

Investing with a Safety Net

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Would you like to reduce or eliminate probate fees? Have investments with potentially higher returns than GICs (Guaranteed Investment Certificates), but with some guarantees? Well, life insurance savings products might be for you.

Life insurance companies offer savings contracts (daily savings interest, term funds, and segregated funds) and you can designate beneficiaries, not only for your RRSP / RRIF, but also for your non-registered investments. The depositor protection on insurance contracts is similar to that offered by banks and other financial institutions.

Insurance savings contracts have some unique features and are excellent estate-planning tools:

1. Beneficiaries can also be designated for non-registered investments-- You retain ownership/control of your investments, because there will be no temptation to add someone other than your spouse to your investments in order to avoid probate.
2. Contracts may be joint with right of survivorship --then payable to beneficiaries on second death.
3. No need to probate the estate--funds are paid directly to beneficiaries.
4. No delays --simply provide the insurance company with a claim form together with a death certificate.
5. Privacy -- insurance savings contracts do not become public record like probated wills.
6. Creditor protection -- insurance contracts with preferred beneficiaries (spouse, common-law spouse, parent, child or grandchild) may be protected against creditors.

There are a number of savings products:

1. **Daily Interest Savings**--interest is usually compounded monthly with funds available any time.
2. **Term fund**-- similar to a GIC, where you invest a specific amount for a predetermined period of time (from a 30-day term to a 10-year term) at

a fixed interest rate. Interest could be paid to you on a regular basis, or it could compound (interest stays in the contract and you earn interest on interest). You know at the time of investing when your investment will mature and the maturity value.

3. **Segregated Funds**--often referred to as "seg funds", so named because the investments are "segregated" (not included in the insurance company's general assets). They are professionally managed pooled investments, similar to mutual funds. The pool is divided into units, and you purchase units. The value of the units fluctuates as the value of the underlying securities fluctuates.

Seg funds have some distinctive benefits:

1. You have an array of investment portfolios to choose from.
2. Your income tax reporting is simplified.
3. Your risk tolerance may increase because of guaranteed minimum values at maturity or death--from 75% to 100% of your investment.

Depending on the underlying securities, growth could be in the form of interest, dividend income, or capital gains. Growth outside of your RRSP / RRIF is taxed at various tax rates. Interest is taxed at your highest rate, dividend income has an effective lower rate (due to dividend tax credit), and capital gains have the lowest effective tax rate because only 50% of the capital gain is taxable.

There are some differences between seg and mutual funds when reporting growth for tax purposes. These differences have an impact only with non-registered investments, because earnings in a RRSP/RRIF are sheltered, and are taxed as income (same rate as interest income--at the highest rate) only when funds are withdrawn.

1. With seg funds you are responsible for the fund's profits only while you own the units. With mutual funds, you are responsible for the "distribution" (profits distributed to unit holders) when the distribution is made -- usually annually except for bond or money market funds, which could be monthly or quarterly. Therefore if you happen to own the units of a mutual fund when a distribution is made, you could have the same reportable taxable income as someone who owned the units for the entire year.
2. A loss in a seg fund can flow through to the unit holder, who can use it against other capital gains (or carry forward to future years). Mutual fund losses cannot flow through to the unit holders.

3. At disposition, the insurance company provides the information for your tax return; with a mutual fund, however, you need to keep good records to be able to calculate your adjusted cost base (ABC).

Seg funds have guaranteed minimum values at maturity or at death of at least 75% of your investment (less withdrawals, of course). You can establish a maturity date—which must be at least ten years in the future. Some insurance companies have guarantees of up to 100%, and some even allow you to lock in the growth of your fund by “resetting” the guaranteed minimum value. The cost of these guarantees is often reflected in higher MERs (Management Expense Ratios), ranging from .2% to 1% above mutual fund MERs. However, at the end of the day, it is the growth of your investment in relation to your risk comfort level that matters.

I recommend that you work with a financial advisor before investing.

Disclaimer: Investors should read the fund’s Prospectus and/or Information Folder before investing. Mutual and segregated funds are not guaranteed; their values change frequently and past performance may not be repeated. Segregated funds have guaranteed minimum values at maturity or death.

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## How to ...

**Claim an “unclaimed bank balance” held at the Bank of Canada.** Did you know that as of December 31, 2004 there were approximately 804,000 unclaimed balances at the Bank of Canada worth approximately \$245 million? The numbers are increasing – as in 1999 there were roughly 736,400 balances worth \$158 million. Have you forgotten a bank account, bank draft, certified cheque, deposit receipt, money order, or traveller’s cheque? If there is no transaction in a bank account for ten years and/or the bank cannot contact the owner, the balance is forwarded to the Bank of Canada, who maintains custody – indefinitely for balances over \$500, and for ten years for balances under \$500. The oldest balance dates back to 1900. Go to [www.bank-banque-canada.ca/en/ucb](http://www.bank-banque-canada.ca/en/ucb) or call 1-888-891-6398 to search. Who knows what you may find!