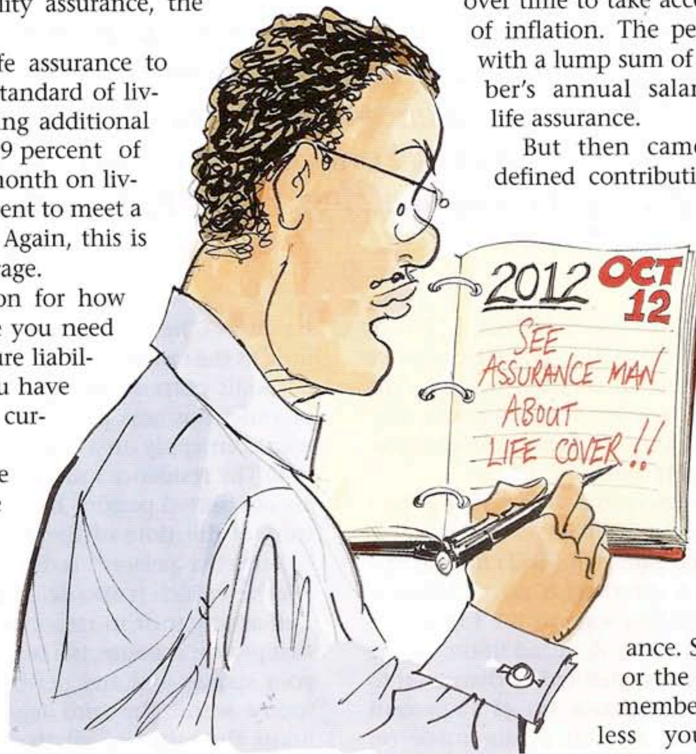
So, if you are Mr or Ms Average and the main breadwinner in your family dies or is disabled today, you will either have to cut your living expenses by between 30 and 34 percent, on average, or earn more – you'll need an extra R3 177 a month if the breadwinner dies or an extra R4 696 a month if the breadwinner is disabled and unable to work.

The same average family, however, could be saved financial hardship if a further 2.4 percent of income is spent on life assurance and 1.5 percent is spent on disability assurance, the research suggests.

To have sufficient life assurance to maintain your current standard of living, you should be paying additional premiums of about 3.9 percent of what you spend every month on living expenses (or 2.2 percent to meet a belt-tightening budget). Again, this is if you are Mr or Ms Average.

The simple calculation for how much risk life assurance you need is: your current and future liabilities, less how much you have (your assets), less your current assurance.

Most people's future liabilities are likely to be as high as between 15 and 20 times their current annual income. Obviously, the calculation is affected by the number of dependants you have and the period for which they will depend financially on you.




You may be lucky enough to belong to an occupational retirement fund that provides group risk assurance. But John Anderson, the head of national consulting strategy at Alexander Forbes, says that most group life assurance is insufficient to meet the needs of members. Most group life assurance schemes provide what he calls core cover, leaving a significant gap in what you need. Core cover is normally based on a multiple of your annual pensionable salary and not your actual needs.

Research by Alexander Forbes shows that 65 percent of retirement funds provide a group risk benefit multiple of up to four times a member's pensionable income. The average is three times.

Anderson says the research shows that the benefits paid to the dependants of 80 percent of fund members are, on average, more than 50 percent less than what they require.

Group risk cover based on a multiple of salary does not take account of all the important factors that must be considered when buying assurance. These factors include your age, how many dependants you have and their ages, your state of health, how much you have saved and how much debt you have.

The main reason most group schemes offer only core cover is historical. When most retirement funds were defined benefit schemes, if you died before retirement age, the benefit paid to your dependants was based on a pension that was calculated as if you had reached retirement age. In most cases, the benefit was paid as a monthly pension that increased over time to take account, at least partially, of inflation. The pension was topped up with a lump sum of about twice the member's annual salary, paid from group life assurance.

But then came the big switch to defined contribution funds, where you take the risk that you will have sufficient money on which to retire. Only the contributions you and your employer make are defined, not the final pension. If you die before retirement, your dependants receive only your accumulated savings plus any group life assurance. So the younger you are or the shorter your period of membership of the fund, the less your dependants will receive in accumulated benefits if you die prematurely.

The problem is that when most retirement funds converted from defined benefit to defined contribution schemes, group life assurance was not altered to make good the potential shortfall, particularly for younger members. At best, many schemes simply increased the group life benefit cover from two to three times annual pensionable salary. Some retirement funds, now realising the potential problem, are revising their group life assurance schemes.

Anderson says it is vital that you approach a financial adviser, who will calculate how much risk assurance you should have based on your circumstances. You should compare this amount with your existing risk assurance and identify any shortfall. ❑