

You Too Can Be A Philanthropist

By Wilfred Ling



In May 2009, there was a secret meeting organised by the two richest men in America. Bill Gates and Warren Buffett presided over a confidential billionaires meeting hosted by David Rockefeller. Mayor Michael Bloomberg and Oprah Winfrey were said to have been among those attending. The agenda? Philanthropy. The goal was to get the super rich starting from the Forbes list of 400 wealthiest Americans to pledge at least 50% of their net worth to charities during their lifetimes or upon their demise.

While the world's wealthiest were thinking of giving their wealth to the needy, an unrelated event occurred. Ms Gail Posner - daughter of Victor Posner, an American businessman and philanthropist - died in March 2010 bequeathing £8 million to her dogs. So, on one end of the spectrum are billionaires who are thinking of donating billions of dollars to charities and yet there is the other extreme of individuals who are more concerned with dogs than that fellow human beings.

The man-in-the-street would view such news as unimportant. After all, most of us do not own billions of dollars to give away. Besides, charities in Singapore have been hard hit by bad publicity due to poor corporate governance. Perhaps the last thing in our mind is philanthropy. I will address the issue of poor corporate governance later. For now, I want to show that the man-in-the-street is capable of philanthropic giving - not just in a small way but in a very big way. It will not be as big as Warren Buffett's net worth but enough to have a lasting impact on many in-

dividuals. There are three considerations that I will examine in this article: source of wealth, structures and identification of managers.

WHERE IS THE SOURCE OF WEALTH?

We first start with the most important ingredient in philanthropic giving - wealth. You cannot give what you do not have. Without wealth, there will be no gift. Not only do you need money, but you will need to have surplus money in order to give it away. The source of wealth comes from three sources namely: earned income, accumulated wealth and the usage of estate creation techniques. I believe that many charities rely significantly on donors giving a portion of their earned income on a regular basis. With technology, it is easy to set up an automated deduction (like GIRO) from the bank account to be paid to the charity concerned. However, this assumes there are sufficient "spare cash" to give. While high income earner will have no problem setting aside some spare change for regular giving, it may be difficult for middle income earners to do likewise. Wages do not increase every year. In year 2009, according to Singapore Department of Statistics, Singapore's average monthly household income from work per household member among employed households decreased by 2.9% after taking into consideration inflation. For the second source of wealth called accumulated wealth, it is common for retired individuals to have accumulated a significant portion of their wealth. Every financial adviser preaches the importance of retirement planning. When they say "retirement planning", it

is almost synonymous as saying the need to accumulate wealth through disciplined savings and investments. If these financial advisers do a good job, retirees will accumulate a significant portion of their wealth for their golden years. Going forward, there will be a significant portion of CPF monies being used to participate in the national annuity scheme called CPF Life. Other than the Life Income Plan, the remaining three CPF Life plans do have bequest values if the amount being paid out is less than the capital invested. The third source of wealth is provided by using estate creation techniques or better known as insurance. The most efficient type of insurance to create an immediate estate is by using term insurance. Take for example, a male non-smoker last age 35 insuring S\$1 million and costing \$148.50 per month in premium for a coverage period of 25 years. Most professional financial planners like myself use estate creation method for clients with significant liabilities (such as dependents and mortgages). My question is this, why not double the sum assured to S\$2 million with the second million to be set aside for charitable giving? By the way, the premium is not double - it is \$285.75 to be exact. Borrowing from the investment jargon, estate creation using insurance is equivalent to leveraging a small amount of capital (premium) to have access to large capital (sum assured).

WHICH STRUCTURES TO CHOOSE?

The second consideration is the selection of a structure. A structure can range from simple to complex. Life time giving is considered

a relatively simple method of giving. This could simply be giving a lump sum to your favorite charity. This works for small amounts but if you are giving a large amount, you may want to spread your wealth across different charities. This increases complexity because you have to “pick” suitable charities just like you have to pick stocks. But large lump sum giving during one’s lifetime may not be practical for most man-in-the-street as there is little liquid assets to begin with. Many Singaporeans are asset rich but cash poor. However, lump sum giving upon one’s demise is feasible due to the availability of insurance to increase the estate value. As an illustration, the \$2 million death benefit term insurance can be given away easily at no cost by using nomination under Section 49M of the Insurance Act in which the policyholder can specify the beneficiaries in percentages. As an example, you can bequest say 50% of the death benefit to your favourite charity and the remaining 50% to your dependents. The disadvantage of this method is that the life insurance payout is given in lump sum to the beneficiaries. To address this problem, one can set up a testamentary trust to hold the life insurance proceeds. A testamentary trust is a trust that is only set up upon a demise of an individual. The testamentary trust is part of a Will. The benefit of the testamentary trust is the ability to appoint trustees (professional or otherwise) to manage the trust assets. I always recommend testamentary trust to hold assets for parents with young children since minors are unable to inherit assets until they are of legal age. So why not “piggy back” on the testamentary trust for charitable giving? Another advantage is that the transfer of property upon one’s death via the Will to the testamentary trust only incurs \$10 of stamp duty. On the other hand, a lifetime transfer of a property to a living trust could cost up to 3% in stamp duty! Hence, from cost point of view testamentary trust is economically viable.

However, there are individuals who already have a living trust setup. For individuals such as businessmen and professionals who are at constant financial risks of legal lawsuits and business failures, they should

already have in place asset protection structures like discretionary irrevocable living trusts. It is my usual practice to suggest the setting up of such living trust for these individuals. If they already have such a structure in place for asset protection purpose, why not “piggy back” on these existing trusts for philanthropy cause? All it takes is to amend the Letter of Wishes to include a desire to give a certain portion of the trust assets to charities.

HOW TO SELECT YOUR MANAGER?

The third consideration is the selection of managers and trustees. No manager or trustee is required if you are giving a lump sum to specific charities. However, if the assets are held in a trust, you will have to decide who should be managing your trust assets and how these managers are going to disburse money to the designated charities. My suggestion is to forget about having the trust employ individuals to manage these trust assets. Unless you are as rich as Bill Gates, it is more economical to outsource. There are three components to outsource: the trustee, investment manager and the selection of target charities. For trustee, always outsource to a commercial trust company regulated by the Monetary Authority of Singapore. Never use an off-shore trust company because you will not be protected by the regulator here. It is impossible to take any legal action against a trustee whose address is a virtual mailbox located in some exotic island. I have also heard of unconfirmed horror stories of financial institutions putting clients’ monies in off-shore trust companies so as to escape the scrutiny of the regulator here as they engage in unethical practices such as churning. To ensure no conflict of interest and to maintain objectivity, the trustee should not be commercially related to the investment manager. The trustee should also not receive any “kickbacks” such as trailer fees and soft dollar commissions from the investment manager. Of course, the trustee should be given the discretion to replace the investment manager. The third component to outsource is the selection of charities. This is the most difficult element to address. Selection of chari-

ties is almost like selecting which stocks to invest in. These days, you have to scrutinise charities’ corporate governance and financial statements to uncover any suspicious activity. Unfortunately, selecting charities is more difficult than selecting which stock to pick because the latter is always driven by profitability while the former non-profit. It does not mean that a low profit margin charity is bad. Similarly, a high profit margin charity is not necessarily good. However, the principle of diversification applies similarly to both. For simplicity, one can simply “outsource” and use the Community Chest as a diversification platform by instructing the trustee to give say, 5% of the trust assets annually to them. Community Chest is a fund rising division of the National Council of Social Service (NCSS). NCSS is established by an Act of Parliament although not part of government. For year 2010, 72 charities have been targeted by Community Chest to benefit from its fund raising activity. For individuals who desire more control, they could for example specify that the trustee is to support all charities in equal share with specific aims such as helping children with autism or elderly suffering from dementia. It is important that the selection criterion should not be too narrow otherwise there is a danger of having only 1 or 2 charities meeting the requirements resulting in a loss of diversification benefit.

Philanthropy need not necessarily be restricted to the wealthy and is possible even for the man-in-the-street. With some planning, it is possible to have a large impact on those who are needy. If in doubt always consult professional financial planners for assistance. ■

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