Wealth Protection Against Creditors

By Wilfred Ling

Asset protection is needed to manage the risk of bankruptcy.

All of us are constantly subjecting ourselves to risks. Some of these risks are small and will not be of significant issue. However, risks such as major illnesses, disability and death could cause undue financial hardship. Majority of the financial advisers would use life insurance as an instrument to manage these risks by selling a medical or life insurance policy. In this article, I want to touch on another type of risk: the risk of bankruptcy.

In Singapore, anyone who could not pay debts of at least $10,000 can be made a bankrupt by the High Court. As it can be seen, this amount threshold is really quite low. When a person is made a bankrupt, all his assets will be managed by the Official Assignee (OA). The Official Assignee (OA) is a public servant and an officer of the Court. The role of the OA is to realise all the bankrupt's assets for distribution to his creditors and to assist the bankrupt in obtaining a discharge.

HIGH RISK OF BANKRUPTCY

Professionals and business owners are people who are most at risk to bankruptcy. Professionals such as doctors, accountants and financial advisers themselves can be sued due to professional negligence and breach of contract. Take the recent case of the 44-year-old Mr Franklin Heng, chief executive of the $1 billion property management firm YTL Pacific Star. Mr Heng died on 30 December last year following a liposuction treatment at a clinic. The general practitioner (GP) is now undergoing investigation. If the investigation turns out to be against his favour, the GP runs the risk of financial bankruptcy due to lawsuits.

Business owners can also be liable if they have taken personal guarantees. For example, it is very common for businessmen to be guarantors of loans taken up by their companies. Sole proprietors are also at risk of becoming a bankrupt due to business failures because they are personally liable for all liabilities incurred by their businesses. Even individuals who are directors on the boards of companies can be sued by shareholders if they acted against the interests of shareholders. Thus, there is a need to manage these risks. Under financial planning, this subject is called "Asset Protection".

ASSET PROTECTION AGAINST CREDITORS

There are a few ways to do asset protection. However, for most techniques used, it is not possible to avoid bankruptcy if there was a deliberate intention to defraud creditors. The following are some common techniques used for asset protection against creditors:

1. The HDB flat is generally protected from creditors because under the HDB Act Section 51(2), such property does not vest with the Official Assignee on the bankruptcy of the owner. However, many HDB flats are financed using bank loans. For such cases, the bank has the first cut. Hence, it is still possible to lose one's HDB flat if the bank forecloses the flat due to the borrower's inability to repay the mortgage loan installments.

2. CPF monies are also generally protected from creditors. Moreover, CPF savings cannot be used to satisfy any debt or claim. Creditors have no direct access to members' CPF monies. If CPF monies are used for investments under the CPFIS scheme, these are also protected from creditors provided they continue to be in the CPFIS scheme. However, upon death of the CPF member, CPFIS assets form part of the estate which is subjected to creditors' claims.

3. The CPF Life is a life long annuity insurance scheme managed by the CPF Board. Income from the CPF Life is also not subjected to creditors' claims.

4. Nominations of life insurance policies under the previous Section 73 of Conveyancing and Law of Property Act are protected from creditors provided there was no intention to defraud creditors at the time which the policy was bought.

5. Similarly, life insurance nominations under the Section 49L of the Insurance Act are protected from creditors. If there was an intention to defraud creditors at the time which the nomination was made, the creditors can initiate a clawback of the amount equivalent to the premium paid.

6. Finally, an irrevocable trust setup will generally be protected from creditors after a period of five years. I would like to explain in general how an irrevocable trust works.

For asset protection to be effective, the trust must be irrevocable. By irrevocable, it means that the settlor (the person who is transferring his assets to the trust) cannot change his mind and neither can he benefit directly from the trust. He can place his family members as beneficiaries of the trust so that in the event of his bankruptcy, at least his family members will not be financially devastated. Some people feel that it is better to give assets to the beneficiaries directly instead of putting in the trust as this appears to achieve the goal of asset protection. However, there will be situations which this could be impractical. For example, if the settlor's children are still minors, it is not possible to transfer the assets to them. Even if the children have already grown up, they could end up squandering the money away if a large amount of money were given to them.

By placing assets in a discretionary trust instead of a direct gift, the trustee can be guided to the amount which the beneficiaries can benefit through the settlor's Letter of Wishes. Although the settlor has "given" away his assets through the irrevocable trust, he can still reserve the power to make investment decisions. However, if he dies or becomes mentally incapacitated, the trustee would have to step into his shoes to assume the investment decisions.

> "Asset protection, being part of financial planning, is not about products. It is about providing a service to solve specific problems."

ASSET PROTECTION PLANS NOT COMMON IN SINGAPORE

In Singapore, it is quite rare for businessmen and professionals to make any asset protection plans. One reason that is often cited is that a trust requires millions of dollars in assets for it to be economical. Another commonly cited reason is that such a trust should be set up in offshore countries.

These two reasons are just fallacies. I know of one person who pays just a few hundred dollars of annual trustee fees to have such a trust. The trustee does not even impose any minimum trust size. For the second fallacy, Singapore's regulatory regime is good enough to have such a trust setup here. In fact, it is better to have a trust setup in Singapore so that in the event of a dispute, the settlor can seek help from the authorities here rather than flying to another country whose regulations (if any) might be unfamiliar to him.

LACK OF PROPER PLANNING DUE TO POOR FINANCIAL LITERACY

For many Singaporeans, the lack of a proper plan is primarily due to poor financial literacy as well as financial advisers and planners focusing on product sales. The higher the commission of a product, the more number of financial advisers would be recommending and selling such a product.

Asset protection, being part of financial planning, is not about products. It is about providing a service to solve specific problems. Some countries like United Kingdom have plans to scrap commissions for financial products altogether as they have come to realise that clients' interests are not taken care off. Unfortunately, the removal of commission is not likely going to happen in Singapore. Hence, the lack of proper financial planning will continue to persist in the foreseeable future. Businessmen and professionals will continue to receive poor advice on their wealth and it is unlikely they will ever get to know and understand how to protect their hard earned monies. ■

Wilfred Ling is a Chartered Financial Consultant with Promiseland Independent Pte Ltd. He is also a Professional Estate Planner with Rockwills Corporation Pte Ltd.

Wilfred is strictly a fee-based financial planner and holds the regulatory license to provide financial advice to individuals.

Consultation hours: Monday to Friday (excluding public holidays), 9am to 6pm. For more information, please visit www.wilfredling.com