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How seg funds can be an estate-planning tool

CONTENT FROM GLOBE CONTENT STUDIO

PUBLISHED SEPTEMBER 1, 2020

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As many Canadians start to exit the accumulation phase of their lives and commence planning for retirement and beyond, what strategies serve them best? For advisors and these clients, segregated funds are becoming an increasingly attractive option – especially for estate-planning purposes.

Older investors might gravitate toward seg funds because they can "facilitate the protection and efficient transfer of wealth in a cost-effective manner," says Raymond Yates, senior financial advisor at Save Right Financial Inc. in Vaughan, Ont.

Seg funds are sold only by advisors who are licensed to sell insurance. They are similar to more popular mutual funds and can hold the full spectrum of asset classes but have an insurance contract wrapper that provides several key estate-planning benefits.

One of the biggest benefits is that seg funds have guaranteed investment and death benefit values that are unaffected by stock market conditions, says Prem Malik, financial advisor at Toronto's Queensbury Securities Inc. As such, the minimum value transferred to a beneficiary for estate-planning purposes is known.

In fact, the value can be greater if higher values are locked in during the lifetime of the insurance contract. That's because seg funds normally have a feature that resets the maturity guaranteed value of the insurance contract on each anniversary date, or less frequently. The maturity date of the contract may also reset at the same time.

Typically, guarantees range from a 75- to 100-per-cent payout of the principal at maturity and death. The maturity period, which may be linked to the level of the payout, normally ranges from 10 to 15 years. Costs could rise along with the level of the guarantee.

"For my clients, the most important benefit is the guaranteed principal at maturity," says Dawn Zhang, financial advisor with Citistar Financial Services Ltd. in Vancouver.

She says most of her clients emigrated from Asia, bringing the assets they had accumulated over half their lives. For them, "security of their assets is a top priority."

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Mr. Yates says another major benefit of seg funds for estate planning relates to probate. The value of the insurance contract of a deceased policyholder can be paid directly to a named beneficiary without going through probate. That avoids paying probate fees, which can be substantial depending on the size of the estate, as well as legal and administration fees.

The ability to name a beneficiary can be very advantageous for estate planning if a policyholder wishes to have different seg funds and names specified beneficiaries for each. Heather Holjevac, financial planner at Holjevac Financial Group in Mississauga, says this “provides peace of mind that assets will be distributed according an individual’s wishes.”

One example in which this strategy can be useful is if a policyholder has children from a previous marriage and wants to ensure that children from that marriage have a share in his or her legacy, says Ms. Holjevac, adding that “children from a previous marriage can be disadvantaged in the division of probated assets.”

Another benefit of seg funds is that they can provide potential protection from creditors in the event of bankruptcies or lawsuits. Mr. Yates says that creditor protection is especially beneficial for business owners who wish to safeguard their personal assets. Still, creditor protection can be challenged if a fund was knowingly purchased at a time when the policyholder was experiencing financial difficulties.

Ms. Holjevac says that one of the fringe benefits of using seg funds for estate planning is that they facilitate privacy. The proceeds from a fund are not part of a probated will, which is part of public record. “Some individuals do not want their private affairs to be public.”

Seg fund fees are typically higher than those of mutual funds, which have similar investment objectives. Fees across the industry have come down in recent years, says Tim Prescott, president of Quadrus Investment Services Ltd., a subsidiary of Canada Life, and those fees shouldn’t be viewed in isolation. He believes investors should consider seg fund in terms of the value derived from investing in these solutions, which include the cost of the insurance contract that provides the guarantees investors are seeking.

Mr. Prescott contends that some investors only look at the value of guarantees relative to the equity market as the singular benefit of seg funds. By working with an advisor, he feels investors can participate in the additional features that this solution can provide as part of balanced portfolio.

Mr. Yates suggests that for estate-planning purposes, different features of seg funds appeal to different investors. But at the end of the day, he says, “it’s the peace of mind provided by segregated funds that matters.”

Advertising feature produced by Globe Content Studio. The Globe’s editorial department was not involved.

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