



UNIVERSITY
OF
JOHANNESBURG

DEPARTMENT OF FINANCE AND INVESTMENT MANAGEMENT

INTEGRATED FINANCIAL PLANNING (CASE STUDY) IFP8X02

FINAL ASSESSMENT OPPORTUNITY
NOVEMBER 2019

Time: 5 hours

Marks: 100

Assessor: Ms C Venter CFP®

Moderator: Ms Jackie Palframan

INSTRUCTIONS:

- This paper consists of 7 pages
- Answer ALL questions in the **answer book** provided.
- Round all calculations to the nearest rand. Show all calculations clearly.
- **Always provide reasons for your recommendations and suggestions made**
- Silent, non-programmable calculators may be used, unless otherwise instructed.
- Answers that have been corrected by the use of Tippex or in pencil **will disqualify** you from a re-mark.
- Scratch out all open spaces and empty pages
- Good luck!

You obtained the following information from Brian when you met to discuss his financial plan.

Brian, 55 years old, is married to Carla who is 45 years old. They are married out of community of property excluding the accrual.

Their children are:

Paula, 19 years old

David, 17 years old

Lionel, 12 years old

Brian's business interest

There are 4 shareholders, each have 25% shares in Star Ads (Pty) Ltd. Brian and his brother Bob are 2 of the shareholders. The company's total value as of 1 June 2019 was R18 000 000.

Brian bought his 25% (25 shares) interest in the company for an amount of R800 000 on the 1st October 1998. The shares were valued at R1 800 000 on the 1st October 2001.

All shareholders are actively involved in the day to day management of the business. Each earn a salary of R880 000 per annum. The company declared dividends of R1 156 a share and distributed the dividend to the shareholders in July 2019. The dividend declared is low as the company has experienced a decline in new business. They are attempting to retain as much of the profits as possible to ensure that their liquidity and solvency ratio remains positive.

In Jan 2018 each one of the shareholders provided the company with a loan of R500 000. The loans are payable on demand and no interest is payable on the loan. The loans are currently still outstanding. At the same time that the shareholders loaned money to the company, the company was also granted a loan of R1 000 000 by the ABC Bank. Brian collaterally ceded one of his life insurance policies to the bank as security for this loan. Brian signed surety for this loan.

Brian is the oldest of the four shareholders. His brother Bob is 47 years old, Reginald is 44 years old and Sam is 50 years old. All, with the exception of Reginald, are in good health. Reginald is uninsurable as a result of a serious stroke.

Medical cover

Brian is not a member of a medical scheme. In fact, he and his wife were last members of a medical scheme in 2006.

Pension fund

Brian is a member of the company's pension fund. In terms of the rules of the fund he and his employer each contribute 7.5% of his salary to the fund and 1% of the total contribution is used for administration and other costs. In terms of the rules of the fund, Brian must retire at the age of 60. He anticipates that his salary will increase by 6% per annum from now until his date of retirement. The rules provide that he can retire earlier as long as he has attained the age of 55 years. The rules provide for cover in the event of his death or disability equivalent to twice his annual salary, paid as a lump sum in addition to the investment value of his pension interest in the fund. The value of his interest in the fund is currently R3 345 100. Brian is also a member of a retirement annuity fund with a current value of R1 250 200. He contributes an amount of R110 750 per annum to the retirement annuity fund. There is no annual increase in the contributions. Contributions not yet deducted amount to R220 000 of

which R186 790 are contributions made after 1/3/2015.

Buy-and-sell agreement

The shareholders are interested in entering into a buy-and-sell agreement, but Brian is not sure whether he would be party to the agreement. He has been thinking about retiring and offering his shares to the other shareholders. He feels that in the event of his death before retiring, the provision in his Will and Testament will adequately address the distribution of his shares.

Brian's assets and liabilities, other than those already mentioned, are as follows:

1. A primary residence in Cape Town with a market value of R7 100 000. He bought the house for a total amount of R2 600 000 in 2002.
2. A collective investment scheme portfolio. The base cost of these investments are R1 300 000. He invested a lump sum equally among the 2 funds. The values of the investments are:
Allan Gray R 1 020 000
Sygnia R817 000
3. Cash investments (money market) R600 000. This investment attracts 4.5% per annum compounded monthly.
4. Furniture and household appliances R600 000 which cost R650 000.
5. Motor vehicles R450 000 with a base cost of R380 000.

Liabilities

1. Outstanding loan over the primary residence: R4 250 000. He took out a second bond on his house as he had to assist family members with their finances. He donated the money and donations tax was paid at the time.
2. Car loans :R190 000
3. Credit card: R35 000.

Carla owns no assets and has only a clothing account which is settled at the end of every month.

Inter vivos trust

Brian's father founded an inter vivos trust during his lifetime. He donated assets to the value of R6 million to the trust. Brian, his wife and their 3 children are the beneficiaries of the trust. It is a discretionary trust. None of the beneficiaries has a vested right to any income or capital in the trust.

The trustees have a discretion to vest any capital gain that it may make on the disposal of an asset in any one or more of the beneficiaries. The trust sold a piece of land in August 2019 and the capital gain is R800 000. The trustees decided to vest the gain in Brian and, instead of distributing it to him, they have left it in a loan account. No interest is being paid on this loan account.

Pension interest of Carla

Carla resigned from her employment on 30th August 2019. The total value of her retirement interest is R1 800 000. She is still undecided on what to do – take the cash or not. She had previously received a retirement benefit from her previous employer when she was retrenched in June 2015. The amount available at the time was R690 000. She drew an amount of R100 000 and transferred the remainder into a Retirement Annuity.

The value of her retirement annuity is currently R808 900. She does not intend to take up new employment.

Retirement planning

After Brian's retirement at the age of 60 he would like to receive an income of 55% of his current salary (in today's value). He would like to receive this for 20 years after retirement. Brian however advises you that he does not think he will retire at 60 for 2 reasons:

1. He does not believe he will have sufficient capital to retire on; and
2. He believes he can still contribute by working until the age of 65 and earn income for additional saving and to pay monthly expenses for a further 5 years. He can contract back to the company earning the same salary but without the additional benefits.

Children's education

He would like to have a special investment fund from which he will be able to fund Lionel and David's tertiary education. He would like to provide for an amount of R45 000 per annum for a period of 4 years as from the beginning of the year after David and Lionel attain the age of 18 years. He would like to start this fund by way of monthly contributions.

Paula is leaving SA for the USA at the end of December 2019. She will be an au pair in the States for 3 years. Brian does not need to make any provisions for her.

Provision for his wife

He would like his wife to have sufficient capital to invest after his death so that she can get an annual income of R900 000 per annum in today's value. This income must increase annually by the rate of inflation. Income is needed until the youngest child is 21 years old. He is comfortable that any investment she makes will grow at 8%.

Their monthly cash flow other than what has already been mentioned

Bond installments (20 year term at 11.5% interest)	R27 464
Car installments	R 5 072
Household expenses and other	R35 000
Credit card (attracts 16.5%)	R 3 500

Brian's Last Will and Testament

In terms of his current will he bequeaths R1,5 million to each of his children, the Allan Gray unit trust fund to his brother Bob and the residue of his estate to his wife Carla.

He wants to ensure that Carla retains the primary residence for their use. This is the reason why he has made Carla the residual heir.

Carla's Last Will and Testament

Carla is unsure where she placed her will and she cannot find anyone that has the original copy. She advises you that her will has the same provisions as that of Brian's but, she has a 14 day survival clause – should Brian die within the 14 day period, her estate will devolve upon her children in equal shares.

Annexure: Brian owns the following life insurance policies on his life:

A Life insurance (no cash value) – with no beneficiaries nominated
R3 000 000 which is payable on death.
Premium: R 3,500 per month

Endowment policy E (cash value R386 000) – his wife is the nominated beneficiary.
Premium: R 1 750 per month

B Life insurance (no cash value) – his children are the nominated beneficiaries in equal shares.

Life cover of R1 700 000 which is payable on death
Premium: R 800 per month

C Life insurance (no cash value) – no nominated beneficiary but ceded
to the ABC Bank as security for the loan that is owed to the bank by Star Ads (Pty) Ltd.

Life cover of R1 800 000 which is payable on death
Premium: R 300 per month.

D Life Insurance (no cash value) – his wife is the nominated beneficiary

Life cover freestanding	R315 000
Own and Similar occupation disability lump sum freestanding	R750 000
Dread disease–freestanding	R815 000
Premium R 4 500	

ANNEXURE: CIS PORTFOLIO

Allan Gray Balanced Fund Number of units 6321

Sygnia CPI +6% Number of units 513 840

(minimum disclosure documents attached)

Assumptions to be used unless otherwise stated:

Bank account credit interest	4.5%
Inflation	6.8%
Investment before retirement	12%
Investment after retirement	9%
Income after retirement to increase at 10%	
Executor is registered for VAT.	
Marginal tax bracket to be used in calculations	45%

QUESTION 1 (TOTAL 21 MARKS)

Brian wants to know whether he should re-invest his current portfolio in another fund and also whether he should invest the money currently in the money market differently.

He is concerned that the majority of his investments are in equities and, being so close to retirement, he believes the funds should be more conservative—but, at the same time is worried that he may lose out on potential gains.

Question 1.1(8 marks)

Advise Brian on whether he should invest his money market differently. Make recommendations and motivate.

Question 1.2 (12 Marks)

Analyse his CIS funds and **comment on** the following variables:

- Investment risks (at least 3 risks identified) **(6 marks)**
- Would you recommend that he rebalances the asset classes that he is invested in? If so, what would your recommendation be? Should you recommend that he not re-balance, please provide your reasons for this.(Comment only on the asset classes and not necessarily on new funds or investments).Remember to **always motivate** your recommendations.**(6 marks)**

QUESTION 2 (TOTAL Marks 37)

He is concerned that there may not be sufficient inheritance (as a result of his death) for his wife to invest to generate income as needed.

QUESTION 2.1 (21 Marks)

Calculate whether there will be sufficient liquidity in the estate should Brian die today.

QUESTION 2.2 (8 Marks)

Assume that there is surplus liquidity (cash) available of R1 500 000 and, further assume that the retirement fund will pay 40% to Carla and the remainder to the kids in equal shares, (the children's funds will be transferred to a beneficiary fund). Will Carla have sufficient cash to invest to generate the income she needs? (For this question, ignore lump sum tax and assume all liquid assets that form part of the residue were used to settle estate liabilities, debts and expenses)

QUESTION 2.3 (6 Marks)

Assume that your answer to question 2.2 resulted in a shortfall of R2 000 000. Considering that Brian is 55 years old which, can make premiums to life insurance policies expensive, suggest at least 3 changes that can be made to his current portfolio that could possibly address this shortfall. Motivate fully. No calculations are necessary.

QUESTION 2.4 (2 Marks)

Should Brian not adequately address Carla's needs on death, is Carla able to institute a claim against the deceased estate for additional funding? Refer to legislation in your answer.

QUESTION 3 (TOTAL 23 MARKS)

Brian believes that he will not have sufficient capital to retire at the age of 60. He will consider contracting back to his company for an additional 5 years (to age 65) should he not have the capital required at his preferred retirement age.

QUESTION 3.1 (12 Marks)

Advise him, by showing calculations, on whether he will in fact have to work for another 5 years. For the purpose of this question, take only retirement funding into account.

QUESTION 3.2 (4 Marks)

Assume a shortfall of R3 000 000 at retirement, how much should he invest on an annual basis if he increases his contributions by 10% a year?

QUESTION 3.3 (7 Marks)

If you assume that your calculation in 3.2 resulted in Brian having to make an **additional annual** contribution of R160 000 for retirement purposes, how much of his TOTAL annual contributions will he be able to deduct for tax purposes in the current year of assessment?

QUESTION 4 (TOTAL 9 MARKS)

Carla has asked your opinion on whether she should utilize her retirement interest of R1 800 000 to settle debt and invest for other goals or, whether she should transfer the lot into a pension preservation for retirement purposes.

QUESTION 4.1 (5 Marks)

Calculate and advise her on how much funds there will be available to settle debt should she cash in the full pension interest.

QUESTION 4.2 (4 Marks)

Provide Carla with a brief summary on what you recommend she does and the reason for your recommendation. Provide 2 recommendations.

QUESTION 5 (TOTAL 10 MARKS)

You should have a good understanding of the shortfalls that need to be addressed at this point in time.

QUESTION 5.1 (10 Marks)

Advise them on any other areas of risk that you have identified that have not as yet been dealt with. In pointing out the risk, provide a reason why you feel it is a risk and, advise them on what can be done to either minimize the risk or to address it in its entirety. Provide at least 5 risks.

TOTAL
100 marks