

4 HOW TO INVEST YOUR PACKAGE

It's always so easy to tell others what to do with their money, but it's never easy to invest your own funds – particularly if a large amount is involved.

Thousands of brokers have never invested R10 000 of their own money and would probably have many sleepless nights if they have to do so!

It's sad that so many investors give their hard-earned money (packages) to a family member to invest on their behalf, especially when this cousin/nephew/niece has been a 'broker' for only three weeks or three months.

This is not the time to worry about commission for a member of your family – think of your own financial future and worry about that.

The aim of our discussion is to point out the various factors that should be taken into account before you invest, reinvest or utilise your package. I can only provide broad guidelines, since each household has its own unique composition of assets, liabilities and family structure, as well as its own needs, risks and objectives.

In the discussion below I refer to five situations, namely where the investor

- invests his package in the same employer's old/new retirement fund
- transfers a package to a new employer's retirement fund (pension or provident fund)
- wants to use the package to start a business (from scratch or by buying an existing one)
- has to invest the package for retirement
- wants to invest the package (or part of it) in a foreign country

It is never easy to choose an investment – you soon become aware of the long-term implications of this very important decision. After you have assessed your

individual and household financial situation, identified your needs, and determined and prioritised your short-, medium- and long-term objectives, you should have more clarity about which investment(s) to choose. Of course different households will utilise or invest money in different ways.

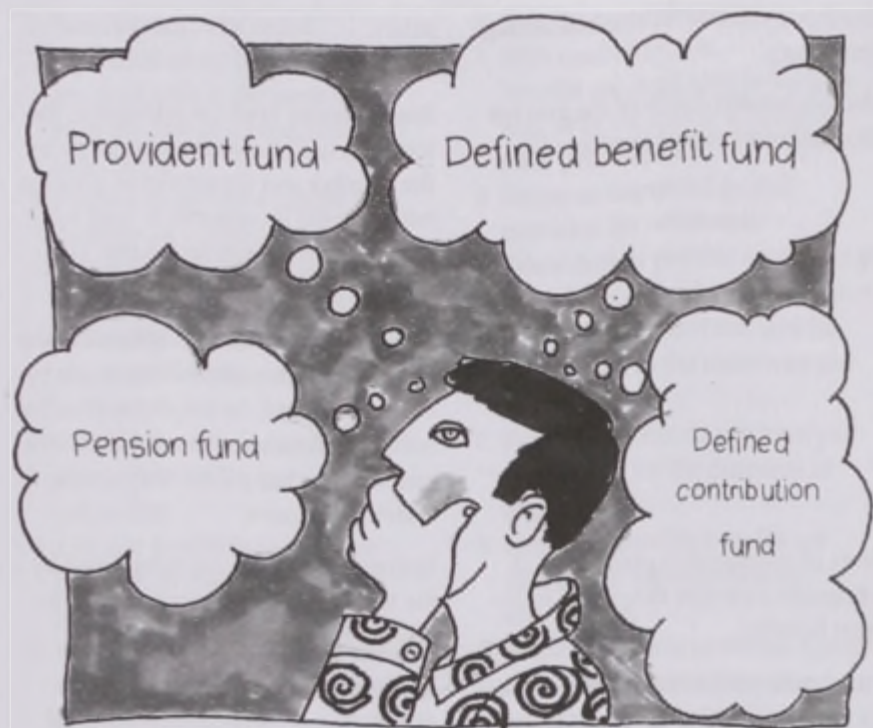
4.1 I AM GOING TO CONTINUE WORKING FOR MY PRESENT EMPLOYER – WHICH FUND SHOULD I CHOOSE (PENSION FUND OR PROVIDENT FUND, DEFINED BENEFIT OR DEFINED CONTRIBUTION FUND)?

In the past few years many employers have switched from defined benefit funds to defined contribution funds. It is important to know that a defined contribution fund can be a defined contribution pension fund or a defined contribution provident fund. These funds differ in the handling of contributions and the taxability of contributions as well as lump sums.

The possibility of switching to a provident fund usually creates a lot of uncertainty among fund members. In the discussion below we discuss

- differences between a defined benefit fund and a defined contribution fund
- similarities between a pension fund and a provident fund
- differences between a pension fund and a provident fund
- transferring the taxable as well as the non-taxable part of your pension fund benefits to a defined contribution provident fund or a defined contribution pension fund
- transferring the taxable part of your pension fund benefits to a life annuity
- which portfolio to choose (after you have chosen a fund)
- the most important factors to take into account when making your choice
- a preservation fund

The advantages and disadvantages (ie suitability) of each type of fund should be weighed up carefully before you make your decision (choose a fund). The most common differences between a defined benefit fund and a defined contribution fund (not between a pension fund and a provident fund) are as follows:



Defined benefit fund

1 Contributions

Members' contributions form a fixed percentage 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 members' benefits. The employer contributes more for older members than for younger ones.

2 Retirement benefits

Benefits are promised and defined according to a formula based on the

Defined contribution fund

1 Contributions

The contributions of the employee and the employer form a fixed percentage of the retirement funding service. The employer's contribution covers costs as well as death and disability benefits.

2 Retirement benefits

Benefits are not calculated according to a formula based on years of service or

member's years of service and average salary.
final salary.

Monthly pension: 2.22% of the average final salary \times years of service $\div 12$.

Years of membership plus salary at retirement therefore determine retirement benefits.

Investment performance does not have such a significant effect on retirement benefits. The employer must pay in the difference to make provision for the promised retirement benefits.

The investment risk therefore rests with the employer.

Let's now compare a pension fund and a provident fund.

Pension fund

Similarities

- 1 Membership requires an employer-employee relationship

salary.

Benefit pension fund: On retirement, the total amount of contributions made by the member and the employer, plus the return on the investment, is used to buy an annuity from an insurer. The member receives a monthly pension.

Benefit provident fund: On retirement the total sum of the contributions made by the member and the employer, plus the return on the investment, is paid to the member as a lump sum. Very similar to a savings account.

Retirement benefits are determined by the total sum of the contributions plus investment performance.

The investment performance has a direct effect on retirement benefits. If benefits are taken during an economic boom, or when the stock exchange is strong (a bull market), the member may receive high retirement benefits. If the member retires during an economic downswing (a bear market), the member may receive low retirement benefits.

The investment risk therefore rests with the employee or member.

Provident fund

- 1 Membership requires an employer-employee relationship

- 2 Benefits cannot be ceded
- 3 With insolvency, benefits are dealt with in the same way as in the case of a provident fund (see chapter 8)
- 4 Forms an important part of provision for retirement
- 5 Estate duty is payable on the lump sum after the death of the member
- 6 In the case of a divorce, benefits are handled in the same way (see section 7.2)
- 7 Pension benefits do not form part of an estate for the purposes of estate duty
- 8 Life and disability benefits are included in the membership at a low cost
- 9 Members are not protected against themselves, and may use the lump sum as soon as they have received it
- 10 Estate duty is paid on group benefits because they form part of the member's estate
- 11 Life-cover is provided by means of group benefits
- 12 It is very expensive to borrow from the fund because of the cost of interest, loss of capital growth and the taxability of repayments made to the fund

Pension fund

Differences

- 1 Retirement benefits are based on final salary and years of membership

- 2 Benefits cannot be ceded
- 3 With insolvency, the benefits are dealt with in the same way as in the case of a pension fund (see chapter 8)
- 4 Forms an important part of provision for retirement
- 5 Estate duty is payable on the lump sum after the death of the member
- 6 In the case of a divorce, benefits are handled in the same way (see section 7.2)
- 7 Pension benefits do not form part of an estate for the purposes of estate duty
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Provident fund

- 1 Retirement benefits are based on the total contribution the member made to the fund plus growth

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|---|--|
| 2 Employer bears the risk | 2 Employee bears the risk |
| 3 Benefits older members of the fund | 3 Benefits younger members of the fund |
| 4 Members do not get back their contributions to the fund | 4 Members get back their contributions to the fund |
| 5 At retirement the member receives one third of the retirement benefit as a lump sum | 5 At retirement the member take 100% of the total retirement benefit as a lump sum |
| 6 The relation between the lump sum (one third) and the pension (two thirds) is fixed | 6 The member may choose between only a lump sum, only a pension or a lump sum as well as a pension |
| 7 The cost of administration is higher because of more actuarial calculations (salary adjustments, years of service, highest salary per period) | 7 Lower administration costs because of fewer actuarial calculations (no calculation of salary adjustments, years of service, highest salary per period) |
| 8 In order to be effective, the fund must have a large number of members | 8 The fund requires only a limited number of members |
| 9 Ideal for large organisations and businesses | 9 Small or new organisations and businesses may use the fund |
| 10 The size of the fund is determined by the age of the employees, their salaries and years of membership | 10. The size of the fund is determined by the monthly contributions made by the members |
| 11 Ideal for the remaining members where the staff turnover is high | 11 The staff turnover does not have an effect on the benefits of the remaining members |
| 12 Monthly contributions are tax deductible (the biggest of R1750 or 7,5% of remuneration from retirement funding services) | 12 Monthly contributions are not tax deductible |
| 13 Lump sums of up to R120 000 or R4 500 x the number of years of service (the larger of the two amounts) are tax-free | 13 Lump sums of up to R120 000 or R4 500 x the number of years of service (the larger of the two amounts) are tax-free |
| 14 Where additional years of service have been bought, the outstanding amounts, up to R1 800 per year per person, can be deducted from | 14 Not applicable |

income tax

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| 15 No flexible retirement and estate planning can be done | 15 Because the member has control over benefits very flexible retirement and estate planning is possible |
| 16 Years of service may be bought | 16 It is not possible to buy years of service |
| 17 A married person will do better because there will be dependants who will need a monthly pension after the death of the member | 7 A single person will do better because there will be no dependants who will need a monthly pension after the death of the member |
| 18 The younger the wife of a man who is a member, the more beneficial | 18 The wife's age is only relevant where a pension is chosen instead of a lump sum and the man dies soon after retirement |
| 19 In cases where annual salary increases are high the defined benefit fund will be better, because benefits are calculated on the basis of final salary. (There are problems with the benefits for government and semi-government departments because of the absence of any real salary increases – except when inflation is lower than the rate of the increase over many years) | 19 With relatively low real salary increases (or no increase at all) the defined contribution fund is better because benefits are not calculated on the final salary. (This is particularly suitable for government and semi-government departments and of course for the private sector) |
| 20 The primary objective of a pension fund is to provide a pension at retirement | 20 The primary objective of a provident fund is to provide a lump sum at retirement |
| 21 Trustees are free to increase retirement benefits after retirement, based on the performance of the insurers | 21 After the member has received the lump sum, the member has nothing to do with the fund |
| 22 In the event of the death of a member after retirement a pension is paid to the spouse and/or children. Pension increases are also paid out to the spouse and/or children | 22 No member will receive death benefits if he or she dies after retirement because the person is no longer a member of the fund. Death benefits will depend on arrangements the member made with the insurer |
| 23 If you already receive a pension it | 23 Where benefits have been taken in |

- will be very difficult to qualify for a further state pension
- | | |
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| <p>24 Contributions to the fund are paid from pre-tax money and therefore your taxable income will be lower</p> <p>25 Pension is taxed at the PAYE/SITE rate. Therefore tax is deducted at your marginal rate</p> <p>26 Except for the tax-free part of the lump sum (the larger of R120 000 and R4 500 x number of years of membership) the rest of the lump sum will be taxed at your average rate</p> <p>27 In the event of death the tax-free part of the lump sum will be the larger of R60 000 or twice your annual salary (maximum R120 000). After this, tax is calculated at your average rate</p> <p>28 Should you leave the fund before retirement the first R1 800 of your benefits will be tax-free. The balance will be taxed at your average rate</p> | <p>the form of a lump sum it is still possible at present to qualify for a state pension</p> <p>24 Contributions to the fund are paid in terms of a salary sacrifice basis</p> <p>25 Should you buy a pension in the form of a voluntary annuity with your lump sum the pension will be only partly taxable (see discussion of a voluntary annuity later)</p> <p>26 As in the case of a pension fund. The tax-free part will be further increased by your contributions that could not be deducted from tax before</p> <p>27 As in the case of a pension fund. Your tax-free part will be increased further by your contributions that could not be deducted from tax before</p> <p>28 Should you leave the fund before retirement the first R1 800 or your contributions will be tax-free. The balance will be taxed at your average rate</p> |
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TRANSFERRING THE TAXABLE PART AND THE NON-TAXABLE PART OF YOUR PENSION BENEFITS TO A PROVIDENT FUND OR A PENSION FUND

You are free to transfer the two amounts you are going to receive to one of the funds mentioned above. As a result, you will be taxed on the taxable amount immediately and won't be able to postpone payment of tax. Unfortunately you don't utilise the tax relief that you would get if you put the taxable amount in a voluntary annuity.

TRANSFERRING THE TAXABLE PART OF YOUR PENSION BENEFITS TO AN ANNUITY

An annuity should not be confused with a retirement annuity. When you take out an annuity you use your lump sum to buy an annuity from an insurer. You may buy an annuity of your choice. It's also possible to transfer the lump sum to an existing retirement annuity. The annuity may be linked to other products such as an endowment policy or unit trusts. The insurance broker you consult will be able to give you more information.

VOLUNTARY ANNUITY VERSUS COMPULSORY ANNUITY

When you are compelled by law to purchase an annuity it is called a compulsory annuity. An example is when you have to use the two-thirds you receive from a retirement annuity to buy a compulsory annuity (either a traditional annuity or a living annuity). In a voluntary annuity the pension you are going to receive will be only partially taxable. The interest part of your pension will be taxed, while the capital part will be tax-free.

TRANSFERRING THE TAXABLE PART OF YOUR PENSION BENEFITS TO A RETIREMENT ANNUITY

We have seen that the lump sum may be transferred to an existing annuity. However, I would suggest that you invest the lump sum in a new annuity, particularly when the one-third lump sum of an existing annuity already amounts to R120 000. The new annuity is a voluntary annuity because a lump sum is invested in it. (We discuss the functioning of retirement annuities in section 4.4.)

WHICH PORTFOLIO TO CHOOSE (AFTER YOU HAVE CHOSEN A FUND)

When you have decided in which fund you would like your money to remain (eg a pension fund) or in which one you would like to invest (defined contribution pension fund or defined contribution provident fund and/or voluntary annuity) you will have to decide on the specific portfolio. You may choose from the following investment portfolios: a stable bonus portfolio, a market-linked portfolio, a balanced portfolio and a unit trust-linked portfolio.

- *A stable bonus portfolio:* This portfolio is suitable for more conservative investors (eg people who are 55 years and older) who want to protect their capital and receive an annual bonus. Bonuses consist of income that is accumulated during good years to make provision for bad years. Stable bonuses are thus provided.
- *A market-linked portfolio:* This portfolio is particularly suitable for those who like more risk in a growth portfolio (younger people). No guarantees are given and the return is directly linked to the underlying assets in the current market conditions or economic cycle. The return may be positive or negative, depending on market conditions or the economic cycle.
- *A balanced portfolio:* The investment consists of growth assets as well as fixed interest investments. Investors who prefer a rather average risk with an average return will invest in this type of portfolio (eg 40–55 years).
- *A unit trust portfolio:* You may invest in a unit trust portfolio with a view to capital growth when the market conditions are good. It is therefore possible to have a balanced portfolio. As with shares you will have to retire when the market conditions are good, or you may experience a negative return.

The following are important when you choose a specific portfolio:

- your risk profile
- your age and state of health
- the possibility of death or earlier retirement in a weak market or economy with low returns and capital growth
- whether you need a great deal of capital growth and are prepared to make more risky investments (in other words, when you have not made sufficient provision for retirement)

THE MOST IMPORTANT FACTORS TO KEEP IN MIND

You should know the characteristics of each of the funds before you can make an informed decision. The following factors should be kept in mind:

- Do you want to control your own retirement money after retirement, for example by receiving the total lump sum from a provident fund?
- If you are in bad health you may have no option but to leave your money in a pension fund or to choose a guaranteed life annuity.

- If you are going to receive a very high income from other sources after retirement you may rather choose to take all your money from a provident fund and invest it for capital growth (and not receive a pension, which will only increase your tax liability and devour your capital).
- Should you need an income because currently you do not have adequate provision for retirement (no other sources of income) you should ensure that you receive a pension after retirement.
- A younger person who resigns will receive higher benefits from a provident fund.
- Your decision will depend on whether you want to invest your own money and take the risk or not.
- The taxability of benefits should be kept in mind.
- Will the transfer from one fund to the other be taxed?
- Your own personal financial situation should help you to decide what would be best for you.
- If you take a large lump sum from a pension fund (a maximum of one third) your monthly pension will be less.
- The lump sum (100 %) that you receive from the provident fund is intended exclusively for retirement. It should not be spent or wasted but should be invested.
- With a provident fund your employer does not guarantee your retirement benefits any longer.

DEPOSIT YOUR MONEY IN A PRESERVATION FUND

Funds from an employer's pension or provident fund can also be deposited in a preservation fund. This money can be left in the preservation fund in the following ways:

- temporarily (to transfer it to the retirement fund of another employer at a later stage)
- permanently (with a view to retirement)

This is discussed in more detail in section 4.2.

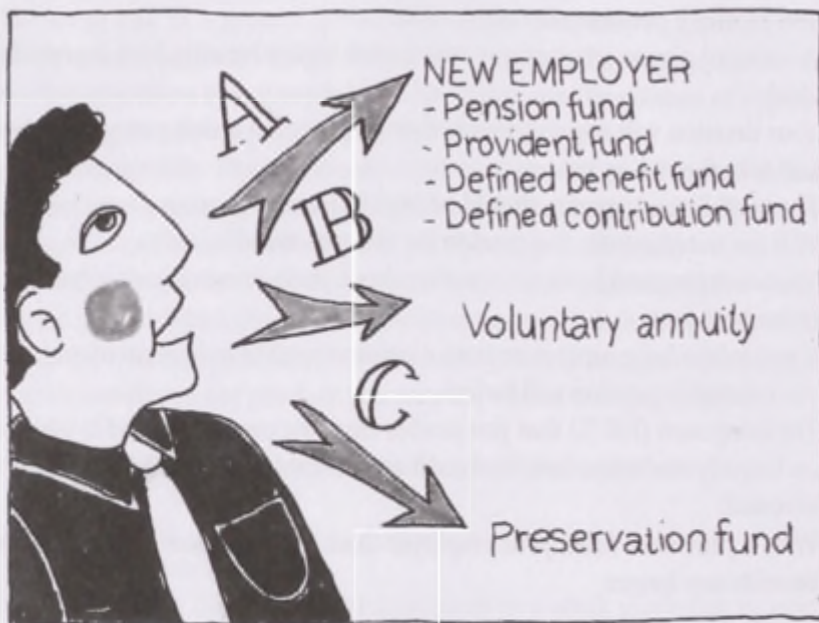
NOMINATION OF BENEFICIARIES

You will have to complete a form for your employer to nominate one or more

beneficiaries of your retirement benefits.

YOUR WILL

In your will you should refer to the contents of this form. The stipulations in the two documents (the form and your will) should be the same.



4.2 I AM GOING TO WORK FOR A NEW EMPLOYER

A number of aspects are important when you join a new employer. Pay particular attention to the following:

- Do you want to invest your package in the new employer's retirement fund?
- Would you rather take out an annuity?
- Are you still uncertain about where you should invest your package?
- Have you considered a preservation fund?

YOUR NEW EMPLOYER'S RETIREMENT FUND

If your new employer has a retirement fund you will have to channel the

money from your previous fund to a preservation fund. It is important to become familiar with the various advantages and disadvantages of defined benefit, defined contribution, pension and provident funds (as discussed in section 4.1). See whether your financial needs and objectives will fit in with the characteristics of the fund.

AN ANNUITY

We have discussed annuities in section 4.1. Make sure that you understand the cost of commission when you take out an annuity. Be aware that you will never get all your benefits from a traditional annuity. If you feel uncertain about what you should do with your package and you need time to come to a decision, you may place your money in a preservation fund either temporarily or permanently.

A PRESERVATION FUND

A preservation fund is a type of retirement fund in which retirement benefits from a pension or provident fund are kept. Insurance companies have preservation funds.

With a lump sum annuity you may not touch the benefits in the fund until you reach the age of 55. This is not the case with a preservation fund. Access to the benefits is therefore an important criterion that should be considered before you make a decision.

With a preservation fund, money may be withdrawn only once before retirement, which is set at the age of 55. It will of course be possible to withdraw the total amount from the fund with this single withdrawal. You must be careful and discipline yourself not to spend this money which you saved for retirement. The access facility may be a disadvantage for undisciplined people.

For the purposes of preservation funds the retirement age is described as the age at which you leave the services of a future employer, which may not be before the age of 55 or later than 70. Similarly, an unemployed person who deposits money in the fund may not retire from the fund before 55 or later than 70.

The transfer of a retirement package from a pension fund or a provident fund to a preservation fund (both types) is tax-free. If money is transferred from a

pension fund to a preservation provident fund (instead of a preservation pension fund) there are tax implications, however.

An advantage of a preservation fund is that the employee'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.

The flexibility (control) and transferability of the investment are important investment criteria. When you have little or no financial discipline the package should rather be transferred to a lump sum annuity for self-protection, in other words to protect your retirement benefits (even though you will have to pay commission on your investment).

4.3 I AM GOING TO ESTABLISH OR BUY MY OWN BUSINESS (OR A FRANCHISE)

You could also use the money from your package to buy an existing business or start a new one.

BUYING AN EXISTING BUSINESS

If you buy an existing business you should ask a chartered accountant to analyse the financial statements, if available. Ask a consultant who knows the specific type of business you want to buy to do a viability study. As potential investor (buyer) you should look out for possible pitfalls, for example if there are no financial statements or inadequate statements. Don't accept anything at face value! The following documents and particulars may provide valuable information:

Bank statements, deposit slips, cheque counterfoils and debit orders or stop orders

A business's bank balance does not necessarily indicate whether the business activities are favourable or unfavourable, because the bank account may be used for private deposits as well as withdrawals for personal use. Obtain deposit slips and/or copies of bank statements from the bank if the owner cannot supply them. Cheque book counterfoils or copies of cheques drawn against the account of the business are useful if you want to calculate the expenses in

the cashbook. The bank, with the permission of its client, will supply details of debit orders and stop orders.

Tax returns

The seller's annual tax return will not necessarily reflect the business's taxable income either, because income from other sources may be included (eg the spouse's income). Also, more expenses may be indicated and deducted as business expenses than were actually incurred. Often such expenses are incurred for personal purposes.

VAT

VAT is payable every two months and is calculated on the gross turnover of the previous two months. Returns are available from the Receiver of Revenue if they cannot be obtained from the owner. From these returns you can determine the gross sales (turnover) of the business. It can be assumed that the actual total sales will not be less than those indicated by the tax that was paid. They would probably have been higher. Until September 1991 general sales tax was payable.

Accounts: particularly telephone, electricity and water, and rent

Each of these accounts will also tell you more about the business. It should be quite easy to obtain copies from the specific organisations.

Property rates

If the building in which the business is located is the property of the owner of the business, you will have to pay property tax instead of rent. The amount payable can be obtained from the local municipality.

Salary and wage deductions

Copies of weekly or monthly deductions from salaries or wages for tax, unemployment insurance, etc, can be obtained from the offices of the Receiver of Revenue.

Suppliers

Contact suppliers to obtain information about, among others, average annual

or monthly purchases, outstanding payments (amounts), and in particular the business's image and creditworthiness. Keep in mind that these purchases may often have been made for private purposes.

Stocktaking

Stocktaking will give the potential investor an indication of the stock in the business. A comparison between the code that the owner uses to determine the cost price of products and the suppliers' cost price will help you to calculate the profit margin. Be on the lookout for stock that is damaged or old, as well as stock on lay-by. Also identify the core stock.

Debtors

Obtain a list with the names of all the debtors from the owner. When a large number of debtors meet their obligations in time the business will be worth more. Contact the debtors to compare their debts with those on the list and to discuss the credit policy with them. The same applies to creditors.

Knowledge of the market

Investigate the business's location, products, prices, services and promotion policy. These aspects should be compared to those of competitors.

Staff

Conduct interviews with all employees about sales, products, product prices, competitors, clients, the image of the business, their relationship with the owner, salaries and wages, the standard of training and experience, suggestions for changes, general job satisfaction and possible resignations, etc.

Personnel administration and management

Some owners of small businesses do not keep records of their employees' qualifications, experience, period of service or even salary increases. The results are predictable. The absence of complete financial statements will also point to poor management, which may be the reason that the business is not doing so well. A clever potential buyer could see this as an opportunity.

Determining goodwill

Goodwill refers, among other things, to the value of the business as a result of the number of years it has been rendering a service, and the fact that a specific owner or manager is heading the business. Don't pay too much for goodwill as it often leaves the business with the previous owner, especially if the new owner does not have the necessary capital to maintain existing standards.

Unattractive appearance

The appearance of the business may be the reason that people do not buy there. This could be changed by painting the walls a new colour, renovating the building and changing the layout of the shop. But don't spend too much money if the building is owned by somebody else.

Lease

The prospective buyer must find out whether the lease (if the building is leased) can be transferred. If not, another building with a favourable location should be found. The lease should be studied carefully to determine the rights and obligations of the tenant, as well as precisely what is rented.

The real reason for selling

It will be difficult to determine the real reason for selling. Ill-health, moving or family problems are usually given as reasons for selling a business. A proper financial analysis will usually provide the real answer.

Selling price

A low selling price is not necessarily an indication of a profitable investment opportunity – it's often the opposite. Neither does a high selling price guarantee a profitable investment. Ask a consultant to determine a realistic selling price.

BUYING A FRANCHISE

Small businesses are springing up in South Africa every day because numerous franchise opportunities are available.

Between 1980 and 1987 small businesses in the USA were responsible for 66% of all new job opportunities. The same is happening in countries such as Japan (80%), Switzerland, Italy, Hong Kong, Korea and Taiwan (60%).

All indications are that franchises are going to grow fast in South Africa.

What is a franchise?

FASA (Franchise Association of South Africa) describes a franchise or agency as a concession given by a franchiser to a beneficiary or franchisee to use a complete business package. This package provides the necessary elements to help even an inexperienced person to establish the business and run it successfully.

A person who qualifies as a franchisee (according to the franchiser) buys a franchise from the franchiser. A franchisee is an entrepreneur who obtains his own small business.

Retirement packages should not be invested in franchises indiscriminately. First do your homework properly.

Advantages

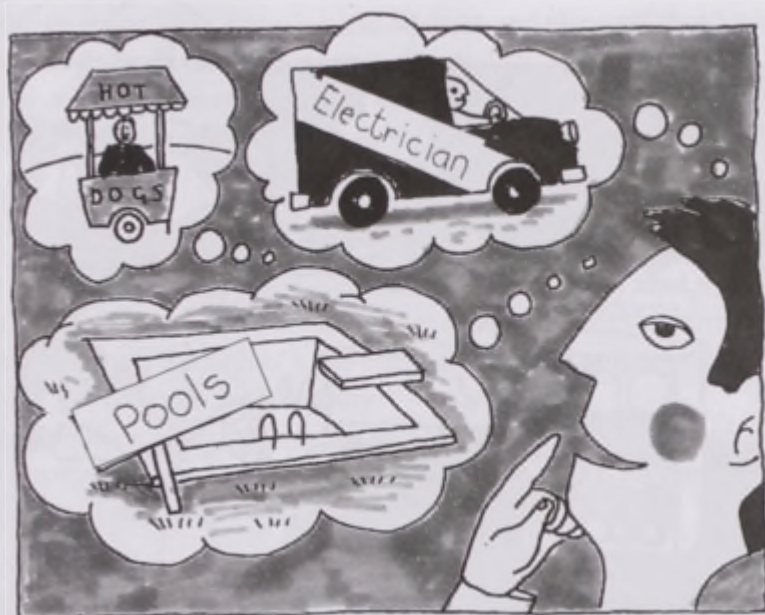
- A good name is an important asset.
- Managerial assistance and continuous training are supplied.
- A substantial profit can be made.
- The franchiser shares his experience with the franchisee.
- It will be quite easy to obtain financing.

Disadvantages

- Levies are imposed by the franchiser.
- The franchisee loses his independence.
- All the outlets look the same.

ESTABLISHING A NEW BUSINESS

There are thousands of business opportunities. If you want to become an entrepreneur you should first spot a business opportunity. Of course the risk should be weighed against the benefits – namely return – as well as against the possibility that you may lose something: your belongings (or part of them) and/or your health (you may suffer a stroke or you may die). It's very important to



have a good look at your personal strengths and weaknesses to determine what you really want to do and what you would probably succeed in. Also remember to weigh up the time the business will take up against your family life and the quality of your life in general.

Once again a reminder: don't risk all your possessions or gamble with your possessions if you are an older person.

Look for a service or product that does not exist yet but which will make life easier for other people. Do something better, cheaper or quicker. Really, there are too many opportunities (future businesses) to list all of them. Here are a few examples:

- Develop a new game that will promote recreation and health.
- Provide a service by renting out empty rooms in houses on behalf of other people.
- Look after houses on a large scale (40-50) during holidays.
- Find work for other people.
- Teach other people's children to master specific skills at home.
- Market health products.



- Do repair work on houses.
- Transport small parcels quickly between cities.
- Help people to plan their holidays.
- Take people on tours (game reserves, Garden Route, Kalahari)
- Teach people new life skills.
- Produce something you can sell at a flea market.
- Sell something at a flea market.
- Start a crèche.

Certain ideas might appear not to be within your reach because of a lack of knowledge, funds, skills, financing, etc. Sit down and plan until they are within your power, or choose something you feel ready to do.

You should therefore work from an idea to a business opportunity and then draw up a business plan.

Which business form should I choose?

After you have registered your business for tax purposes you must register the name of your business. You will then have to choose whether you want to operate the business in the form of a one-man business (sole proprietorship), partnership, close corporation or company.

If you are alone in the business you should run it as a one-man business or a close corporation. Form a partnership or a close corporation if there are two or three of you. I recommend a close corporation for young people.

- *A one-man business:* This type of business has only one owner who enjoys the profits and carries the risks and losses. A sole proprietor can never separate his income from that of a one-man business.
- *A partnership:* Two to twenty people may form a partnership. As with a one-man business, a partnership cannot be separated from the partners, who are liable for the debts of the partnership.
- *A close corporation:* One to ten people may form a close corporation (CC). The members of the CC have limited liability for the debts of the CC, which means that the personal possessions of the members are protected. The close corporation is definitely the best form of business for young people who want to start their own businesses. There are many tax benefits.
- *A private company:* One to fifty people may form a company. As with a CC, the company is a legal entity that exists apart from its members. It is much more complicated to form a company than a CC and a company is subject to many more legal requirements. Except for estate planning, a CC is the best form of business to choose.

First draw up a business plan

All the activities and other aspects of your business are explained in your business plan. A business plan indicates what, how, when and why the entrepre-

neur wants to do what the business is supposed to do. A business plan holds the following benefits for the entrepreneur:

- It forces the entrepreneur to look objectively at the business.
- Research is done into various aspects of the business to be established.
- Business plans are not only written down but are also expressed in financial terms.
- The plan may be submitted to suppliers of funds (banks, businesspeople) to obtain funds for financing the business activities.
- The entrepreneur is forced to evaluate his own business skills and resources (assets and staff).
- Risks, opportunities, threats, strengths and weaknesses are identified.

A business plan could contain the following:

- A cover with the name of the business, details about the owner, the logo of the business, and a table of contents in which the structure of the business plan is set out.
- Explain why you chose this specific type of business. Include a feasibility study (a study done beforehand to determine the chances of success) as well as the business objectives.
- Describe the business with reference to the product or service, the market (those who are going to make use of the product or service) and location.
- Provide a marketing plan (sales plan) for the product or service of the business.
- Draw up a financial plan (expenses, income, capital needs, income statement and balance sheet, breakeven point, own funds) that reflects the financial activities and administration.
- A staff plan stating the number of employees and post requirements is also required.
- Add a summary with the necessary facts and motivation to show why the business – and the application for funds (financing) – should succeed.

Business insurance

Protect yourself and your investment!

When an investor buys or establishes a business he should take out business insurance (protection) in the form of a life policy.

Protection planning is required for those who work for an employer, as well as for the self-employed. People who are involved with a business in some way or another should protect themselves against all possible business risks. If the business should close for some reason it could have serious financial implications for the member (CC), partner, or shareholder (company).

Insurance is the best way of protecting yourself against business risks.

Agreements of purchase and sale

The purpose of this kind of agreement is

- to ensure the continuity of the business
- to accumulate reserves for unforeseen events

In terms of this type of policy all the partners and shareholders of the business enter into an agreement of purchase and sale, which stipulates that the shares of a deceased partner must be sold to the remaining partners or shareholders. The remaining partners or shareholders are compelled to buy the deceased's shares.

A method for the valuation of the deceased's share is also stipulated in the agreement.

A life policy, for example on the lives of all the members, directors or shareholders (the large shareholders), may be the solution. In this way a cash reserve may be built up for the remaining members (those who took out the policy on the life of the deceased) to buy the deceased's share.

Partnership insurance

The main objective of this type of insurance is to provide the remaining partners with sufficient cash to buy the share of a deceased partner in the event of the death of that partner.

The estate of the deceased should therefore make provision for his or her part of the partnership's assets. Partners would like to prevent the deceased's share from falling into the wrong hands (people they don't want to be part of the partnership).

Joint life policy

This type of policy is taken out on the lives of two partners (rarely more than

two). The costs involved are lower than they would have been for individual life policies. The policy will therefore terminate and pay out on the death of the first of the two partners. A new policy must then be taken out.

Individual life policy

One partner may take out a policy on the lives of the other partners. The agreement between the partners will then state that this policy should be used to buy the deceased's share in the partnership. The remaining partners will have to pay the premiums of the life policy. In this way, the yield of the policy is regarded as capital and they do not have to pay income tax on it. These premiums are not tax deductible.

Proprietary limited company insurance

A company is a legal entity and exists separately from its shareholders. A proprietary limited company may have only one shareholder.

In the event of the death of one of the shareholders, conflict may arise between the remaining shareholders and the heirs for the following reasons:

- The shareholders may want to effect future growth while the heirs require an immediate income.
- For the shareholders, salaries are of primary importance and dividends are of secondary importance. The heirs may require high dividends, however.
- The heirs may sell their shares to a stranger, or even to a competitor.

Conflict, suspicion and even court cases may follow.

The only possible way of preventing all these negative outcomes may be to buy the deceased's shares via an agreement of purchase and sale, supported by a life assurance policy.

Close corporations

A close corporation (CC) is an independent legal entity. The CC may take out insurance policies on the lives of the members with an interest in the corporation with a view to buying a member's interests in the event of disability or death.

Professional incorporated companies

The shareholders of a professional incorporated company may also take out

insurance policies on the same basis as shareholders of a proprietary limited company.

Policies on the lives of employees

Key person insurance

A business often has one or more employees who make a significant contribution to the profitability of the business. The employer may protect himself against losses by taking out key person insurance on the life of a specific employee.

Insurance to cover a specific liability

- to insure an overdraft
- to cover a personal guarantee
- to cover a shareholder's loan account
- to cover a mortgage loan
- to make provision for cash reserves

It is important to note the various business insurance policies as well as the needs in which they provide.

4.4 I HAVE TO INVEST MY PACKAGE FOR RETIREMENT – WHAT ARE THE INVESTMENT ALTERNATIVES?

WHEN YOU MAKE AN INVESTMENT FOR YOUR RETIREMENT
YOUR PRIMARY OBJECTIVE IS FINANCIAL INDEPENDENCE AFTER
RETIREMENT

REMEMBER YOUR OWN PERSONAL FINANCIAL NEEDS AND OBJECTIVES
(YOUR LIFESTYLE AND STANDARD OF LIVING)

When discussing investing a package for retirement, it is impossible to go into all the details of all the possible financial situations in which you may find yourself as an investor. There are many variables, in particular

- age
- composition of your family
- financial needs and objectives
- the myriad financial products and other investments via which the same retirement objectives can be realised
- various estate and income tax objectives
- the possibility of offshore investment (see section 4.5) for rand hedging
- emigration
- future and career planning for children
- the rate at which investment products are changing
- changes in local interest rates and in the exchange rate

We are dealing with the investment of packages (or other lump sums) by the general South African public and therefore only rough guidelines can be given. Potential and prospective investors should determine their personal position when they consider the various steps and actions that will lead to the eventual investment of their packages. Certain investors will also have greater confidence in some products than others. The property tycoon will still invest in property; the multimillionaire businessman will still invest in business interests. There's nothing wrong with having preferences – it only makes life more interesting.

The investment of your package should not be seen as the end of your life but rather as an opportunity or adventure from which you hope to gain a lot of knowledge. The investment process will involve consecutive decisions that will eventually lead to financial peace of mind.

As it is impossible to discuss everything that is of relevance here, this discussion should be read together with some of the other chapters in this book and not in isolation. I'll refer briefly to a few concepts in other chapters just to give more perspective. The information in this chapter will not be sufficient to help you to come to a final and correct investment decision.

YOUR PACKAGE WILL OFTEN BE THE SUM TOTAL OF YOUR WHOLE
FINANCIAL LIFE – INVEST IT WITH THE REST OF YOUR LIFE IN
MIND

THINK ABOUT THE FOLLOWING ...

The income gap after retirement (supplementing your pension)

The income most retirees receive from their pensions is much lower than the salaries they once earned and their income has to be supplemented by making additional provision before retirement. This is the only way they will be able to maintain their standard of living. Figure 4.1 will give you an indication of the income gap that you will have to fill, unless you will be satisfied with a much lower standard of living. Your investments should be such that your net income after retirement will be equal to your net income before retirement.

Figure 4.1 Income gap after retirement (Swart 1996:580)

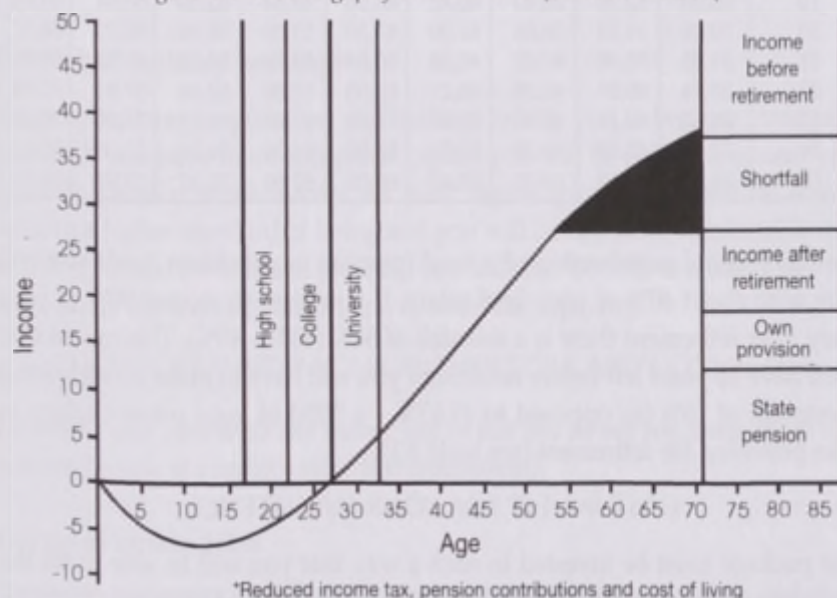


Table 4.1 shows the percentage of additional provision required to maintain the same standard of living (the same income) after retirement.

Table 4.1 Percentage additional retirement provision required (Swart 1996:582, 583)

Years to retirement	Percentage of your current income needed to supplement your provision								
	8,0%	9,0%	10,0%	11,0%	12,0%	13,0%	14,0%	15,0%	16,0%
10	13,63	15,58	17,45	19,50	21,46	23,41	25,37	27,33	29,29
11	15,41	17,32	19,49	21,67	23,84	26,01	28,19	30,38	32,53
12	16,69	19,08	21,48	23,87	26,26	28,66	31,05	33,44	35,84
13	18,26	20,88	23,50	26,11	28,73	31,35	33,96	36,58	39,20
14	19,86	22,71	25,55	28,40	31,24	34,09	36,93	39,78	42,62
15	21,49	24,57	27,65	30,72	33,80	36,88	39,93	43,03	46,11
16	23,15	26,46	29,78	33,09	36,40	39,72	43,03	46,34	49,65
17	24,84	28,23	31,94	35,50	39,05	42,61	46,16	49,71	53,27
18	26,55	30,35	34,15	37,95	41,75	45,55	49,35	53,14	56,94
19	28,30	32,35	36,40	40,45	44,50	48,54	52,59	56,64	60,69
20	30,08	34,39	38,69	42,99	47,29	51,59	55,89	60,20	64,50
21	31,90	36,46	41,02	45,58	50,14	54,70	59,26	63,82	68,38
22	33,74	38,56	43,39	48,21	53,03	57,86	62,68	67,51	72,33
23	35,62	40,71	45,80	50,89	55,98	61,08	66,17	71,26	76,35
24	37,53	42,89	48,26	53,62	58,99	64,35	69,72	75,08	80,45
25	39,48	45,12	50,76	56,40	62,05	67,69	73,33	78,97	84,61

After 20 years of membership of a fund (pension or provident fund) you will retire with about 40% of your final salary. If you want to receive 90% of your salary after retirement there is a shortfall of 50% (90% – 40%). This means that if you have 16 years left before retirement you will have to make an additional investment of 16% (as opposed to 49,65% – ± 50%) of your present salary to make provision for retirement (see table 4.1).

FIRST INVEST FOR YOUR SUBSISTENCE

Your package must be invested in such a way that you will be able to fill the gap in your income with the additional monthly income before you consider any other possibilities or come to any other decision.

Determine the gap in your income by drawing up a table for periods of 5, 10, 15, 20, 25, 30, 35 and 40 years. From this table determine two annual figures:

- your annual cost of living after tax
- your annual pension income after tax

By deducting your pension income from your cost of living you can determine

your income gap/income surplus per year. You will then be able to see to what extent you should use your package for income or capital growth.

Inflation will consume your pension/capital

Remember that the rising cost of living is a reality and you will feel the effect on your income as well as your capital. Annual increases in pension income (really only adjustments) are always lower than the actual inflation rate. As a result your pension will be worth less every year and your standard of living will drop every year.

INVEST IN SUCH A WAY THAT THE INCREASE IN YOUR MONTHLY
INCOME (PENSION) WILL BE MORE THAN THE INCREASE IN THE
INFLATION RATE (RISE IN THE COST OF LIVING)

Protect and build up your capital

Your capital must be protected and built up to help you to become more prosperous. If you have more sources of capital you will be able to augment your monthly pension more readily. As your capital grows, you will be able to achieve a higher standard of living and you will have a more comfortable style of living (in line with capital growth). You will also be able to afford more luxuries (more expensive holidays, travel, overseas trips, etc).

THEREFORE INVEST YOUR MONEY FOR CAPITAL GROWTH

Determine your own needs and income gap so that you do not pay unnecessary commission (because of a broker's subjective involvement).

Get rid of certain debts

There are two types of debt: those incurred in our everyday lives and those used to obtain assets such as a house or to finance a business. When you incur debt to earn an income it is not advisable to use money from your package to pay off this debt (unless you are having serious cash-flow problems) as the interest on the debt is tax-deductible. This principle means that the return on your own capital will be higher.

Nor would it be wise to invest only your own money in a business. Borrow money or use some foreign capital as well. Don't risk all your money. Rather



invest part of it for capital growth in case your business fails and you have to fall back on your capital to survive.

But it's wise to pay off your short-term debts (ordinary accounts) as well as your bond if you no longer receive a subsidy on your house. If you still receive a subsidy on up to R75 000 it is advisable to pay off everything above this amount as monthly payments on an amount above R75 000 will not be subsidised by the employer.

PAY OFF ALL DEBTS THAT ARE NOT SUBSIDISED AND DO NOT HOLD ANY TAX BENEFITS

When you invest part of your package in your mortgage bond (when you no longer get a subsidy) you will receive a tax-free return that is equal to the interest rate of your bond.

Most people who own their own homes have financed the transaction with a bond they pay off in monthly instalments over a period of at least 20 years (or 30 years). People often don't realise that they pay back more than four times the initial amount to the bondholder during the 20- or 30-year term. It takes more than 16 years of the 20-year term to pay back half of the initial loan.

It's obvious that very few investments will offer the same benefits as paying

off your bond, particularly when interest rates are high. By increasing your monthly payment by 10% the homeowner (mortgager) can reduce the pay-back period of 20 years by almost half.

Suppose, on the other hand, someone buys a house and finances it partly with a bond of R100 000 over 20 years at an interest rate of 15,5%. The monthly instalment will be R1 353,88. The buyer must therefore make 240 payments of R1 353,88 to the bondholder.

Let's see what happens when the monthly payment is increased by 10% (ie, R135,39). The new payment will be R1 489,27 per month and the new term will be about 13 years or 156 months. This increased payment will mean a saving of R113 726 (R1 353,88 x 84 months). Of course, the additional payment of R21 120 (R135,39 x 156 months) must be deducted from the R113 726, which means a net saving of R92 605.

At the end of the thirteenth year you could buy a second, much smaller property (house) – possibly with a view to retirement. The 'saving' (the amount you would have paid during the 20-year period) could be used to finance the second property and a tenant could help you to pay off the bond.

You can get a high return by paying a lump sum on your bond. Suppose someone has R20 000 to invest. Although short-term debts should almost always be paid off first, I would suggest that a payment (in other words an investment) on a bond should be made, for the following reasons:

- The return on the investment is tax-free, irrespective of its size.
- The bond term will be much shorter.
- Thousands of rands are saved, particularly if the investment is combined with an increased monthly instalment.
- The return on the investment is high, it is guaranteed, and there are no risks attached.

Another calculation: An owner pays an additional R20 000 on his or her bond a few months after buying a house and financing it with a bond of R100 000. The bond amount is lowered by R20 000 to R80 000 and the bond term (with the same instalment) will now be only nine years (about 112 months). With a further increase of 10% in the instalment the period will be even shorter: 7,7 years (or 92 months).

In table 4.2 below the tax benefits of partially redeeming a bond are explained (it is in effect a tax-free investment). Suppose someone's marginal tax rate is

40% and the interest rate on his bond is 15%. Investing in the bond will yield a return of 25% per year before tax. Should the interest rate rise to 18%, the homeowner will earn 30% interest (before tax) on his investment.

Table 4.2 Tax benefits on redeeming a bond (Swart 1996:347)

Your marginal tax rate	Annual interest rate charged on your bond												
	12%	13%	14%	15%	16%	17%	18%	19%	20%	21%	22%	23%	24%
10%	13,3	14,5	15,6	16,7	17,8	18,9	20,0	21,1	22,2	23,3	24,4	25,6	26,7
15%	14,1	15,3	16,5	17,7	18,8	20,0	21,2	22,4	23,5	24,7	25,9	27,1	28,2
20%	15,0	16,2	17,5	18,8	20,0	21,3	22,5	23,8	25,0	26,3	27,5	28,8	30,0
25%	16,0	17,3	18,7	20,0	21,3	22,7	24,0	25,3	26,7	28,0	29,3	30,7	32,0
30%	17,1	18,6	20,0	21,4	22,9	24,3	25,7	27,1	28,6	30,0	31,4	32,9	34,3
35%	18,4	20,0	21,5	23,1	24,6	26,2	27,7	29,2	30,8	32,3	33,8	35,4	36,9
40%	20,0	21,7	23,3	25,0	26,7	28,3	30,0	31,7	33,3	35,0	36,7	38,3	40,0
45%	21,8	23,6	25,5	27,3	29,1	30,9	32,7	34,5	36,4	38,2	40,0	41,8	43,6
50%	24,0	26,0	28,0	30,0	32,0	34,0	36,0	38,0	40,0	42,0	44,0	46,0	48,0
55%	26,6	28,8	31,1	33,3	35,6	37,8	40,0	42,2	44,4	46,7	48,9	51,1	53,3

This paid-off part of the bond may of course be recalled later in an emergency or to finance something else. However, you should consider such a step very carefully, because it may have many disadvantages.

If you compare a 'bond investment' – as explained above – to a fixed deposit you would be astonished by the difference. In a fixed deposit, tax has to be paid on a return of 16%, while the value of the investment is eroded by inflation. In addition money must be invested for long periods to earn 16% and the investor is not allowed to touch it during that period. The same will happen with an investment in insurance.

Spread your financial/total investment risk (diversification)

Diversification means that you spread your risk by investing in different products. For example, you should not invest all your money in Krugerrands or a specific industry, unless the industry cannot really be affected adversely by economic and political events. You could, for example, diversify by investing your package in cash, government securities, fixed property and unit trusts (shares).

This doesn't mean that you should always look for the investment that carries the lowest risk, but you must ensure that a specific economic, political or financial crisis (local or international) will not cause your whole investment portfolio to collapse. You will spread your investment risk (diversify) best by investing in such a way that the value of your investments will increase and decrease at different times. The average risk of all your investments will be lower because you will not have all your eggs in one basket.

DIVERSIFY – PUT YOUR EGGS IN MORE THAN ONE BASKET

Ideally you should obtain the lowest risk for a specific return on an investment. In the same way, you would want to obtain the highest return for a specific risk level.

YOUR INVESTMENT NEEDS WILL DETERMINE THE RISKS YOU TAKE

If, for example, you have insufficient capital and find (in consultation with your broker) that you will have to make a more risky investment, you can do so. Up to now your investments have possibly been too conservative and you have never taken any risks. In the long run this may count against you because you did not allow for sufficient capital growth.

ARE THE RISKS OF THE COUNTRY TOO HIGH?

If you have all your eggs in South African investments (assets) it may be necessary to invest part of your package – or even your whole package – offshore. In so doing you will

- lower your international risk
- increase your international wealth

Read more about offshore investments in section 4.5 below.

Ways of supplementing your income

You may supplement your income from an emergency fund such as a fixed deposit, a 32 days notification deposit, a money market fund and an income trust. When interest rates are high, money market funds (see below) are of course much more than emergency funds. I only refer to fixed deposits and 32 days notification deposits because of the interest you'd earn, but these deposits

are not a good option when you want to invest your package. However, you could place your package in a money market fund temporarily (at high interest rates) and later transfer the money to income plans, linked products, or as part of a structured fund.

Money market funds

MONEY MARKET FUNDS ARE GOOD SHORT-TERM INVESTMENTS

South Africa is somewhat behind several other countries when it comes to money market funds as investment instruments. The first money market fund was established in the USA in 1971 and ten years later (in 1981) in France to counteract restrictive financial legislation. In South Africa the small investor could never invest in the money market directly because of the minimum amount (R100 000) that had to be invested. Money market funds now offer investors an opportunity to earn a high return on joint investments according to the 'stokvel' principle.

What is a money market fund?

A money market fund is a unit trust that serves as a short-term investment instrument. The objective is to provide a current income to investors. A money market fund invests joint investments of a large number of investors in the money market. The capital is safe (low risk) 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 no longer than 12 months.

For what situations will it be suitable?

- When you have a minimum of R2 000 to invest (the amount differs from institution to institution).
- If you want a monthly income from your investment.
- If you are looking for a risk-free investment.
- If you want to invest a rather large amount for a short period.
- If you want to create an emergency fund in which the money will be available within a day.
- When you have to invest money from an estate temporarily.

- When churches or schools need a continuous income.
- If you require total liquidity.
- When trust money can earn a relatively high interest.

What is the minimum amount that may be invested?

Institutions may vary considerably. The minimum initial investment is R2 000. After that, the minimum investment is R2 000, or R200 if money is invested by debit order.

The minimum balance required

R2 000 (one specific institution). Institutions vary.

What are the costs?

Initial levy: 1,5% on R2 000 – R99 999
 1,0% on R100 000 – R999 999
 0,6% on R1 000 000 and more

Service fee: 0,6% (already included in daily quoted rate)

Money market funds versus unit trusts

Although certain unit trusts (such as income 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 therefore much lower than in unit trusts. In unit trusts, the term is supposed to be more than three years, while in money market funds it may be from one day to 12 months. The income from both is fully taxable. Interest is paid every six months in 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 are fixed. In money market funds the investment (excluding the minimum balance) may be obtained within a day. The money in fixed deposits may

be withdrawn after a fixed term. Money market funds are therefore more liquid. In both cases the interest or income is fully taxable. 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.

Benefits of money market funds

- Small investors may invest in them.
- Investments are very liquid.
- They yield a higher return than other short-term investments that offer an income.
- They are more diversified than other, similar investments.
- The competition they generate will lead to better service.
- The investor's 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 don't have the benefit of a South African track record.
- Fund managers are still 'inexperienced'.

How to choose a money market fund

As there will probably be relatively little difference in the returns of the various money market funds, you won't be able to base your choice on return only. The size of the fund also plays a role. Larger funds should pay higher interest rates because of lower administration costs. The shorter the investment period of the instruments in which the money market funds invest, the safer the funds.

You may also use a retirement annuity to supplement your income. Another option is to use part of your package (as a lump sum) to buy a voluntary annuity (ie, a monthly pension). Buying a second-hand policy is a third option.

There's also the option of investing in income-producing fixed property (various types) to obtain a monthly income. You can expect this type of investment to be accompanied by more worries. It also has its own managerial requirements.

Also ask your broker whether government securities could be used as an alternative income-producing investment.

Retirement annuities

Invest in a retirement annuity and enjoy the tax benefits allowed by law. An annuity is a series of payments or investments that are made in equal instalments.

A retirement annuity is a tax-friendly way of making provision for retirement. For each R100 invested in a retirement annuity, R45 (45%) is received back from the Receiver of Revenue. The investor therefore only pays R55 for each investment of R100 (if his marginal tax rate is 45%).

If you have an approved four-year post-matriculation qualification you may take out a PPS annuity. (PPS stands for the 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. A PPS annuity is intended only for professional people who have an approved four-year qualification and is offered/underwritten only by Sanlam. A PPS annuity is an ordinary retirement annuity and functions in much the same way as other annuities. The only difference is that extra tax-free dividends are paid out for each share you own.

The retirement annuity's option must be exercised when you are between 55 and 70 years old:

- The investor must take one third of his total investment as a lump sum and reinvest it.
- The remaining two thirds must be used to buy a compulsory annuity.

The compulsory annuity may be a traditional annuity, or a modern, flexible annuity:

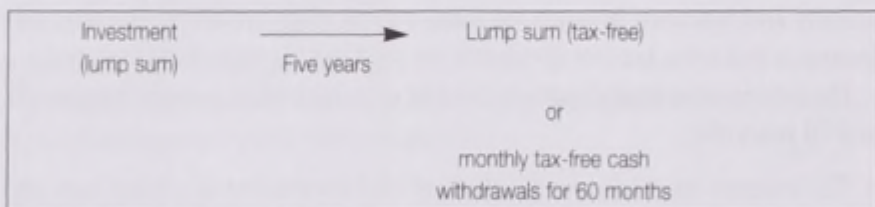
- A traditional annuity may be taken out on the life of a single person or the lives of both spouses (husband and wife). At the death of a single person all further benefits will lapse. In the event of death in a joint annuity the surviving spouse will receive an income until he or she dies. Where both people are still alive (after exercising the option) there are different income combinations to choose from. For example, older people (as well as those who smoke) will receive a higher income because of their shorter life expectancy, while women will receive a lower income because of their longer life expectancy.

- Two thirds of the compulsory annuity may be invested in a living/flexible annuity. The investor is allowed to choose his own level of income based on his current needs, for example between 5% and 20% of the two-thirds capital amount. This option is preferably when there are heirs. After the death of the surviving spouse (in a joint annuity) they may receive the remaining funds over a period of five years, or continue with the annuity in the same way as the initial investor(s).

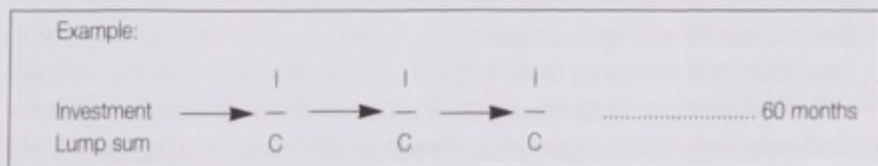
A lump sum endowment policy

You could also invest a lump sum (eg part of your package) in a policy. One of the following investment options should be chosen when you take out a lump sum endowment policy:

- The amount may be invested for five years (without any withdrawals), after which cash withdrawals are made every month. These withdrawals are tax-free.



- Another option is to invest the lump sum for five years but to make 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.



With monthly withdrawals the following will happen:

- Interest received during the five-year period is added to the capital (investment amount).
- The income should be indicated on the investor's income tax return because it is taxable.
- If the capital or income is taken only after five years, it will be tax-free.
- Income received after five years does not have to be indicated on the investor's tax return.

A lump sum annuity (voluntary annuity)

See the discussion on retirement annuities and make sure that you know the difference between a compulsory annuity and a voluntary annuity. Note that the income and capital of a voluntary annuity are handled in the same way as the second option of a lump sum endowment policy (see above). The amount (your income) is divided between income and capital – income is taxable while capital is tax-free.

Second-hand policies

Policyholders often borrow money against a policy to satisfy certain needs (or 'greeds'). These loans are interest-free. But sometimes they borrow so much that their policies become worthless, and they want to get rid of the burden (the loan against the policy). Sometimes the value of the policy is even equal to the loan, and the policy owner may want to sell the policy.

Some investors who want to invest in a policy are not willing to wait five years for it. They are interested in buying a second-hand policy from a policyholder. The purchase price usually amounts to

- the gross value of the policy at that stage
- plus 3% – 7% profit for the policyholder on the value of the policy

Second-hand policies are available for investors who want to invest a lump sum or part of a package.

Advantages for the investor

- The value of the policy (surrender value) is tax-free at any stage during the investment period.
- All income from the policy is tax-free.

- Cash bonuses are tax-free.
- Personal income may be increased.
- The policy period may be extended or shortened.
- It is a safe investment.
- It is the ideal investment for those in a high tax bracket.

Disadvantages for the investor

- Second-hand policies are not readily available even though certain brokers may have some 'in stock'.
- The cost may be as high as 7%.

Of course, you should weigh up the cost against your tax savings and the numerous other benefits.

Shares

Another way of supplementing your income is to use part of your package to buy a computer and a share program to speculate with shares. Technical analyses (the historical analyses of share prices) are used to determine when shares should be bought or sold. Your timing must be right. You will receive the necessary training when you buy the program, and together these will cost you about R7000. Various programs are available, for example Sharefriend and Compushare. Via your computer package you'll receive information about developments at the Johannesburg Stock Exchange every day.

What are shares?

As a company grows, shares are issued to the public. You therefore invest money in the company and this money enables the company to grow. A certificate is issued as proof of the number of shares you own. These shares may be sold at a profit when the price has increased.

What is a unit trust?

A 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. To reduce the risk there are usually more than 20 securities and shares in a unit trust. Securities are financial assets issued by the government, state-aided institutions

such as Eskom and Iscor, and larger municipalities and companies. You can also invest small amounts (eg R50) in unit trusts. Your capital grows and you also receive dividends (a share of the profit) and interest. In April 1999 there were more than 220 unit trusts in South Africa and more than 35 000 worldwide.

Are shares more risky than unit trusts?

Yes, but shares offer a bigger return. Investments in most unit trusts are spread over more than 20 shares, so the chance of losing money is much smaller. Different unit trusts also mean higher or lower risks for the investor, depending on the company in whose shares the trust invested.

How can I invest in shares?

You may invest either directly or indirectly. A direct investment means that you buy shares that are listed on the Johannesburg Stock Exchange. A unit trust is an indirect investment (money is invested in the shares of other companies). You or a broker (stockbroker, insurance broker/agent) may make direct investments as well as indirect ones.

Why invest in shares?

- You can make a relatively large profit (eg 30% or 50%) 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.
- Capital growth is also tax-free.
- If you are interested in capital growth you may request that the dividends be reinvested. The company will keep the dividends and invest them somewhere else.
- A positive growth rate can be obtained over the long term (20–30 years).
- You can invest in companies that earn their income in foreign exchange. This will allow you to protect your rand against a depreciation in value (this is known as rand hedging).

- Capital may be increased (and lost!) quickly.

How much money do I need?

If you want to speculate you can buy shares for a few hundred rand every now and then. You can also invest about R500 or R1 000 (or more) per month in shares. (Even R1 may be invested, but the broker's fees do not justify such small amounts.) This is the principle of rand hedging. In this way shares are obtained in the cheapest way over a long period. But remember that a broker will take more trouble with an investment of R100 000 and more because it will be possible to spread the risk of the portfolio.

What is the difference between an investment and speculation?

It depends on whether you are buying shares as an investment or to speculate.

- *An investment:* Shares are bought as a long-term investment. The investor keeps the shares for a long period (eg 10 or 50 years). You don't buy and sell shares all the time. The purpose is long-term capital growth.
- *Speculation:* The shares are bought and sold to make a profit. The speculator invests his money on the short term and is not interested in capital growth. A share may be bought today and sold after two weeks. (The period may be shorter or longer.) Investors buy shares when they think they are undervalued and sell them when they think the shares are overvalued, or when the price has risen sharply.

Can people invest in shares on their own?

Yes, but it requires knowledge, time (one or two hours per day), motivation and discipline. Many schoolchildren are making money in this way: they follow a course, buy a computer and speculate with shares. Some of these courses are WEN Software, Progressive Systems, Richard Cluver Investments and Equitrac CC. They cost anything between R1500 and R4000. Information about the Stock Exchange is supplied regularly.

Do I have to use the services of a broker?

If you don't want to speculate on your own (don't want to decide on your own which shares to buy or sell, and when) a broker will be the answer. Choose a

company that has its own research team and can provide a full range of services. You may decide yourself whether the company has to make all the investment decisions (buying or selling) on your behalf and whether you want to be consulted, but I suggest that you leave these in the hands of your broker. You have to trust your broker with large amounts of money, so it's important that you both feel the same about risks. Discuss it beforehand.

How do share transactions take place?

Previously shares were traded on the Stock Exchange floor and there was total confusion, with everybody shouting. But in 1997 the JET (Johannesburg Equities Trading) system was introduced. Dealers are linked to the JET system and share transactions are done by computer.

Are there any extra costs involved?

Costs are involved in most investments – including shares. Fees are payable when purchasing as well as selling shares. If you are buying, you have to pay broker's fees (1,5% of the value of the transaction, calculated according to a sliding scale – the more you buy, the lower the cost) and marketable securities tax (0,25%). When you are selling, you only have to pay broker's fees.

How do shares react to the economy?

This depends on the type of company in which you have invested. Not all industries are affected in the same way by a recession. Growth industries such as the computer industry would do well even in a recession. Defensive industries (such as the food and beer industries) are least affected by the economy – people have to eat and they will always drink beer. Cyclical industries (eg durable goods such as cars and furniture) may even do better than the economy in good times. In bad times people will keep their old cars and furniture. Industries that are sensitive to interest rate fluctuations include financial services, the banking industry and the property industry.

What investment approach can I follow?

Shares are bought when they are undervalued and sold when they are overvalued. The value of an undervalued share is higher than the price perceived by people in the market. You therefore buy the share because you believe that

it is worth more than the owner (shareholder) thinks. The owner believes that the share is worth less than the value you attach to it and therefore he will sell it to you. There are two approaches (we'll discuss them very briefly):

- The fundamental approach consists of three steps: first, a macro-economic analysis that determines and explains the course of the general economy; then an industry analysis that determines the possibilities of growth within a certain industry (eg electronics); and finally an analysis of the individual business in a specific branch of the industry.
- The technical approach analyses the historical movement of share prices.

Specific patterns and tendencies are taken into account. This will give an indication of the future course of share prices. The point of departure is that the actions of buyers/sellers will be similar in the same market conditions.

When should I invest?

First obtain information from the Johannesburg Stock Exchange, brokers and financial publications. If you are an older person you must never invest all your money in the hope of becoming rich overnight. Never invest the money you saved for retirement, or your retirement package, in shares until you have made provision for your short-term, medium-term and long-term needs. Never borrow money to invest in shares. Shares should already be part of your investment portfolio (especially in your middle years). Begin investing in shares while you are young – first in unit trusts and then in shares.

What is the future of shares?

As in the past, many short-term and long-term investors will either make money or lose money. Even if share prices drop, they will rise again. There is always an upward tendency. You can make a lot of money. But you may also lose a lot of money if you buy and sell shares indiscriminately and without expert advice.

How should you 'read' it?

What is the meaning of those fine-print share columns in newspapers?

- *H*: Highest price (in cents) of a share the previous day
- *L*: Lowest price the previous day

- *Co*: Company name (usually abbreviated)
- *LAST*: Closing price the previous day (price at which the last transactions were closed)
- *BUY*: Price at which the buyers wanted to buy (how many cents buyers were prepared to pay for the share)
- *SELL*: The price at which the sellers wanted to sell (how many cents sellers were prepared to accept for the share)
- *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-earnings ratio – this is calculated by dividing the price of the share by the earnings per share. Suppose the earnings are 20c and the share price is R1,20. The share is therefore sold at six times its yield (120c divided by 20c). The PE is therefore 6, which means that the present share price includes six years' earnings. (Note that these are historical earnings, ie the earnings of the previous six months of the company, which are usually declared every six months.) If the PE was 20, it would mean that the earnings of 20 years have been included. Therefore, the higher the PE, the higher the expectation that that specific share will perform for many years to come (20 years).
- \pm : The movement of the day (the rise or fall of the daily selling price)
- *DV*: Day's volume (in hundreds or thousands) (the number of shares that have been traded)

And what about those 'strange' terms?

Here are a few terms we often hear:

- *Money market*: market for short-term funds
- *Capital market*: market for long-term funds
- *Bank acceptance rate*: the interest rate banks pay for bank acceptances
- *Bank acceptances*: 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 (they amount to millions of rand)
- *Consumer price index*: the inflation rate (or average rise in the price of consumer goods)
- *Blue chips*: Blue chips are shares in the strongest companies with the best per-

formance record (SA Breweries, Anglo American)

- *Black chips*: Companies under 'black control' on the JSE (eg Real Africa)
- *Bull market*: a buying phase during which the prices of shares are continuously rising
- *Bear market*: a tendency for share prices to fall
- *Sentiment*: the sentiments of dealers in expectation of or following certain events or announcements concerning, for example, interest rates and the repo rate
- *Gold index*: the total movement (or average price) of selected gold shares
- *Industrial index*: the total movement (or average price) 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

Ways of building up your capital

You want to have positive real capital growth, in other words capital growth after inflation and tax (where applicable). There are numerous investment alternatives or investment options: hard assets (Krugerrands, Persian carpets), fixed property (erven and buildings), as well as financial assets such as unit trusts and shares.

If you have to invest your package you should seriously consider unit trusts and shares. Unit trusts are in effect an indirect investment in shares, because your investment is spread over 20 different shares.

Shares

You can invest in shares via a stockbroker. If you don't have the knowledge or time this will be the best option. You should give the broker certain powers (or not) to make decisions about buying and selling shares on your behalf. A bank may also assist you with investing in shares. Read the discussion on how to choose a stockbroker in section 2.2. It will be best to use the services of a full-service broker (one who has a full team of researchers and who offers all necessary services).

Information about investing in shares can be obtained from the following sources:

- the Johannesburg Stock Exchange (JSE)
- information supplied by full-service brokers
- the Investment Analysts Society of Southern Africa (IAS)
- financial publications (*Business Day*, *Financial Mail*, *Finance Week*, *Finansies & Tegniek*)
- suppliers of electronic financial information (Reuters, Intelligent Network (I-Net), Dow Jones Telerate Southern Africa, Bureau for Financial Analysis (BFA), McGregor Information Services)
- South African professional journals (*Investment Analysts Journal*)
- South African sources of information (the South African Reserve Bank (SARB), Statistics South Africa, the International Monetary Fund (IMF))
- other sources of information (banks, the Internet, bureaux)
- information from inside the Stock Exchange ('insider trading')

You may speculate with shares in the short term or make a long-term investment (more than five years). Insurance companies may also invest directly in shares on your behalf. This is accompanied by a guarantee scheme that lowers your risk and is also suitable for older investors.

Unit trusts

Unit trusts offer high capital growth (a high tax-free return) and may be realised quickly because they are very liquid. These unit trusts may be used as a deposit for a home if you don't already own one.

Unit trusts allow the relatively small investor to invest indirectly on the Johannesburg Stock Exchange. Money is invested in the shares of different companies (20 companies at the same time). You may invest in unit trusts on a monthly basis.

Unit trusts can be divided into three general categories:

- general trusts
- specialist trusts
- income trusts

Income trusts and specialist trusts are aimed at capital growth, while income trusts provide a regular income for investors such as retirees. Young people should invest in the first two types – never in income funds. The risk factor varies considerably among unit trusts. Young people should invest in risky unit

trusts with a view to long-term capital growth, for example in the unit trusts of new, developing companies. It's also possible to invest in unit trusts with international interests, in other words a type of international trust.

Money market funds – one of the latest types of unit trust – provide an income for investors while their capital is protected. At present money market funds have the lowest risk of all unit trusts.

Buying unit trusts requires a small initial deposit, for example R200 for certain trusts. Subsequently even smaller amounts (R100) may be invested every month. Various methods may be used to buy unit trusts:

- completing application forms supplied by a broker or an institution
- filling in newspaper and magazine advertisements
- e-mail
- websites on the Internet
- dialling the toll-free numbers of customer care services
- Computicket

Unit trusts offer high capital growth, particularly when the investment is kept for more than three years (as long as 30–50 years for effective capital growth). They also protect the investor against inflation. Unit trusts are very liquid: the total investment may be called up within ten days if the investor needs the money urgently.

For information about unit trusts and their returns or results over different periods (eg 1, 3, 5, 10 or 15 years) consult

- books
- newspapers
- brokers
- banks
- insurance companies
- the Internet

Here are a few useful Internet addresses:

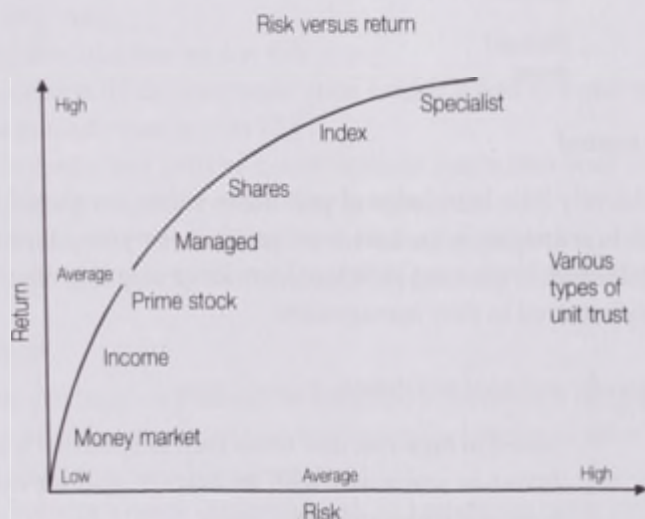
- Bureau for Financial Analysis (UP) – <http://www.bfa-net.com>
- Brantom – <http://www.brantom.co.za>
- Stones – <http://www.infostones.co.za>
- Easyinfo – <http://www.investment.co.za>
- TMA – <http://www.tma.co.za>

- Guardbank – <http://www.guardbank.com>
- Norwich – <http://www.norwich.co.za>
- Plexus – <http://www.plexus.co.za>
- Old Mutual – <http://www.oldmutual.com>
- Business Day – <http://www.bday.co.za>
- Financial Mail – <http://www.atd.co.za/fm>
- Finance Week – <http://africa.com/mags/finweek>
- Business Times – <http://www.btimes.co.za>

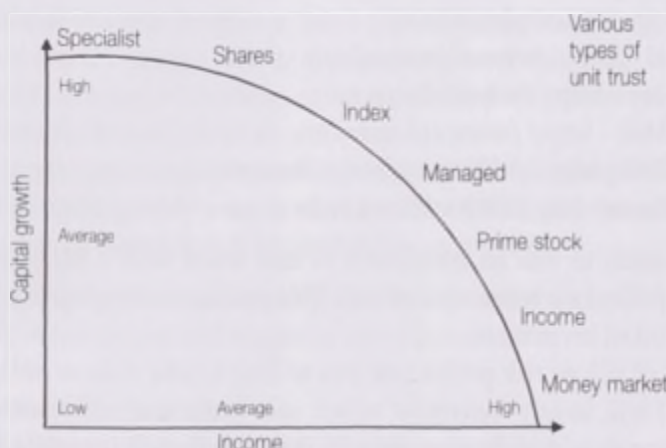
It is also possible to link an investment in unit trusts with a life policy, an endowment policy, or a retirement annuity. This product or investment is called a unit trust-linked investment.

Your view of risk or risk profile (are you willing to take risks or anxious to avoid risks?) will largely determine which unit trusts you will invest in. A younger person should make more risky investments than, for example, a middle-aged person.

Here are a few characteristics of unit trusts from the point of view of risk, return, capital growth, income, short-term needs, medium-term needs, long-term needs, knowledge required, age and taxability.



Capital growth versus income



Short term versus long term

Short term	Money market Income
Medium term	Prime stock Specialist
Long term	Managed shares

The knowledge required

If you have relatively little knowledge of unit trusts, either you should not be involved at all in managing your unit trust portfolio, or your involvement should be very limited. If you have sufficient knowledge of unit trusts you can become actively involved in their management.

Investment options for unit trust investments at specific ages

20–40 years	Invest in high-risk unit trusts such as specialist trusts
40–60 years	Invest in unit trusts with an average risk, for example managed trusts and index trusts
60 years and older	Invest in low-risk unit trusts such as income trusts

Taxability

Tax is paid on the income received from income trusts and money market funds. (For more information about unit trusts consult N Oldert, H Lambrechts & L Still, 1998, *Unit trusts handbook*, Johannesburg: Profile.)

Unit trust-linked products

Unit trust-linked products are products in which unit trusts are linked to retirement annuities, living annuities, preservation funds, guaranteed income plans, guaranteed capital plans, etc. These products allow the investor to switch from one unit trust to another. You may invest monthly in unit trust-linked products, or invest a package or lump sum (or part of it) in unit trusts.

At present unit trusts are the product used by most South African investors for long-term capital growth. If unit trusts are linked to other products the investor obtains the benefits of both, for example the capital growth of unit trusts plus the tax benefits of a retirement annuity.

Businesses that sell unit trust-linked products (through a broker) are known as 'product factories'. When retiring or investing a package you should distinguish between the following unit trust-linked products:

- retirement annuities (the retirement annuity functions as usual but is linked to a unit trust)
- living annuities (see section 4.4)
- preservation funds (the preservation fund is linked to a unit trust and functions as usual – see section 4.2)
- guaranteed plans (part of the investment guarantees your income/capital and the rest is used for more risky investments)
- unit trust exchanges (with unit trust-linked products it is cheaper to switch from one unit trust to another than with ordinary unit trust investments)

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 (R1 000 per month or R10 000 as a lump sum).
- As with structured funds (see section 4.4) an investment may be gradually phased in to lower the risk.
- Information about your investment is easily obtained and all aspects of your investment (such as costs) 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

- It may be to your disadvantage if you switch from one unit trust to another at the wrong time, for instance when you sell at a low price (in a weak market) and reinvest at a high price (and lose capital).
- If your needs change you won't be able to cancel the unit trust link free of charge and reinvest the money in another product (which is not linked to unit trusts).
- If you choose the wrong unit trust portfolio, the average return of your linked investment may be considerably lower.
- Even though you won't be charged for switching between unit trusts, there are other compulsory charges that are not always mentioned by the broker.
- You may choose a company whose computer system is not up to standard, with the result that market disasters such as very high sales volumes cannot always be dealt with promptly and investors lose money.
- Investors don't 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.
- Linked-product companies need not pay back your investment at, or within, a specific time (eg on request). An annuity will only pay out when you are 55.

A UNIT TRUST-LINKED INVESTMENT IS VERY FLEXIBLE AND
COMBINES THE BENEFITS OF VARIOUS PRODUCTS

Structured funds

A structured fund is used mainly for investing a lump sum such as a retirement package, or any other lump sum. It is also possible to invest on an ad hoc basis in these funds. Recurring investments (usually larger amounts) are also allowed.

Structured funds offer income plans, guarantee schemes, an emergency fund and options for capital growth. In this type of fund there are facilities for switching between financial products according to the investor's changing needs at almost no charge. For example, the investor (you) will be informed about the management and performance of your investment(s) by only one institution. This provides investors with flexibility, and they have various options such as investing in any local unit trust. Capital can be guaranteed and can be used to buy an income (pension). There is no penalty when you make withdrawals from these funds. You can usually switch from one fund to another within the same management company at no charge, but there are always certain compulsory charges. There are also requirements regarding the smallest investment amounts, the term of certain investment options, and the number of unit trusts you may invest in.

The effect of changes in the economic environment on the composition of a portfolio

Suppose someone's package of R50 000 is invested in a structured fund as follows:

Structured fund				
Income plan	Government securities	Money market fund	Unit trusts	Offshore
R50 000	R50 000	R100 000	R200 000	R100 000

Example 1:

Should long-term interest rates drop and a definite downward tendency is experienced it would be advisable to move the funds in the money market fund (R100 000) to unit trusts. The R50 000 invested in government securities should also be moved to unit trusts. The portfolio will now look as follows:

Structured fund		
Income plan	Unit trusts	Offshore
R50 000	R350 000	R100 000

Of course you will be able to move these investments only if you (the investor) can survive on your income from the income plan plus other possible additional income. You could also invest money in the income plan if a specific interest rate is guaranteed for, say, five years.

Example 2:

Should long-term interest rates rise and the tendency is maintained it will be advisable to move the R200 000 that was invested in unit trusts to money market funds and/or government securities. Suppose the investor moves R100 000 to a money market fund and R100 000 to government securities. The portfolio will now look as follows:

Structured fund			
Income plan	Government securities	Money market funds	Offshore
R50 000	R150 000	R200 000	R100 000

Note that the offshore investment was kept as it was, because it was made with a view to rand hedging (protection against a falling rand). High or low interest rates in other countries don't have to be taken into account.

Obviously you will want to invest money that has to earn an income for as long as possible at the highest possible interest rate. Sudden fluctuations in interest rates often prompt people to invest money for periods that are too long (when interest rates are high) or too short (when interest rates are low). Here we are thinking specifically of investments in fixed deposits.

Suppose interest rates are very high but the prices of shares and unit trusts are very low and the returns are negative. The investor may now decide to move his investment around and use a part of it (not the part already invested in shares and unit trusts) to buy more shares and/or unit trusts. Should prices rise again, the investor would have a lot of shares and/or unit trusts that were bought at a very low price. The market was therefore right for investing in cheap shares and/or unit trusts, particularly when the investor had invested too much money in income-producing investments in the first place. This move, however, should be postponed for as long as possible to

- earn high interest rates for as long as possible

- invest in shares and/or unit trusts just before their prices begin to rise

A good broker and a great deal of luck will determine whether the move took place at the right time. This is true in periods of both high and low interest rates.

I have described the above scenario at a time that there was a very wide difference between interest rates and inflation in South Africa. If the difference is small, investments with capital growth become more popular (as opposed to income-producing investments). This is true when an investor can choose between income and capital growth, not when his income is just enough (or even too little) to survive. In periods of high inflation most income-producing investments offer a negative real return (after inflation and income tax).

What should your investment product(s) look like?

I would have liked to paint a simple picture here. Unfortunately the answer to this question involves various scenarios and many combinations of them. Each would enable you to be independent when you retire.

Whether you use a single product (or more products) or investment(s) and/or linked product(s) and/or a structured fund, ideally the investment you are considering for your package (or any other lump sum) should provide the following services or have the following characteristics:

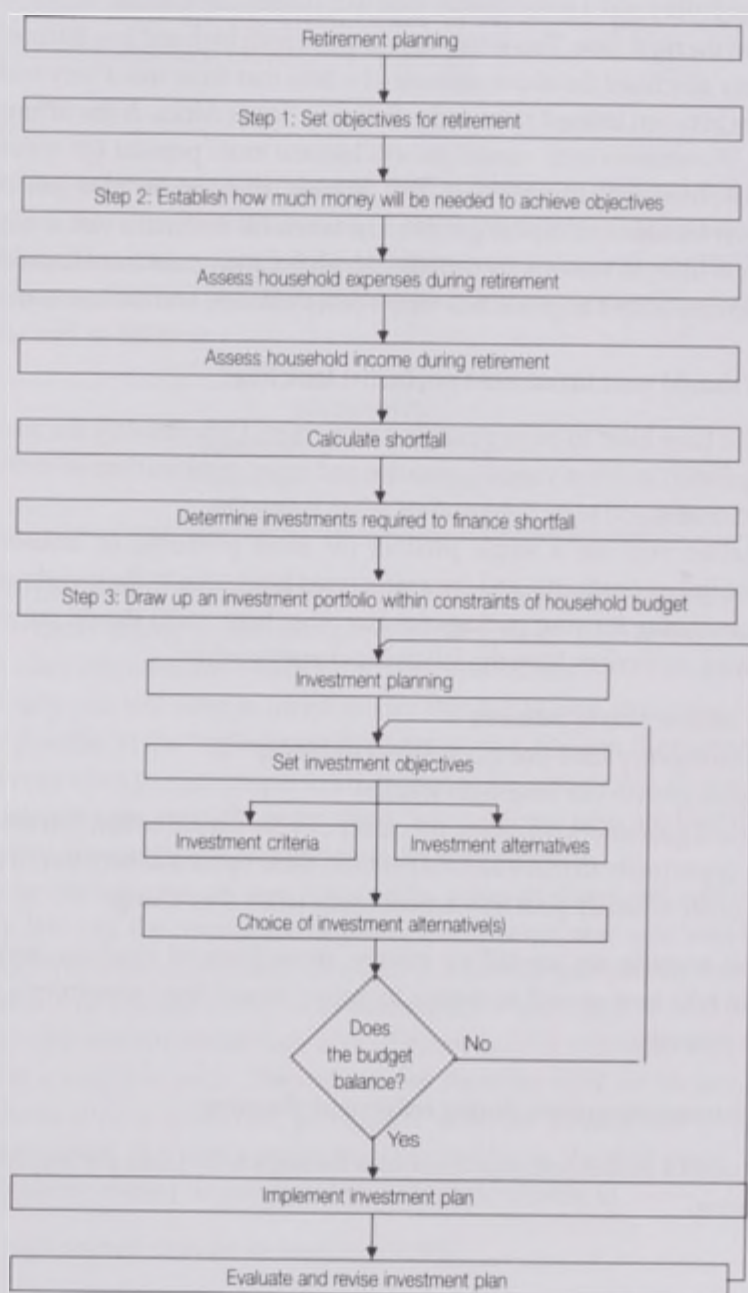
- an income plan (a pension)
- an emergency fund (for quick access to funds)
- capital growth (for long-term wealth)
- certain guarantees regarding the safety of your capital (when you are older)
- an opportunity to move around between these options at very low or no cost in order to satisfy your investment needs when they change

In this scenario we are talking mainly about financial products, because it would take time as well as money to 'move' to and from investments in, say, fixed property.

The investment process during retirement planning

Diagram 4.1 on the next page illustrates the steps to be taken during retirement planning.

Diagram 4.1 Steps to be taken in retirement planning (Swart 1996:584)



The first step involves setting objectives such as the following:

- to maintain the same standard of living as before retirement
- to build up an offshore investment portfolio
- to travel overseas every year
- to build a share portfolio for your children and/or grandchildren

Retirement objectives should be placed in order of priority and should be accompanied by a time horizon (eg 1, 3, 5, 10, 20 years).

The second step involves determining all domestic income and expenses to establish what your income requirements will be after retirement. Also determine which investments may/will be used to supplement the shortfall in your income.

The third step involves establishing an investment portfolio based on the income requirements in step 2. The investment objectives should be the same as the retirement objectives in step 1. The various investment alternatives (products, options) are evaluated on the basis of investment criteria such as

- income
- capital growth
- safety of the investment (capital)
- flexibility (within the investment)
- liquidity
- taxability of income/return
- ease of management (time)
- risk
- return
- investment amount
- investment term
- marginal tax rate of investor (tax position)
- transaction costs (investment costs: joining, management and withdrawal)
- timing (buying and selling shares to speculate)
- diversity of investor's portfolio
- control required by investor
- knowledge or management requirements (invest in a holiday resort)
- protection against inflation
- investor's objectives

It is important to determine whether certain investment alternatives can be accommodated within your budget (only your package, or including your package). If not, you will have to draw up new investment/retirement objectives. If your budget can accommodate your objectives you should go ahead and invest your retirement money through one or more brokers or advisers. Keep an eye on your investments and how they are 'managed' by the fund manager(s) and broker. Revise and evaluate your investments constantly.

4.5 OFFSHORE INVESTMENTS: WHY, HOW AND WHERE?

'Don't rush in where angels fear to tread.'

'Offshore investments' is currently one of the buzzwords in the South African financial world, particularly in the media. Whether you are young, old, poor, rich, have your own business, are a farmer or are unemployed, you want to know more about offshore investments. If you have a package to invest you will obviously consider this type of investment. But if your package is just big enough (or not even big enough) to survive on, you should rather not make any risky investments (locally or internationally). Offshore investments are not necessarily risky, but they are clouded in a lot of uncertainty and confusion that will remain with us for many years.

MOST SOUTH AFRICANS DON'T EVEN KNOW HOW TO INVEST IN
SOUTH AFRICA WHERE THEY HAVE BEEN LIVING ALL THEIR LIVES
- LET ALONE OVERSEAS ...

There is not a great deal of transparency in offshore investments and sometimes we even have difficulty locating the country where we want to invest on a world map. Brokers find it just as difficult.

In this book I give brief explanations and point out possible pitfalls in an attempt to clarify this mysterious concept. When making offshore investments your peace of mind will depend on whether you have acquired the necessary information and knowledge.

South Africans have been torn from their relaxed public service background with its prospects of a peaceful retirement. Suddenly we are living in an information environment. We are informed about offshore investments, wills, trusts, tax havens, income tax systems, donations tax and estate duty. To add to our confusion, all these differ in one way or another (or even totally) in the various countries.

SURELY THIS SHOULD WAKE US FROM OUR FINANCIAL SLEEP?

Suddenly the whole world's investment products are being sold on our doorsteps or inside our homes via the Internet. South Africans can invest and reinvest on other continents within seconds. South African investors are therefore ripped from their comfort zones by the realisation that most of us have all our financial eggs (assets) in one basket (in South Africa). In addition the value of our currency is constantly dropping against those of developed countries.

WE DON'T HAVE A CHOICE – WE MUST FIND OUT MORE ABOUT OFFSHORE INVESTMENTS AND HAVE TO APPLY THIS KNOWLEDGE

We are now waking up (hopefully) to the fact that our investment portfolios by no means meet international standards. And what about South African investors whose investment portfolios don't even meet South African standards, or who don't even have local portfolios? Really, some of us are standing well back in the investment queue. We have to restructure our investment portfolios to prevent ourselves becoming poorer all the time.

WHY DO WE HAVE EXCHANGE CONTROL?

The South African government applies exchange control to prevent large amounts of capital from flowing out of the country as a result of factors such as

- local political shocks
- a poor economy (markets)
- changes in legislation (particularly income tax and estate duty)

Exchange control amounts to government control over the buying and selling of foreign currencies. This restricts the free market system. Of course, South African investors also want to be free to invest where they wish to. This would help them to cope with the increasing financial demands government is making on their assets.

THE ABOLITION OF EXCHANGE CONTROL

Since 1995 there have been continuous attempts to reduce exchange control. In 1995 the financial rand was abolished. Subsequently a few asset swap transactions were allowed from which investors could benefit. Sanlam and Old Mutual

were the first to take advantage of this opportunity. Current account transactions with overseas accounts are now allowed. South Africans may, among others,

- invest R500 000 (1999) per person above the age of 18 years in overseas countries
- open a South African foreign bank account and use a foreign currency of their choice (eg invest in overseas countries)
- open a foreign exchange bank account
- buy property overseas (fixed property)
- invest in various overseas financial assets (eg unit trusts and shares)

The Reserve Bank, of course, has set a prerequisite, namely that South Africans must pay their taxes before they can invest in foreign countries. (These investments will be discussed later.)

We expect exchange control to be relaxed gradually and ultimately abolished. Only then will foreign countries and foreign investors see that the government has faith in investment opportunities in its own country and will the average South African investor be able to escape from the 'investment jail' (the rich are free and long gone).

Advantages of the abolition of exchange control for investors

If exchange control is abolished investors will be able to invest in various overseas products, each with its own unique advantages. The risk of limiting our investments to South Africa will increase, because we will have all our eggs in one basket in terms of international wealth. 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.

OUR MONEY IS IN THE 'WRONG' CURRENCY – THE RAND

ASSET SWAP TRANSACTIONS

The first asset swap transactions took place in 1995 via Sanlam's Offshore Fund. R250 000 per investor could be invested in a special endowment policy and investors would carry the full risk of fluctuations in the return and exchange rates. This one-off investment opportunity lapsed on 31 December 1995, or when 500 policies were sold (whichever came first). Soon after this Old Mutual

offered investors an opportunity to invest either R15 000 as a lump sum or R75 per month in one of the following products: a pure endowment policy, a retirement annuity or a deferred compensation scheme.

Investors expected a higher return on their investments, but the costs at which the asset swap took place, plus the management fee, resulted in lower returns. However, if we take the falling value of the rand into account very high returns have already been earned on these investments.

WHY INVEST OFFSHORE?

There are numerous reasons why you should invest offshore. Investors are motivated by a number of events (see also emigration in chapter 9) but the main reasons are

- protection against fluctuations 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 a after-tax basis
- investment opportunities in emerging foreign markets

I recommend that the following groups of investors should invest in the international market:

- all investors – about 10–20% of their investments (total belongings) depending on the composition of their asset portfolio
- wealthier people – up to 50% of their assets
- those who are considering emigration – as much as possible (set up an offshore trust, make assets liquid, buy an expensive timeshare that may be exchanged later for an overseas timeshare)
- people with children who may later want to emigrate or work in overseas countries and/or who want to send their children (your grandchildren) overseas
- people whose income is sufficient to live on after they have invested part of their packages offshore
- if you think you may live for another 10, 20 or 30 years. Your international investment will later be worth a lot in rand terms if you bring it back to South Africa, because the value of the rand will continue to drop for many

years compared with the currencies of the strong economies of developed first-world countries.

REMEMBER, THE VALUE OF THE RAND IS FALLING BUT THE VALUE OF FIRST-WORLD CURRENCIES IS RISING – A DOUBLE BLOW FOR SOUTH AFRICANS

As South Africans, what should we do now? First, we should make provision for rand hedging (protect ourselves against a falling rand) and second we should diversify our investments internationally. We'll now look at these two actions.

PROTECT YOURSELF AGAINST THE FALLING RAND

The value of the South African rand is falling and will keep on falling for many years to come. Low productivity and high real wages are placing more and more pressure on our inflation rate. If we add the overseas influences and perceptions about Africa and South Africa to these factors, it is only logical that we should keep a falling rand in mind when we do our financial planning.

THE LONG-TERM TENDENCY OF THE VALUE OF THE RAND IS DOWNWARDS BECAUSE OF NEGATIVE PERCEPTIONS OF OUR COUNTRY AND ECONOMY INTERNATIONALLY (AS WELL AS LOCALLY)

Unfortunately overseas investors are able to read – they find out more about what is happening here every day. The most important realities include increasing violence, lack of law enforcement, corruption, mismanagement, the tax burden on investors, and the undue influence of the trade unions on the government, not to mention the unrealistic socio-economic expectations of millions of South Africans.

Let's look at a few methods that can be used to protect your money against a falling rand. You'll see that one (or more) of these options is within reach of your package (after your needs and objectives have been taken into account). Your broker or adviser can help you. Note that the risk and return of an exchange account (that invests in a call account and fixed deposits) are lower than those of an offshore investment in shares. The various rand protectors/

offshore investments fall in the following spectrum as far as risk is concerned:

Low risk and return

	Local/international exchange account (call money, fixed deposits)
	Policies
	Linked unit trust products
	Local unit trusts
	Structured funds
	Guaranteed share schemes
	Offshore property trusts (PUTS)
	Fixed property
	Containers
	Offshore unit trusts
	Offshore share portfolios

High risk and return

Other than the two extremes, each investor will have a different perception of the risks of the various types of offshore investment. Unfortunately you will have to take these risks if you want to protect your rand, whether you like it or not.

Policies

It is possible to contribute to retirement annuities and endowment policies via offshore investments (eg an offshore share portfolio). The usual income tax deductions for annuities will apply. Consult a broker for information about the latest products. You will also be allowed to borrow against this type of endowment policy, or cede it.

Unit trusts

At present South Africans may invest in about 35 000 unit trusts all over the world. For the purposes of this discussion it is important to be informed about the three categories from which the investor may choose.

First, you may invest in South African unit trusts that are investing in South African shares. These unit trusts do not invest in overseas assets. They include the well-known general, specialist and income trusts (as well as other groups).

Second, you may invest in South African unit trusts that invest in offshore assets (shares). At present these unit trusts may invest up to 15% of their assets in overseas countries. These international trusts offer so-called 'onshore' investments. They include

- ABSA International
- BOE Global
- Coronation International Growth
- Fedsure Global
- Guardbank Global
- Investec Worldwide
- Old Mutual World Equity
- Sage Global
- Sanlam Global
- Southern Global
- Standard Bank International
- Syfrets International
- Syfrets Universal Opportunities

As an investor you don't 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 Africa and don't form part of the R500 000 you are allowed to take out of the country (1999) to invest permanently overseas. You may, for example, invest R1 million (or more) overseas in this way through onshore/offshore unit trusts.

Third, you may invest directly in offshore unit trusts as part of the R500 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. Investors will have to complete certain Reserve Bank forms and supply proof that they don't have any overdue tax liabilities. 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.

An offshore unit trust investment may be made via Sanlam's Dublin Fund and Old Mutual's Guernsey Fund, for example.

Like all other investments, the choice in overseas countries is not so easy as it is in South Africa, which is familiar to investors. Research has shown that people who want to invest offshore regard the security, trustworthiness and

return of a fund as the most important investment criteria. Of course these aspects are of the utmost importance when offshore unit trusts are selected, but there is one more vital question: Who will be able to link these criteria for you, as an investor, to specific offshore unit trusts?

It is clear that a multi-management approach or a fund of funds approach should be followed. This means that a very reliable overseas company that is a good performer will give your investment to various offshore fund managers in various sectors to manage. These fund managers are regarded as the best in their fields.

If you are a more cautious investor, index trusts will be the best unit trusts to invest in. The return is always good and the risk relatively low. It would be even better to invest in a group of different index trusts.

An analysis of offshore unit trusts showed that specialist trusts are at the top of the list. A specialist trust is a unit trust that invests in shares in a specific industry, for example computers or finance. As in South African specialist trusts the risk is higher, but so are the returns.

There are various methods of investing in offshore unit trusts. Brokers, financial institutions and insurance companies can help you here, either with an local investment or an international one.

Shares

It is possible to invest in shares overseas through South African shares listed on the Johannesburg Stock Exchange (JSE). This type of share earns income mainly through overseas business. Examples are Richemont, Minorco, Charter, Sasol and Fit. Another possibility is to invest in export shares (that earn an income from exports), for example gold and platinum.

One 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. Risks and returns are high.

You may invest directly in overseas shares via a broker, or invest in prime overseas shares with an insurance company. Part of these shares may be used to make contributions to retirement annuities, endowment policies, preservation funds and provident funds. You are allowed the usual income tax deductions, even though the contributions to the retirement annuity form part of your

offshore investment. This type of overseas share fund requires (for example) a minimum lump sum investment of R10 000, or a monthly investment of R100.

Like ordinary South African shares these overseas share funds hold a higher risk than other types of investment. Your objectives – and the return on your investment – should always be kept in mind.

Containers

Containers must be one of the least-known investment instruments. The lease of containers originated in the sixties and today it is one of the ways in which South Africans can invest in foreign countries.

What is a container?

A container is made of stainless steel and is used to transport food, cars, motor-bikes, beverages, liquids, chemicals, and the like.

How does an investment in a container work?

An individual or a group of people buy a container and lease it overseas to earn an income. The container will be in a pool with other containers and an income is earned from the pool.

Who can invest in containers?

Anyone who can afford to invest R150 000 may invest in containers. An investor who has R30 000 may club with others to invest in a container. This investment is meant for wealthy investors, particularly those who are about to retire (or have just retired) and need an income from an investment.

Is the investment legal?

The Commissioner of Inland Revenue and the Reserve Bank (exchange control) have both approved this type of investment.

What are the most important benefits?

- Tax savings
- Investments are protected against inflation

- Protection against a weak rand
- The beneficiary of an estate may inherit assets in a foreign country

Can this investment be combined with other investments?

Yes, an investment in containers can be combined with

- annuities
- unit trusts
- managed investment accounts

What are the prospects for the container market?

At the moment about 90 000 containers are in use worldwide. The demand for containers is expected to grow immensely because traditional methods of transport are being abolished. Giant multinational industries in the USA are mainly responsible for the demand.

How can I finance the purchase?

Use borrowed money (a loan) to finance part of the transaction. You may even borrow the full amount. Because the loan is made in order to earn an income, the interest is tax-deductible. The purchase price is also written off over five years (at 20% per year) in the form of depreciation.

What do I have to pay tax on?

The investor pays income tax on the income earned – it forms part of the investor's gross income. If there is a capital profit when a container is sold no tax is payable. When a container is sold there will be a tax refund on amounts received to the date of sale. VAT is payable when the container is bought but may be refunded within two months of being claimed.

What proof do I obtain of my investment?

The investor receives a copy of the certified certificate of ownership from the Reserve Bank (where the original is kept). Each container has three numbers:

- an identity number
- a trade number

- an international number of certification

How do I receive my income?

Income is paid out quarterly in arrear.

May I club together with someone to buy a container?

Yes. Up to four people may buy a container. Each will receive 25% of the ownership and income, while the costs are divided on a pro rata basis between the co-owners.

May I sell the container?

Yes. The agent will handle the marketing and the documentation. The container may only be sold to (a) South African investor(s) because this type of investment was created specially for South Africans.

Are there any other risks?

No. The pool of containers carries the risk. The investor may never be held responsible for anything regarding the use of the container.

Who will manage my investment?

In foreign countries leasing agents will manage your investment. In South Africa the investor will appoint an agent when the container is bought. This agent will enter into certain agreements with the leasing agents on behalf of the investor. The agent will also charge a management fee of 5% of the gross income earned by the container.

Where do I buy or invest?

Investments in containers are marketed by Ocean Container Investments, Seef Container Investments, Investec Bank, International Tank Containers, Multistar Container Transport and Medite Containers. New products are being developed in cooperation with financial institutions, for example First National Bank and Southern Life's 'Combo-Link'. Analyse and compare these companies before you choose one for your investment.

What return can I expect?

The return is determined by the measure of occupation/usage (10%, 20%, and 80%) of the container pool. If the containers are used 80% of the time they will provide a higher income. Very low usage (10%) will mean that you don't receive any return on your investment.

For what term should I invest?

You should invest for 5 to 10 years in containers to get the maximum tax benefits and protection for your rand.

What percentage should I invest in containers?

Preferably not more than 10% of your investment portfolio.

REMEMBER, CHOOSE RAND-HEDGING PRODUCTS THAT ARE MOST
SUITABLE FOR YOUR NEEDS AND OBJECTIVES

Yachts

You may also invest in yachts to protect your rand. Investments in yachts function in the same way as investments in containers, and investors receive a free week per year on the yacht. MASMAS (Marine Syndicate Management Systems) is an example of a yacht investment company. These investments are meant for investors with the same needs as those who invest in containers.

Krugerrands

Krugerrands are a good rand protector and can be bought in the primary market at the South African Mint and in the secondary market (where they are traded) from banks, brokers and the public. The South African Reserve Bank also buys Krugerrands if you want to sell yours. The lower the value of the rand exchange rate, the higher the value of your Krugerrands.

We refer later to secret capital/assets. Krugerrands are an example of secret capital that can be hidden. There are of course certain risks associated with Krugerrands, namely theft, no capital growth or income from interest for certain periods, and the cost of keeping the Krugerrands safe in the bank.

If your package is large enough, or you have another source of income

and/or capital to use until long after retirement, you may invest part of it in Kruggerands. But in my opinion Kruggerands should never make up more than 5% of your investment portfolio.

Fixed property in foreign countries

You can invest in fixed property in foreign countries through a reliable South African estate agency. You can invest directly by buying property, or by investing in property trusts. Another possibility is to invest in a timeshare that can be exchanged internationally.

Don't assume that you will necessarily receive a higher return on property overseas, especially if you are an individual investor. A syndicated investment (where you are part of a group of investors) may be preferable, because a better property may be bought or a better investment made because of the larger amount involved. A syndicated investment may therefore spread (lower) the investment risk through diversification.

At this stage it seems a full-time job to speculate from South Africa (even if the property is renovated and sold at a profit). Anyone who has lived in Pretoria and invested money in fixed property in Cape Town will know immediately what we are talking about, as they will be familiar with the feelings of frustration and helplessness. It'll be much worse if you invest in fixed property overseas.

If you use the R500 000 that may remain in a foreign country to buy fixed property overseas, you may find after conversion that you only have enough for the deposit.

Consult the overseas property giant FPDSAVILLS, which is one of the world's three largest estate agencies and has a branch in South Africa, if you want to invest in overseas property. Contact them at (021) 762-9780 for more information, or use the Internet (www.fpdsavills.co.za).

An export business

We have already discussed investing a package (or part of it) in a business (see section 4.3). If you choose this option you should rather invest in (buy) an export business, because it will offer you an ideal opportunity to profit from the continuously falling rand. The main advantage is that you will receive your business income in a currency that is worth more than the rand. You'll get so much more if you convert your income to rands.

Information about export opportunities (businesses) is readily available and you'll even be able to find out which products or services are required in which countries. As part of a complete business plan, you'll also obtain information on how to start your business and how it will function. Television programmes, magazines, and seminars that are advertised in the newspapers are further sources of information.

A business in a foreign country

Another possibility is to establish or buy a business in an overseas country. If you receive income from an overseas business that is making a trade profit, the 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

The long-term benefits of South African trusts are under threat.

SOON WE'LL HAVE TO PAY ESTATE DUTY ON TRUSTS

Through estate duty the government has placed a huge financial burden on individuals' assets or estates. This has forced many people to use trusts when they do their estate planning.

At present (1999) about 600 to 650 trusts are registered in Pretoria every month. A problem the people who establish trusts may have to face in future is that the government may levy estate duty on trusts.

As early as 1987 the previous government tabled a White Paper in which estate duty on trusts was proposed: trusts would be taxed every 15 to 21 years as if the owner of the trust had died. It may be assumed that the budget (and the small number of taxpayers) will soon 'force' the South African government to take this drastic step.

Why?

Why tax trusts? To finance the budget and provide in the never-ending needs of an ever-increasing population for education, housing, medical services and affirmative action.

The end of trusts?

Will this mean the end of trusts? No, definitely not. At the moment there is no alternative to trusts as an estate planning instrument. But it's important that individuals who want to establish trusts (as well as those who have already done so) realise that this is not the end of their estate planning and that they should continue planning.

Implications

What are the implications for trust assets? The way a trust is structured (eg farms, buildings only, or cash only) will have different implications for donors, income beneficiaries and capital beneficiaries.

Trusts will have to be liquid enough to make provision for estate duty or tax on capital growth, say, every 20 years. The implication of this is that donors who have only fixed assets in the trust (little cash liquidity) will have to donate cash to the trust (or convert assets into cash – inside or outside the trust) to meet these financial liabilities.

Example: Suppose a man establishes a trust for his two-year-old son. In terms of existing legislation the capital growth of trust assets does not incur estate duty.

If estate duty on trusts is introduced it would mean that in the next 62 years the trust (with the son as beneficiary of the trust) will have to pay estate duty three times. If the father passes his assets to his son by inheritance or donates or sells them to the son without establishing a trust, the son would not pay any estate duty, even when he is 62 years old (if he is still alive).

Higher tax?

Will the rate of estate duty be increased first? The rate will definitely be increased (at the moment it is 25% on an estate that exceeds R1 million). The rate of 25% will be increased and the rebate of R1 million will be reduced (eg to R500 000). We expect that adjustments in the rate of estate duty and the rebate will be made before estate duty on trusts is introduced.

Interest-free loans?

What about interest-free loans? We expect that in future loans to the trust will no longer be tax-free when assets are sold to a trust.

If this destructive act is implemented it will have different financial implications for different estates.

Well, then we'll just have to make other plans!

South African investors seem to invest internationally not only for investment planning but also for estate planning in order to protect their assets for their offspring.

Some form of offshore trust in a country that is investment and tax friendly is particularly suited to this.

AN OFFSHORE TRUST OFFERS PROTECTION

Since 1 July 1997 offshore trusts have held certain benefits for South Africans. The main advantage of an offshore trust is that it offers an answer to the Katz Commission's destructive onslaught on the hard-earned assets of the individual.

It should be clear to all of us that the successors of the Katz Commission will tax South African trusts in future.

What is a trust?

A trust is an independent entity (legal entity) that is used for estate planning in particular. The person who establishes the trust places assets in the trust to limit (to stop) their capital growth in his or her own estate. Estate duty is saved in this way. The founder of the trust (the donor) retains control over the assets but loses right of ownership to the trust. There are also tax benefits.

What is an offshore trust?

An offshore trust is registered in one of the 'tax-friendly' countries ('tax havens') of the world, such as Jersey, the Isle of Man, Guernsey, Luxembourg, Monaco, Liechtenstein and the Bahamas.

Advantages of an offshore trust

- * An offshore trust is a substitute for drawing up an offshore will. In a will (local and international) the testator's assets are actually made known to everybody. In offshore trusts the assets are not revealed to third parties.

Confidentiality is of the utmost importance.

- Your assets are protected against local legal and political developments as they belong to an offshore trust and thus cannot be affected directly. New legislation therefore won't have any effect on your assets.
- Assets in offshore trusts are protected against current estate duty as well as an increase in the rate (in 1999, 25% on amounts above R1 000 000) and/or a reduction of the rebate (R1 000 000).
- If overseas assets are in an offshore trust the beneficiaries will find it easy to trace them.
- It is easy to divide assets among capital beneficiaries.
- International tax benefits are obtained in tax-friendly countries.
- International fund managers are in an ideal position to manage these assets by investing and reinvesting. These fund managers have more freedom than their counterparts in South Africa.
- Assets in an offshore trust are protected against the sequestration of the person who established the trust. The same is true of future liabilities.
- Income tax benefits are obtained in these 'friendly' countries – this is really what they are, because they protect investors.

If you want to take your R500 000 overseas you should seriously consider the benefits of an offshore trust.

Should amnesty be granted in future to people who have money and assets in overseas countries 'illegally', they may also use the protection of an offshore trust.

A business trust

Establish a business trust if you want to

- start a business in South Africa
- start an export business
- buy or establish a business in a foreign country
- manage overseas investments or secret capital via a trust

You should also look at tax havens and ask an expert to help you to establish a business trust in a common-law country. When business trusts and companies are linked there are many benefits for the person who establishes them. Some of the most important benefits are that you will save on income tax and estate

duty and that your secret capital will be protected. The usual benefits of a trust will apply.

An investment trust

A tax-friendly country or tax haven is the ideal place to establish an offshore investment trust. You can place investments in this trust by lending or selling them to the trust, depending on the nature of the investment (eg a lump sum or fixed property). An investment trust is particularly suited to people who already have secret capital overseas. Investments in more overseas countries may be made from the investment trust.

Once again give a lot of attention to the trust deed when you consult an expert. Take special note of the measure of control you will retain over the capital, for example by indicating that you, as the founder, are entitled to the income as well as the capital if you need it. Also note the political stability of the country in which you want to establish the investment trust. Ask a legal expert to explain the common-law or civil-law implications of that country on the establishment of an investment trust.

Offshore estates and donations

South Africans should be careful when they have to make decisions about donations tax and estate duty on offshore assets or investments. Consult an expert about international estate duty and donations tax because you may make very expensive mistakes. Never accept that it will be possible to transfer certain assets or investments to, say, a trust at a later stage or after your death. Countries with a judicial system based on civil law may have problems with your trust. You may have to pay donations tax or estate duty in two countries (South Africa will be one of them). An expert can help you to avoid paying donations tax or estate duty.

Note that the beneficiaries of a trust and/or the trust may be held responsible for paying income tax. This depends on factors such as

- the rights of the beneficiaries of the trust
- the discretionary powers of the trustees
- whether the income is divided among the trust, the beneficiaries of the trust and the trustees

- whether income is retained by the trust

The taxability of income from overseas sources was changed drastically by recent legislation. Among others:

- If capital donations or loans at low interest rates are made to a trust or a person who is not a South African resident, the donor will be responsible for paying tax on all income that may accrue.
- If more than 50% of the income from an offshore trust accrues to a South African resident, the income will be taxable even if it is received in the form of capital.

If you have an offshore trust, don't

- form an offshore trust via a donation or loan if you (as the donor) are also a beneficiary of the trust
- transfer trust income or trust capital to a South African resident unless there are other beneficiaries who are not residents of South Africa

Yes, there are various tax pitfalls in offshore donations, estates, income and trusts that should be kept in mind when you decide what to do with your package.

Suppose you inherit assets overseas and you want to leave them there. You now have 30 days to declare these assets through your bank to the Reserve Bank. These assets may be left in a trust if the Reserve Bank is convinced that you will bring the income you earn from it to South Africa. This is to prevent the Receiver of Revenue from inheriting part of the assets that you inherited!

Of course you may deal with secret capital as you wish. You may want to invest this capital in a tax-friendly country and protect yourself against the Receiver of Revenue.

Pay your debts

You won't really protect your rand when you pay your debts, but this strategy is worth considering. As the value of the rand drops, imports become more and more expensive and you have to pay more and more for fuel and other products. Your budget will never balance and you will have less and less money for local or international investments.

Traveller's cheques

Traveller's cheques in an overseas currency may be used to protect your rand in the short term (one week).

INTERNATIONAL DIVERSIFICATION

International diversification means the following, among others:

- You invest in different countries.
- You invest in different offshore investment products in different industries or sectors.
- Your investments are internationalised.
- Your total investment risk is lowered and the returns on your investments are higher over the long term.
- You protect yourself against a decrease in your real wealth.
- Your international risk is smaller and your international wealth increases.

DO YOUR HOMEWORK BEFORE INVESTING IN FOREIGN COUNTRIES

Before you decide to make any offshore investment you have to do a lot of homework. Never make an offshore investment impulsively. After you have talked to a few people and brokers you should realise that one uninformed decision could have a snowball effect. As you go through the learning curve and learning process you will soon find out that an uninformed person is on a dangerous route.

Let's look at the homework you should do before you invest overseas:

- Remember that you want to invest your package in such a way that you will be financially independent after your retirement.
- Consult various sources of information about offshore investments (we discuss this later).
- Consult various brokers and experts.
- Make sure that 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 products, countries and currencies you want to invest in.
- Avoid swindlers and never be too optimistic or too pessimistic – always be realistic.
- Find out whether you have to obtain the approval of the Reserve Bank for your investment.
- Make sure that you know which forms to complete for the Reserve Bank and your own bank, and what additional proof they may require.
- Find out whether the company's way of doing business will be acceptable to you (how they operate overseas – their services, confidentiality and the products they offer).
- What is the situation in the countries where you want to invest? Find out more about political stability, language, religion, acceptance, the strength of their currencies, tax legislation (income tax, donations tax and estate duty) and legislation affecting trusts and companies.
- Let the broker or institution help you to determine the exact time when your investment should be converted into the other currency.
- Identify the economic cycles of overseas countries and invest in countries in which the cycle is favourable for the growth of your investment (eg during a phase of economic restructuring).
- Evaluate the investment risk of the specific overseas countries.
- Ascertain the management style, reputation, infrastructure and performance record of the offshore fund manager (particularly when markets are weak).
- Find out about the inflation rates and interest rates of the various countries.
- Analyse these countries' investment histories for investors.

WHERE CAN I GET INFORMATION ABOUT FOREIGN INVESTMENTS?

Consult the following sources:

- information pamphlets issued by brokers
- newsletters of financial institutions, insurance companies and brokers
- the Internet (www.businessweek.com, www.yahoo.com, www.micropal.com, etc)
- local newspapers (*Sunday Times*)
- overseas newspapers (*Financial Times*, *Asia Money*, *Money Observer*, *International Money Marketing*, etc)

- local information businesses (International Information Business and Stock Press)
- computerised investment analysis (Micropal, Money Mate)
- the University of Pretoria's quarterly survey of unit trusts

HOW MUCH AM I ALLOWED TO INVEST OFFSHORE AT THE MOMENT?

At the moment R500 000 per person may be permanently invested offshore. The usual requirements of the Reserve Bank will apply because the money does not have to be returned to South Africa. (Remember that we are referring to offshore investments.)

If you want to invest overseas in the form of an onshore investment you may invest any amount (there is no maximum) because the investment will have to come back to South Africa and may not be used in a foreign country.

It will of course be possible to invest much more than R500 000 overseas through a donation to a spouse (who does not have R500 000) and interest-free loans to family members (and/or your parents).

HOW MUCH SHOULD I INVEST OFFSHORE?

The average investor should not invest more than 20% of a portfolio offshore. A wealthy investor who has sufficient assets and is in a position to invest offshore without incurring any debts may invest up to 50% of a portfolio. It's impossible to determine a fixed percentage. Decide where you fit in after you have obtained the necessary information.

IN WHICH CURRENCY SHOULD I INVEST?

The American dollar and the British pound are still the most popular currencies. Another possibility is Europe's new currency, the euro. The dollar remains the number one choice.

IN WHICH COUNTRY (OR COUNTRIES) SHOULD I INVEST?

Emerging markets usually offer good investment opportunities – so interna-

tional investors tell us. But even South Africa appears on the list of countries that are regarded as emerging markets.

No, stick to the winners when you invest your package: the USA, the United Kingdom and Western Europe offer long-term benefits.

Find out whether it wouldn't be better to invest in tax-friendly countries and use a trust (or trusts) for your investment or business.

South African investors usually prefer the Isle of Man and the English-speaking (British) Channel Islands, namely Guernsey and Jersey, as tax havens. The British government gave them total financial independence to protect their investors in an acceptable manner and at an acceptable level. The legal system and tax system are also acceptable to South Africans.

TAX-FRIENDLY COUNTRIES

It is possible to invest your package, or part of it, in an overseas country where you don't have to pay any income tax (tax-friendly countries or tax havens). You invest there and receive a monthly income without paying tax on it. All information about that particular investment is confidential and is not made known to any other country.

Certain tax-friendly countries do have a low tax rate. You should therefore make sure that you fully understand the tax implications of your investment in such a country. A few examples of tax havens are Guernsey, Vanuatu, Bermuda, the Bahamas, the Cayman Islands, the British Virgin Islands, the Dutch Antilles, Jersey, Gibraltar, Antigua, and the Cook Islands.

Tax-friendly countries are particularly suitable for establishing an offshore investment trust.

INVESTMENT GUIDELINES – YOUR INTERNATIONAL INVESTMENT STRATEGY

- Decide how much money you have to invest.
- Are you going to invest a lump sum, or are you going to invest on a monthly basis from another source/investment?
- Decide whether you want to invest money locally or internationally.
- Choose one or more investment products, for example a container, unit trusts and shares.
- Choose, for example, a certain type of unit trust in a specific industry.

- Diversify further by not investing only in a single unit trust but in, say, five different index trusts.
- Your investment choices must meet your needs for income or capital growth.
- Choose safe countries, particularly tax-friendly countries, for your investment.
- Establish a trust if it can help you to avoid paying income tax in a tax-friendly country.
- Use the Internet and personal references by brokers (but do your homework first) and choose a management company for your investment.
- Make sure that you understand the investment risk.
- Use the Internet to monitor your investment performance.
- Never make impulsive emotional decisions about your long-term investment.
- Always keep your investment objectives in mind.
- Compare your international investment strategy with the retirement planning process discussed in section 4.4 and make sure that you will achieve your retirement goals.
- Beware of investing only in emerging countries (markets). They are all influenced by more or less the same factors, and you are already exposed to an emerging market in South Africa (with all the risks).
- Regard your investment in an emerging market as a medium- to long-term investment.

These are only a few very general guidelines that should be evaluated together with a lot of other information. Use them to make more informed and sensible investment decisions on your offshore investments.

YOUR OFFSHORE INVESTMENT CYCLE

We have already stressed the importance of knowing your own investment cycle as well as the stage of the general economic cycle. The same principle applies to offshore investments. The ideal is to invest in countries that are undervalued at the moment but whose investment value is expected to grow in future as a result of factors such as an economic boom and upswing. This is why it is important for potential investors to identify these countries before selecting certain sectors and shares for investment. You should therefore choose a country (or countries) whose economy is recovering or in a recession.

A LOCAL FOREIGN EXCHANGE BANK ACCOUNT

At present it is possible to invest internationally via a local bank account. The careful investor who wants to avoid all risks, no matter for what reason(s), usually chooses this option. You can invest your money either as call money or as a fixed deposit. The first step will be to decide in which overseas currency you want to keep your money. You may also decide to keep your money in different currencies. Note that this investment may only be made at an overseas bank and not in property or shares. Ascertain the minimum and/or maximum investment amounts, the interest rate, and the costs involved. This kind of investment is particularly useful for small investors.

A FOREIGN EXCHANGE BANK ACCOUNT IN A FOREIGN COUNTRY

It is also possible to open a foreign exchange bank account in an overseas country to protect you against a falling rand. Unfortunately the interest rates on these accounts are rather low. Even after the fall in the rand they are unlikely to be higher than those of local banks. Compare the various banks and obtain all the necessary information.

You may also use international banks that have branches in South Africa.

HOW DO SOUTH AFRICAN COMPANIES HANDLE OFFSHORE INVESTMENTS?

Local companies that market unit trusts have added an overseas component to their companies. They used various methods for this:

- Some companies opened offices in overseas countries.
- Others formed partnerships with overseas institutions.
- Alliances were formed between local and overseas institutions with the local institutions acting as agents for their counterparts overseas.
- Various offshore fund managers were appointed at different institutions. They handle offshore investments in a specific product as the need arises.

Overseas institutions are already doing business in South Africa to attract offshore investments.

Banks and insurance companies have also appointed offshore fund managers

in various countries and have established certain funds in specific countries where South Africans can invest their R500 000. Brokers, financial institutions and insurance companies all over South Africa use one or more of these methods (and combinations of these) in their offshore investment sections.

These institutions also offer the following types of offshore funds: global or international funds, sector funds, share funds, government securities, money market funds and currency funds.

WHAT ARE THE COSTS OF INVESTING IN A FOREIGN COUNTRY?

It would be impossible to specify the costs of offshore investments here. You have to establish the initial costs and the annual fees (or management charges). It's safe to assume that the costs of an offshore investment will always be higher than the costs of South African investments. As a result you will receive a lower return on your offshore investment, particularly in the beginning.

For example, if we invest the R500 000 in an offshore fund, the costs will be as follows:

Initial cost	5%
Service charge	1,15%
Compulsory charges	0,60%
Initial cost of reinvesting the income	5%

The benefits of such an investment should be compared with the costs to put things in perspective.

ALWAYS COMPARE THE COSTS WITH THE BENEFITS (INCOME/
CAPITAL GROWTH)

WHICH FACTORS DETERMINE THE RETURN ON OFFSHORE INVESTMENTS?

First, 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. Second, the weight (percentage of the total portfolio) of the type of investment should be determined, for example:

Shares 60%
Government securities 20%
Property 10%
Cash 10%

Then you have to decide on the type of economy where you want to invest, namely a developed country or an emerging country, for example

60%	Developed countries (eg USA)
40%	Emerging markets (Brazil, Singapore, Malaysia, etc)

As a last step, decide on the specific currency in a specific country, for example:

60%	}	USA	}
American dollar		60%	
40%	}		}
British pound			
Choose which currency in Brazil		Brazil	
		40%	

All these decisions (and many others, such as the decisions of the fund manager) will affect the returns on your offshore investments.

TAX ON OFFSHORE INVESTMENTS

For various reasons it is not possible to discuss the tax position regarding offshore investments here. Some of these are:

- Tax systems and the basis of income tax calculation differ from country to country.
- Not all countries have entered into tax agreements that eliminate double taxation of investors.

- Different countries attach different meanings to the term 'offshore investment'.

You'll therefore have to consult an international tax expert in order to evaluate and accept or reject the tax implications regarding your offshore investment.

OH YES, OFFSHORE INVESTMENTS REQUIRE A LOT OF HOMEWORK

Keep in mind that it is possible to make investments via tax-friendly countries because no income tax will be involved.

INVEST IN A TAX HAVEN VIA A TRUST AND AVOID ALL INCOME TAX

If South African investors don't place their investments in tax havens they will have to pay income tax on all income earned overseas. We are not talking here about offshore investments that are left overseas permanently (as part of the R500 000) but about onshore investments whose income has to be returned to South Africa.

If you invest in an overseas country that has not entered into an agreement with South Africa to avoid the payment of double tax, you'll have to pay tax in both countries.

Let's look briefly at the tax position of a few offshore investments:

- 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 interest income is converted into rand (may be taxable or not, depending on the purpose of the investment)
- income from the leasing of buildings (rent is taxable unless received by an offshore trust in a tax haven)
- income from the leasing of a container (rent is taxable unless received by a trust in a tax haven)
- dividends (from unit trusts and shares) are not taxable (not all countries distinguish between the interest part and the dividends of unit trusts, however)
- capital growth (tax-free)
- capital profit (taxable unless received by a trust in a tax haven)

These tax arrangements apply only to long-term investors and not to speculators. Speculators have to pay tax on, for example, capital growth as well as exchange rate profits.

AN INTERNATIONAL CURRENCY EXCHANGE GUIDE

If you want to find out how much a specific currency (eg rand) is worth in another currency (eg French franc) you may consult an international exchange guide, which can be obtained from the Reserve Bank and other banks. The guide will enable you to calculate how much your offshore investment is worth in the currency of a specific country. The exchange rate between the rand and the American dollar or the British pound is also quoted every day on radio or TV.

HOW TO INVEST YOUR SECRET CAPITAL

Secret capital (money, investments and assets) is capital that you own illegally in terms of South African law.

Secret assets refer to cash, diamonds, gold coins, etc, that have been accumulated over the years. Many South Africans have large amounts of secret capital which they or their friends have taken overseas over the years. The Reserve Bank is also fully aware of the many investments and offshore trusts that already exist in foreign countries.

Various other methods may be – and have been – used to take secret capital overseas. These include:

- People who have import businesses sometimes quote a purchase price that is higher than the actual purchase price. They will therefore pay more (send more money overseas) and invest the difference between the actual purchase price and the inflated purchase price overseas.
- People who run export businesses are doing exactly the opposite. They quote a selling price that is lower than the actual selling price. They are therefore selling more than the amount they indicate and then invest the difference between the scaled-down selling price and the actual selling price overseas.
- The full travel allowance is sometimes taken overseas but is not used fully. The remaining amount is invested overseas.
- Some people enter into agreements with overseas visitors who come to

South Africa for a holiday. They pay the visitors' holiday and travelling expenses and the visitors then invest the same amount in an overseas currency in a foreign country.

- Often family, friends and diplomats are paid to take South Africans' money overseas for a fee/commission. There are people who do this for a living – some schemes are more risky than others.

For the first time more emphasis is being placed on offshore investments that are made legally (or illegally) and we have to do the necessary investment planning, income tax planning, estate planning and retirement planning about such investments. Consult various specialists about these aspects as well as about offshore trusts.

A SECOND WILL

A second will should be drawn up in the following cases:

- If you have secret capital (give the will to an attorney who is a friend and instruct him to give it to the rightful heirs and to help them with the administration of the estate).
- If you have offshore investments (you may draw up a will for each country according to the legislation of the specific country to make sure that the rightful heirs receive their inheritances).

Investments in different foreign countries should not be covered in a single will (over and above your South African will). The legal systems of countries may vary, which may have conflicting implications for the heirs.

INVEST OFFSHORE MONEY/ASSETS IN A TRUST

We have already discussed the transfer of your offshore money and assets to a trust, which should preferably be in a tax-friendly country.

SHOULD YOU RETIRE ABROAD?

Read the discussion on emigration in chapter 9 if you are thinking about retiring abroad. We are concerned here only with offshore investments for retirement while you still reside in South Africa.

SUMMARY

Offshore investment planning has become a part of the lives of all South African investors. There are thousands of offshore investment products and the South African investor will have to do a lot of homework before investing. Various specialists should be consulted about different subjects to help you master the information required. You should also consult the many sources of financial information that are readily available.

You will have to plan very carefully before you choose specific offshore investments, offshore fund managers, and specific countries and currencies. This will enable you to reap the benefits of investing offshore, while your rand is protected against depreciation and your risk is spread through diversification. You may also take advantage of the different economic cycles of the different countries to increase the long-term returns on your investments.

We recommend that investors who want to invest offshore make use of the services of one or more fund managers. Don't even consider trying to place and 'manage' an overseas investment on your own. If you are somewhat scared of investing overseas you should make less risky investments. You can also use tax-friendly countries and trusts in these countries. Do thorough planning when investing or reinvesting your secret capital.

Use the various opportunities for investing offshore and don't keep all your financial eggs in the South African basket, particularly if you have children or grandchildren who may have to leave the country in future to make a living abroad.

Never make an offshore investment on your own – don't try to manage your overseas investments on your own – don't give your money to any Tom, Dick or Harry to 'invest' and 'manage' overseas.

Choose the right fund manager and enjoy a higher investment return in the long term, as well as income tax and estate duty benefits.

4.6 WHAT PROTECTION DO INVESTORS HAVE?

For many years investors have deserved some form of protection when it comes to financial matters, especially when they have large packages and investments that were made years ago (usually with a view to retirement). Many people and institutions have campaigned for this protection and the first positive signs are now visible on the investment horizon.

A NEW INSURANCE INDUSTRY

The days when the insurance industry was characterised by policy hawkers are over. A new industry has developed which may be forced by law to offer not only information but also protection to the public. After all, you as consumer (investor) deserve to be protected against making uninformed decisions.

Let's look at some positive aspects of the industry.

CONSUMER INFORMATION

Since 1 April 1997 insurers have been providing the estimated value of the policy at the end of each of the first five years. This enables the consumer to see that the initial return is low but that it increases during the term of the policy. The status of the broker is also made known to the consumer by the LOA (Life Offices Association).

The insurance company also supplies the name of the representative of the company where complaints may be lodged and the address of the ombudsman (protector) of the industry. In this way the company takes responsibility for brokers' actions (advice).

CONSUMER PROTECTION

Since 1 June 1997 consumers have a cooling-off period of 21 days after taking out a policy. In this period the new policyholder may cancel the policy if it seems to be the wrong product, or if the broker pressurised him to take out the policy.

If a policy is cancelled, all the premiums that have been paid will be paid back to the policyholder, who will not lose anything.

The industry is therefore trying to be more transparent. The LOA initially suggested that retirement annuities should not be included in this arrangement, but certain institutions acted proactively and want to apply the same code of conduct when annuities are taken out.

Consumers may now expect 'real' financial advice based on their needs because they know the name of the broker and may lodge a complaint with the LOA. Brokers whose only objective is to make their budgets balance will definitely find themselves in hot water.

NEW PHILOSOPHY

When selling insurance the industry's objective is to offer value-adding solutions to consumers. Full financial planning, services and particularly products are now aimed at establishing a positive long-term relationship with consumers. Of course this philosophy will have to work through to the brokers before they will accept it as a guideline.

NEW LEGISLATION

Comprehensive legislation is being introduced whereby investment services will be improved and regulated to protect investors. The Masterbond and Supreme scandals should never be allowed to happen again. The new legislation puts special emphasis on making public all the relevant facts concerning the investment as well as the investor. For example:

- Investors should be able to make an informed decision about the nature of the product, the contract, the expected returns and risks, and the investment criteria.
- They should receive all the information they require.
- The legislation should apply to the whole industry and should be enforced by sanctions.

THE INSTITUTE FOR LIFE AND PENSION ADVISERS (ILPA)

In 1996 ILPA compiled a code of conduct for its members in its Generally Accepted Planning Practice (GAPP). The code has practical guidelines to help intermediaries (brokers or marketers) perform their tasks. GAPP stipulates that ILPA members must always act professionally and maintain a relationship of trust with their clients (investors) to avoid conflict of interests and make the relevant facts known. Nothing should be kept secret. All investors enjoy this protection when they do business (place investments) with brokers who have an ILPA qualification.

ILPA has three levels of membership:

- fellows (who have passed the ILPA examination)
- associate members
- ordinary members

Each member is allowed to market only the products he was trained in.

VARIOUS OMBUDSMEN FOR COMPLAINTS

If investors feel aggrieved about the way that an investment was foisted on them, or have invested in the wrong product, they may submit written complaints to one of four ombudsmen. The problem should be described in detail and the necessary documentation attached. The ombudsmen are

- Ombudsman for Long-term Insurance (for disputes between policyholders and financial institutions or insurers about the marketing of products and not financial calculations of benefits) (PO Box 4967, Cape Town, 8000, Tel (021) 461-5010)
- Ombudsman for Banks (for disputes between clients and the banks that accept the authority of the ombudsman) (PO Box 5728, Johannesburg, 2000, Tel (011) 838-0035/8/9)
- Ombudsman for Short-term Insurance (for disputes between clients and short-term insurers about claims that are rejected) (PO Box 30619, Braamfontein, 2017, Tel (011) 339-6525/70)
- Ombudsman for Pension Funds (for disputes about pension funds that fall under the Pension Funds Amendment Act, 22 of 1996 (PO Box 1041, Cape Town, 8000, Tel (021) 45-4041)

The ombudsmen do not act as financial advisers – they deal only with specific disputes.

There are various important aspects regarding complaints that may arise about pension funds when someone invests a package. We'll discuss some of them.

Everyone who is a member of a pension fund that falls under the Pension Funds Amendment Act, 22 of 1996, has three years to submit complaints to the Ombudsman for Pension Funds. Complaints may be submitted by any person and any institution that has an interest in a pension fund, including present and former members of the fund, beneficiaries, employers, the Financial Services Board, the Registrar of Pensions, and insurance companies. Complaints may deal with issues such as the administration of the fund, the investment of funds and the incorrect interpretation of the rules of the fund.

The steps to be followed when you submit a complaint include:

- Submit a written complaint to your employer or pension fund.
- The employer or fund must react to this complaint within 30 days.
- Submit a written complaint to the Ombudsman for Pension Funds (include personal particulars as well as information about your work and pension fund; proof that the complaint has been submitted to your employer/pension fund, as well as the response you received from them; information about where your employer/pension fund can be contacted; your solution to the problem).
- After this a meeting may be arranged with you and a representative of your pension fund.
- The Ombudsman makes a decision about the case and both parties have the right to appeal against this decision in the High Court.
- If no appeal is lodged the decision is accepted as binding.

If marketers (brokers) are found guilty various sanctions may be implemented against them, such as

- administrative (marketers are no longer allowed to sell certain products)
- civil (the courts become involved)
- criminal law cases (offences are made known to the public and the marketer will lose his good reputation)

FINANCIAL INSTITUTIONS

Financial institutions have already concluded 'contracts' with their brokers. These stipulate that ethical conduct is expected of brokers when they render services. Transparency when marketing products is also called for. As a result various institutions have already compensated clients for losses that they incurred. Brokers are now subjecting themselves to the authority of ombudsmen and even issue cards to their marketers indicating which products they may sell and on behalf of which firm.

Feel free to consult an ombudsman if you have complaints.

MONEY KEPT BY ATTORNEYS

If, for some reason, you invest your package via an attorney, you must make sure that your money will enjoy the same protection as trust money. If this is not the case you should rather invest via another type of broker where your

money will be protected. Find out whether the investment is protected by the Guarantee Fund of the Attorneys Act.

A COOLING-OFF PERIOD FOR HOME BUYERS

Home buyers are now given five days to 'cool off' by the Estate Agents Act, as amended. In this period they may decide whether they want to go through with the purchase. This period excludes the day on which the contract was signed, as well as Saturdays, Sundays and public holidays. The cooling-off period applies only to residences with a value of less than R250 000 and will therefore not apply in the following cases:

- when a property is valued at more than R250 000
- when the buyer had an option to buy the property
- when a property is sold at a public auction that has been advertised
- when a transaction is concluded where the buyer and the seller have previously been involved with the same property
- where the buyer is a legal entity
- if the buyer reserves the right to appoint another person to act as buyer
- if the buyer makes an offer on a second property before exercising his rights regarding the first property (in this case the cooling-off period for the first property will lapse)

This means that if you invest your package in a house you will have five working days to reconsider your decision to purchase as well as the deed of purchase (with the above provisos). If you are not satisfied with your purchase you may cancel the contract and make an offer on another property (or invest or use your money elsewhere).

If you are selling your house the buyer will also have a cooling-off period, so you shouldn't take on any long-term obligations before you are sure that the transaction will go through. If not, you may have to pay the instalments on two houses or use your entire package to buy a new house (when you wanted to use the money from the sale of your old house but now have to rent it out because you weren't able to sell it).

Through its code of conduct for agents the Estate Agents Act, 112 of 1976, offers further protection for buyers during negotiations with agents. In terms of a new, amended act a fine of R25 000 (previously only R1 000) could be imposed

if an agent's conduct is not in line with the code. The buyer will be entitled to receive up to 80% of this amount.

The cooling-off period also applies to a private sale, when buying from a plan, and when you are buying a house through an estate agent.

If you sell your own house the cooling-off period holds no advantages. Because the buyer may still cancel the contract there will be a period of uncertainty because you will not know whether your house has actually been sold. An unscrupulous buyer could waste the seller's time and money because the seller may lose other opportunities to sell the house during the five-day period. The period may also be used (misused) to negotiate a lower price. If a buyer has reserved the right to nominate a third party in the contract, he or she could also use your house to speculate. Sellers are defenceless against this sort of protection.

So remember that you as a buyer will sometimes also be the seller. Keep this cooling-off period in mind when you invest your package.

HAVE YOU INVESTED IN SLOPPY WORK?

You can also invest part of your package (or even your entire package) in building a new house. Often no written agreement is concluded with the building contractor and all the money is paid before the building work has been completed. You can imagine how many things could go wrong!

At present all home builders are forced by law to register with the National Home Builders Registration Board (NHBRB). The board has every house inspected before it issues a guarantee of approval which stipulates that

- sloppy work must be rectified within three months of occupation
- leaking roofs must be repaired within 12 months
- major structural faults should be repaired within five years
- the building material must comply with the minimum quality requirements
- the foundations must be suitable for the type of soil

Complaints about sloppy work should be directed to the National Home Builders Registration Board at tel (011) 886-3636. Assistance is free of charge. If your complaints are valid the board will approach the builder and act as an intermediary until repairs have been completed, even if another builder has to be paid from the Guarantee Fund to do the repairs. The following information is also available from the board:

- the names of all registered builders
- registrations that have been cancelled
- the number of houses built
- previous complaints about a builder

You are strongly advised to find out more about a builder's work before you invest your money in a new building project.

WILL YOU BE INVESTING IN A LEGAL NETWORK MARKETING SYSTEM?

We are not talking about investments of R50 or R500, but about amounts as high as R5000 or R20 000. If you are considering investing a lump sum in a network marketing system it would be advisable to find out whether the scheme is legal. This information is available from the Direct Selling Association of South Africa. The Department of Trade and Industry has also compiled a consumer's code for direct marketing.

Remember that a network marketing system is not about the return on your investment but rather about the return on your very hard and sustained labour.