The value in Segregated fund contracts

If you're an active investor, chances are that you've heard of mutual funds. You also may have heard of segregated funds. So what's the difference and why do segregated funds cost more?

When investors buy units in a mutual fund, the company pools their money together. The mutual fund manager (aka portfolio manager) invests the pool of money into bonds, stocks, or other investments. In turn, the fund manager receives a fee for their investment expertise.

A segregated fund is also a pool of money from investors. And a fund manager invests it in bonds, stocks, or other types of investments. The key difference from a mutual fund is that a segregated fund is an investment within an insurance contract. This provides extra advantages, including guarantees, which is why a segregated fund costs more. Here's the insurance a segregated fund contract provides.

Guarantees

Segregated fund contracts provide death benefit and maturity guarantees. To qualify as segregated fund contracts, each of these guarantees must be at least 75% of all deposits[1]. Some companies offer segregated fund contracts with a 100% death benefit and/or 100% maturity guarantee.

The death benefit guarantee

- Ensures beneficiaries receive the guarantee value or the market value, whichever is higher
- Helps protect the value of the investment, regardless of market performance

The maturity guarantee

- Ensures that at maturity, you are entitled to receive the guarantee value or market value, whichever is higher
- Helps protect the value of the investment, regardless of market performance

Key terms

A **segregated fund** contract is also known as a variable annuity or guaranteed investment fund (GIF) contract.

A **beneficiary** designated in a segregated fund contract is a person entitled to receive the death benefit.

An **estate** is made up of a person's investments and assets, after any liabilities are accounted for. Assets include both real and personal property. Real property would be your home, cottage, or land. Personal property would be your personal possessions and includes bank accounts and contracts. Estates become very important upon death. Estate planning is the process of preparing for the division and inheritance of your estate.

The income guarantee

In addition to the death benefit and maturity guarantees, some segregated fund contracts offer an income guarantee. If you're planning for retirement or ready to retire, this type of contract can be appealing. It will give you a guaranteed stream of income to help finance your retirement. The available underlying funds used for income, such as bond funds, are generally conservative in nature. The income guarantee promises a guaranteed stream of income for your whole life – again, regardless of market performance.

Having these guarantees can provide peace of mind during times of market volatility. This is especially helpful to investors who are risk averse.

Market volatility can be caused by many factors, including:

- Political upheaval
- Economic indicators (think of job and consumer spending reports)
- Changes to economic policy
- When situations block the flow of trade, goods, or services
- Trade wars
- Outbreaks and spread of disease (Ebola, COVID-19)

Other benefits

Leaving a legacy, while bypassing the estate

Having a death benefit with a segregated fund contract means that your investment is protected for beneficiaries. This will help you leave a legacy to loved ones or a favourite charity. Equally important is that the death benefit from the segregated fund contract flows directly to beneficiaries and not through your estate. Lawyers call this bypassing the estate. Probate is an approval process that confirms the validity of your will. It also confirms that who you've appointed to carry out the terms of your will and manage your assets after you die is willing and able. It's a good idea to have a will. However, it's also important to have other ways, like insurance contracts, to pass on assets after you die.

With probate,

Filing the court application makes an estate's value publicly available. Anyone can obtain the details (except, rarely, when a judge has ordered the file sealed)

Various fees can become expensive and erode the value of the estate[2]

It can take months for the money to reach your beneficiaries

Further, because probate is public, beneficiaries and vulnerable heirs could become targets for financial abuse. Segregated fund contracts, however, generally keep the amount of the death benefit and identity of your beneficiaries private. Having a segregated fund contract can help lower the overall cost of administering an estate.

Potential creditor protection

With a segregated fund contract, the money within the contract could be exempt from the claims of creditors if certain beneficiary designations have been made. The ability to have creditor protection can be important to small business owners. A segregated fund contract may protect personal assets held in that contract from any professional liability. Creditor protection is possible when there are certain family member beneficiary designations.

So what does the additional cost of a segregated fund get you?

The answer is "insurance" – in the form of death benefit, maturity, and, in some cases, income guarantees. You and your heirs also benefit from bypassing the estate and possible probate, as well as potential creditor protection. All of these advantages are important if:

01 You worry about the effect of the markets **on the value of your investments**

02 You worry about the effect of the markets **on your income**

03 You want part of **your estate to pass privately and efficiently** to your heirs and

04 You want the ability to **help protect your money from creditors** in the event of the unexpected

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[1]Reduce for withdrawals.

[2]Refers to probate, executor, legal, and accounting fees, which vary by province and the size of the estate.

Any amount that is allocated to a segregated fund is invested at the risk of the contract owner and may increase or decrease in value.

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