Integrating Segregated Funds into Estate Planning

Kathryn Bennett, LL.B., TEP
Senior Regional Sales Director

Blake Attwell
Regional Sales Consultant

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Agenda

- Role of segregated funds and annuities in estate planning - Overview
- Why segregated funds work
- A bit about annuities
- Summary

Elements of estate & financial planning

Our focus today is …

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Where Canadians save their money

Government Sources
- CPP/QPP
- Old Age Security
- Guaranteed Income Supplement

Registered Pension
- Defined contribution
- Defined benefit

RRSP/RRIF/LIRA/etc
- Convert before age 72
- Convert at age 72

Other
- Non-registered monies
- TSFAs

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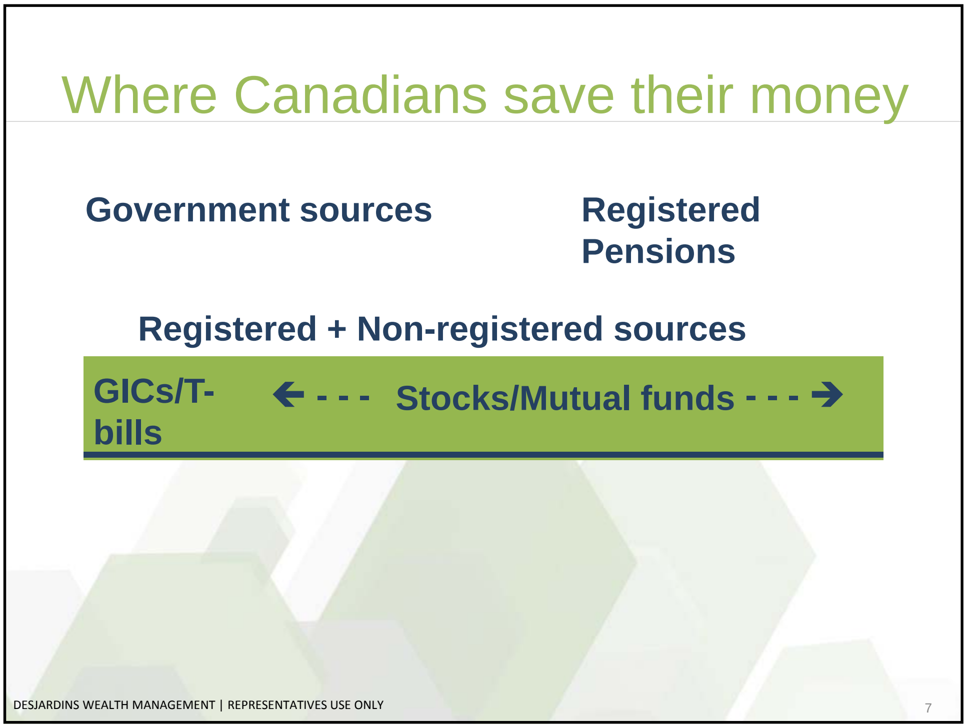
Where Canadians save their money
Government sources
Registered Pensions
Registered + Non-registered sources
GICs/T-bills
← - - - Stocks/Mutual funds - - - →
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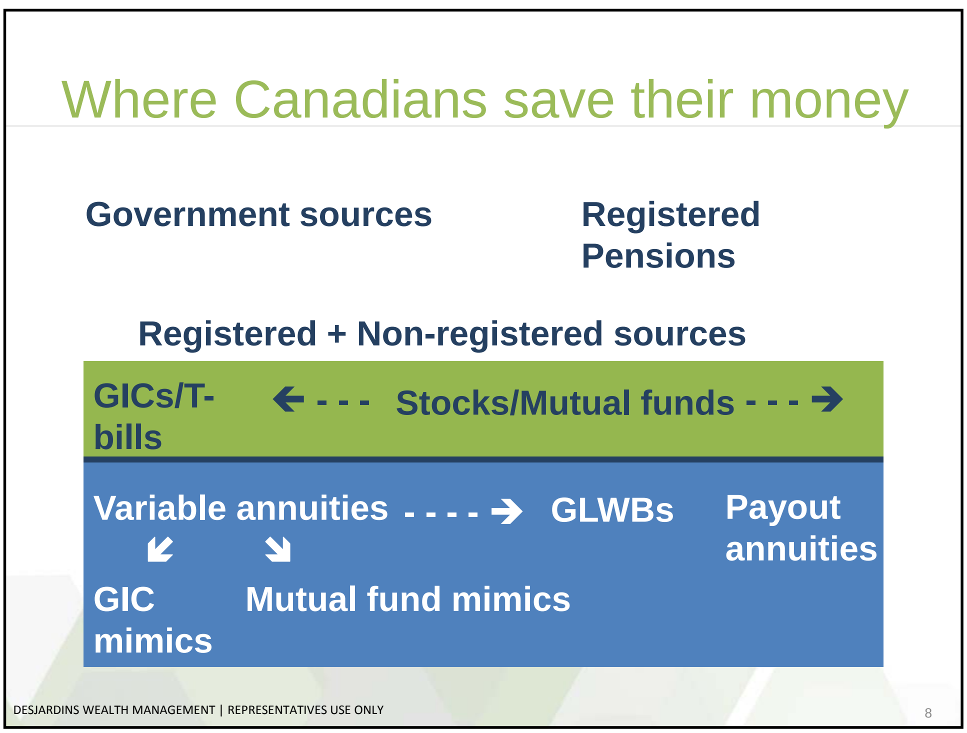
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← - - - Stocks/Mutual funds - - - →
Variable annuities - - - - → GLWBs
Payout annuities
GIC mimics
Mutual fund mimics
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Segregated funds, annuities & estate planning

- Segregated funds and payout annuities offer Canadians:
  - Investment diversity
  - Creditor protection options
  - Income alternatives
  - Probate planning opportunities

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Segregated funds

- Individual variable insurance contract governed under provincial insurance statutes
  - Accumulation or deferred annuity
- Money put into the contract is invested in one or more underlying assets
  - GIC equivalents
  - Mutual funds
- Can be non-registered ("open money") or registered (RRSPs/RRIFs, TFSAs)

Segregated fund advantages

- Principal guaranteed
  - Protected amount can be 75% to 100% of principal investment is guaranteed
  - Most contracts have mandatory holding period to trigger the guarantee
  - "Reset" of the guaranteed amount if segregated fund value increases
    - Reset timing varies across industry

Segregated fund advantages

- Guaranteed death benefit
  - Depending on the contract, 75% to 100% of deposits are paid out when annuitant dies
  - Probate avoidance if designated beneficiary is not the estate

Segregated fund advantages

- Potential creditor protection
  - Plan values are protected during owner's lifetime with strategic beneficiary designation planning
  - This is a key feature for personally-owned segregated funds of business owners
  - Applies to non-registered and registered plans
  - **PLUS:** Proceeds on death are paid to designated beneficiary free from claims of deceased's creditors

Segregated fund disadvantages

- Money is not readily available
  - Typically, clients lose guarantees if they cash out before the plan's maturity date
    - Many plans have 10 year period
  - Early cash-out is current market value – which may be less than original investment
  - Some segregated funds also charge an early withdrawal penalty

Segregated fund disadvantages

- Higher fees
  - Segregated funds usually have higher MERS than mutual funds
  - Covers the cost of the insurance features
    - Right to make a beneficiary designation
    - Potential for lifetime creditor protection
    - Potential for probate avoidance

Segregated fund disadvantages

- Penalties for early withdrawals
  - Depending on the contract, early withdrawal penalty fees may be levied

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Segregated funds and making a beneficiary designation – The basics

- Declaration must be in writing
  - Insurance contract and change of beneficiary form
  - Client's Will
  - Other written document
- To date, only Saskatchewan Courts have recognized beneficiary designations via e-mail
- Most recent declaration governs
  - Does **NOT** apply to insurance or segregated funds issued/acquired after date of document

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Beneficiary classes – Preferred class

- For pre-July 1, 1962 policies
  - Parents (natural and adoptive), legally married spouse, children and grandchildren (natural and adopted) of **the life insured (not the policy owner)**
  - Once a preferred beneficiary is designated, policy owner can only move designation within the preferred class
  - Written consent of preferred beneficiary required to move designation outside preferred class

Beneficiary classes – Family class

- For post-July 1, 1962 policies
  - Spouse (legally married *and* common law), children, grandchildren and parents of **the life insured** in the common law jurisdictions
  - Spouse (legally married *or* civil union partner), ascendants and descendants of **the policy owner in Québec**
  - Policy owner is **not** part of family class for creditor protection purposes as owns the contract

Beneficiary classes – Irrevocable class

- Must be filed with insurance company
- Policy owner's right to deal with policy is restricted (i.e. surrender, policy loans or withdrawals, collateral assignment, changes to policy)
- Beneficiary must provide written consent to any future changes
- If policy issued while your client resided in Québec, designation of a spouse/civil union partner is automatically irrevocable unless owner expressly opts out

Beneficiary classes – Ordinary class

- Any beneficiary designation that does not fall into one of the other classes

Lifetime creditor protection – Segregated fund beneficiary options

- Family class – Parents, spouse (legally married or common law), children and grandchildren of the **annuitant** (not the policy owner)
- Irrevocable
  - Designation can't be changed without written consent of the beneficiary
  - Policy owner's right to deal with contract are limited

Segregated Funds

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Lifetime creditor protection – Insolvency

- Insurance RRSPs/RRIFs and TFSAs with a family class or irrevocable beneficiary are protected if the owner is **insolvent (but not officially bankrupt)**
- Non-insurance RRSPs/RRIFs and TFSAs with a designated beneficiary do **NOT** have lifetime creditor protection in Ontario

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Lifetime creditor protection – Bankruptcy

- **ALL** RRSPs/RRIFs with a designated beneficiary are protected under bankruptcy rules since 2008
  - On bankruptcy, only deposits made in 12 months prior to bankruptcy are exposed
  - On discharge, the RRSP/RRIF is returned intact to the individual
- Insurance RRSPs, RRIFs, **and** TFSAs with a family class beneficiary are covered under provincial exemption rules
- Non-insurance TFSAs are **unprotected**

Probate avoidance – A legal strategy!

- Segregated funds are insurance products
- Beneficiary designation planning can be used to avoid probate
  - Plan proceeds are paid to the designated beneficiary outside of the deceased's estate (per *Insurance Act*)
  - Beneficiary must not be the estate!
- Cost and time for estate administration can be reduced

Probate avoidance & registered plans

- Insurance-based RRSPs, RRIFs and TFSAs can flow outside estate (per *Insurance Act*)
- Non-insurance plans currently avoid estate for probate purposes **BUT** province can change this at any time
  - *Succession Law Reform Act* does **NOT** provide express side-stepping of deceased's estate
- Monitoring of the probate status of non-insurance plans is required!
- **Alternative:** Use registered segregated funds as probate avoidance tool

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Segregated funds and GLWB options

- Many segregated funds offer a Guaranteed Lifetime Withdrawal Benefit
  - Lifetime income stream based on percentage of value
  - Bonus options and market resets can affect plan growth and income entitlement
  - Client has option to trigger after specific age or time period
  - May be attached to registered plans as well as non-registered
  - MERs are higher

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Segregated funds and GLWB options

- 7 key points to know about GLWBs
  - Guaranteed income for life
  - Potential to increase guarantee
  - Protection against market declines
  - Potential payment to beneficiaries
  - Higher fees than non-GLWB alternatives
  - Restrictions on investment options
  - Penalties for excess withdrawals

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Segregated funds and charitable giving

- Segregated fund are considered “publicly traded securities” for charitable giving purposes
- **NO** capital gains tax when you donate a segregated fund policy
- Charitable tax receipt is for the market value
- Donors can combine philanthropy with tax reduction
- Life insurance can “replenish” the estate value for heirs

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Payout annuities

- Individual income insurance contract governed under provincial insurance statutes
  - Income payment can start immediately or be deferred
- Lump sum deposit in exchange for a guaranteed income
  - Lifetime income payments
  - Income payments for specified time period
- Can be purchased with non-registered or registered funds

Payout annuities – Term certain option

- Provides a guaranteed regular income for a set number of years (the term)
- If purchased with money from an RRSP/RRIF, the term must extend to age 90
- Guarantee period option – If annuitant dies during the guarantee period, payments continue to designated beneficiary or estate
  - Purchase of a guarantee period reduces the income amount for the entire term

Payout annuities – Life-pay option

- Provides a guaranteed regular income for lifetime of annuitant
  - Can be single or joint life
- Joint life income options
  - Maintain income amount to survivor's death
  - Reduce income on first death

Payout annuities – Taxation of income

- Qualifies for pension income tax credit if annuitant is over 65
- Non-prescribed annuity subject to accrual taxation
  - Taxable amount of annuity payments varies over time (interest plus return of capital)
  - Income is more highly taxed in the early years

Payout annuities – Taxation of income

- Prescribed annuity get level taxation
  - Owner must be annuitant
    - Exception for certain life interest trusts
  - Certain joint life annuities qualify
    - Spouses/common-law partners and siblings of first holder
  - Payments begin in taxation year of purchase or in following year
  - Payments must be regular, equal in amount, and paid annually or more frequently
  - If term-certain annuity or with a guarantee period, limit is age 91

See Regulation 304 under the *Income Tax Act* (Canada)

Lifetime creditor protection – Payout annuity beneficiary options

- Family class – Parents, spouse (legally married or common law), children and grandchildren of the **annuitant** (not the policy owner)
- Irrevocable
  - Designation can't be changed without written consent of the beneficiary
  - Policy owner's right to deal with contract are limited

Annuities

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Insured annuity strategies

- Client Benefits
  - Provides tax-advantaged guaranteed income for life
  - Offers the added security of tax-free return of capital to your client's estate
- Typical Client Profile Characteristics
  - Healthy clients in their 50s through 70s with substantial, non-registered, low-risk investments
  - Maximize guaranteed retirement income
  - Preserving a generous inheritance for their family and chosen heirs

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Insured annuity strategies

- Three variations
  - – Individual/personal insured annuity - For individuals
  - – Corporate insured annuity – Uses corporate investments and corporate-owned life insurance
  - – Charitable insured annuity – Combines advantages of personal insured annuity strategy with charitable giving

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Why choose segregated funds and payout annuities?

- Segregated funds
  - Can provide income and asset accumulation on tax-efficient basis
  - Can be registered or non-registered
  - Probate avoidance and lifetime creditor protection may be available
- Payout annuities
  - Guarantees income for you and your spouse/common law partner
  - Favourable taxation on the income for prescribed annuities

Probate avoidance – A legal strategy!

- Segregated funds and payout annuities are insurance products
- Beneficiary designation planning can be used to avoid probate
  - Beneficiary must not be the estate!
- Pro-active risk management with insurance solutions may reduces cost and time for estate administration

Probate avoidance & registered plans

- Insurance-based RRSPs, RRIFs and TFSAs can flow outside estate
- Non-insurance plans currently avoid estate for probate **BUT** province can change this at any time
  - *Succession Law Reform Act* does **NOT** provide express side-stepping of deceased's estate
- Monitoring of the probate status of non-insurance plans is required!
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Estate planning with segregated funds and payout annuities

- Lifetime creditor protection
- Can be used for non-registered and registered money
- Enhanced retirement income opportunities
- Can be used for charitable giving
- Beneficiary designation planning can reduce probate, legal and executor fees
- Can provides tax savings for chosen heirs

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Planning is an on-going process

- Regular reviews of corporate and personal planning objectives are essential
- Revisions may be required to meet new or changing needs

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Questions?

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