

Bryan Ference

# The Anatomy of Segregated Funds



**S**egregated funds are a valuable part of any business succession, creditor protection, and emergency fund plan.

Yet only a small percentage of people are taking advantage of them as a risk management tool.

- A segregated fund is an investment fund held within an insurance contract.
- The term “segregated” refers to the fact that the investment is separated from the general assets of the insurance company.
- The insurance contract (component) dictates the insurance protection your client receives.

Segregated funds are similar to mutual funds in many respects but provide a number of additional features and benefits.

## **A Segregated Fund: The Differences! Maturity and Death Benefit Guarantees**

With guarantees that range from 75 to 100 percent on death or maturity of deposits, no wonder segregated funds are getting so much attention. These and other types of guarantees are

rapidly growing in popularity in the Over 50 Market—and sometimes even younger. They provide a beneficiary with a level of financial security not available with other types of pooled investments.

### **Potential Creditor Protection**

This feature of a segregated fund is of primary interest to business owners or professionals because their assets may be exposed to creditors. Inside a segregated fund, a person can achieve creditor protection by naming a “preferred” or “irrevocable” beneficiary.

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The key relationship is between the life insured (the annuitant) and the beneficiary.

There are exceptions to this and it is recommended that you consult independent legal counsel. It is important to point out that only personally owned segregated funds may be protected from creditors and that protection from creditors does not apply to third-party contracts

### **Ease of Estate Planning**

Proceeds of this contract are paid directly to your named beneficiary, avoiding the time and expense of probate. Also, because probate is part of the public process, information associated with anything associated with probate is accessible to the public. Segregated funds can ensure your personal decisions and information remain the way they were meant to be—personal in nature by helping your assets bypass probate altogether.

### **Consumer Protection**

Segregated funds are eligible for coverage by The Canadian Life and Health Insurance Compensation Corporation (CompCorp). This plan protects Canadian policyholders, within limits, from loss of benefits in the event of the insolvency of the company.

Nonregistered segregated funds have an additional tax advantage over mutual funds. If a segregated fund loses capital in a given year, the unit holders can claim the capital loss on their taxes and offset any capital gains made on other investments. Taxation rules allow the allocation of capital gains or losses without cashing in the units held.

Mutual funds do not have the ability to allocate. They distribute gains or losses and a loss cannot be distributed. The only way to declare a loss with a mutual fund is to sell the units held.

Also, if you purchased nonregistered mutual funds toward the end of a calendar year, you could end up paying tax for a year's worth of capital gains even though you did not own the units for a whole year. With segregated funds, income is allocated monthly so you don't have to pay tax on gains that arose before you even owned units.

If you are considering borrowing to invest outside your RRSP, segregated funds are excellent choices because of their powerful guarantees. The capital and death benefit guarantees will provide comfort to an investor who uses leverage (borrowed money) to try to maximize gains by providing a safety net that, if used properly, will prevent the undesirable situation of investments that are worth only a fraction of the loan used to purchase them.

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There are a few other things worth pointing out between mutual funds and segregated funds.

- Mutual funds are regulated under the provincial securities regulators. Segregated funds are regulated by the provincial insurance officials.
- Mutual funds are offered through a prospectus filed with the provincial securities commission. Segregated funds are offered through an information folder.
- As is true with mutual funds, the segregated fund policyholder has no ownership rights in the assets of the fund. They remain

the property of the insurance company.

- Segregated fund units and mutual fund shares are units of value, where the policyholder owns an interest but not a piece of property. According to the market value of a specified group of assets, the insurance company must maintain separate funds with separate assets for each fund.
- Segregated funds offer a few other different features and benefits, so it's important to carefully choose the contract that's right for you! ▲

**Bryan Ference is Manager of Sales and Business Development for Partners In Planning Insurance Services Inc. He works with many top financial advisors as a consultant in helping them build their businesses.**

Voice: 1-877-967-4357, ext. 2223  
bference@pipinsurance.ca