

The Value of a Segregated Fund



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Newfoundland and Labrador

Introduction

In today's economic environment it is important to understand your investment options and alternatives. When looking at investments you need to determine your goals and objectives as an investor.

Asset allocation is at the core of many investment strategies. It helps establish the recommended mix of investments by appointing a portfolio's assets according to an individual's goals, risk tolerance and investment horizon.

However, as we have seen over the last few years in spite of sound investment strategies, exposure to markets during an economic down turn can still leave your portfolios vulnerable and open to significant loss. As an investor nears retirement, safety and security become a higher priority.

What are Segregated Funds?

Segregated funds were introduced into the marketplace over 50 years ago but have had very little exposure in the industry. Segregated funds or “seg funds” are investment products, similar to mutual funds, that are offered by life insurance companies.

Segregated funds:

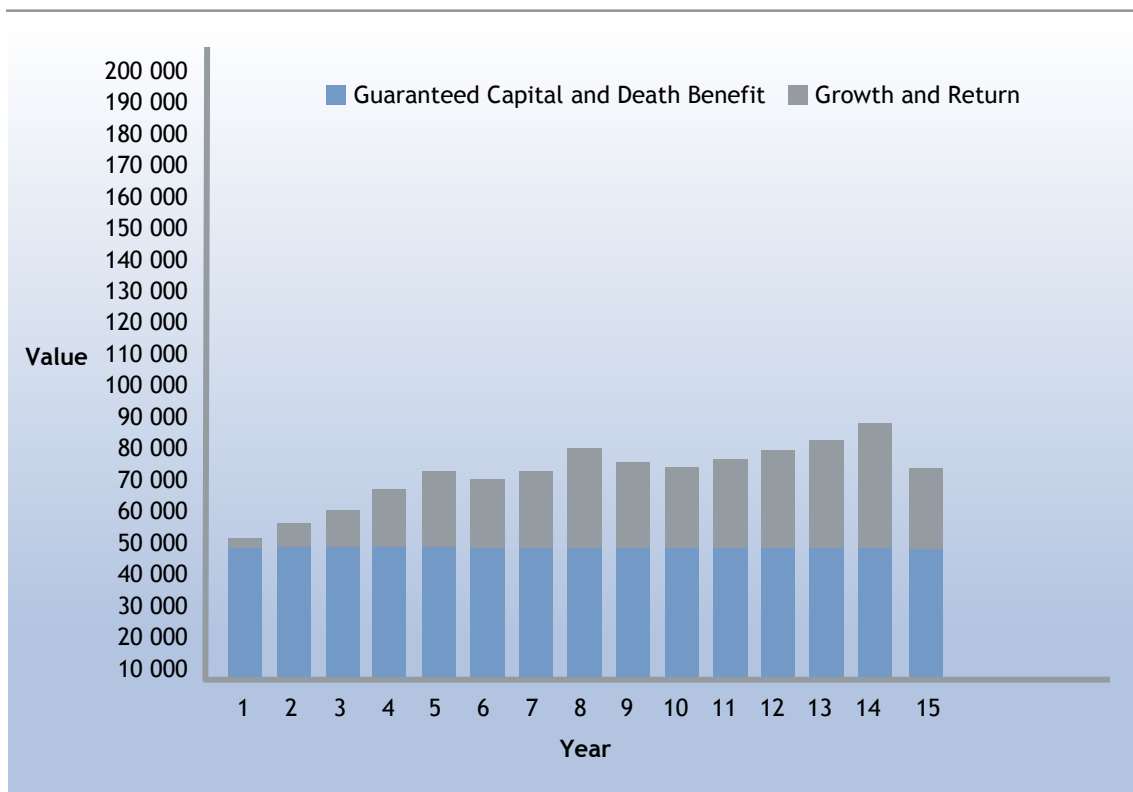
- Contain a diversified selection of investments
- Are available in a number of sizes and asset mixes
- Are managed by qualified professionals
- Have the potential for capital growth and investment returns
- Have a built in guarantee to “insure” your capital

Insuring Your Capital

By law, a life insurance company is required to build in added protection to their investment products. Unlike mutual funds, segregated fund policies guarantee that most, if not all of the initial investment is protected at maturity or in the event of death. Depending on the life insurance company and the segregated fund selected, the guarantee will typically vary from 75% to 100% protection on your capital investment.

Example:

If you were to invest \$50,000 in a 15 year segregated fund policy with 100% maturity and Death Benefit Guarantee, then at maturity, you would receive your initial investment plus any investment gains. Conversely, if the value of the segregated fund has fallen below \$50,000 at maturity, the full \$50,000 principal is protected.



Segregated Fund or Mutual Fund?

Whether you choose a segregated fund or a mutual fund will depend upon your personal circumstances, your objectives and the investment goals you are working towards with your financial planner.

Segregated funds offer additional unique protective features only available through life insurance companies:

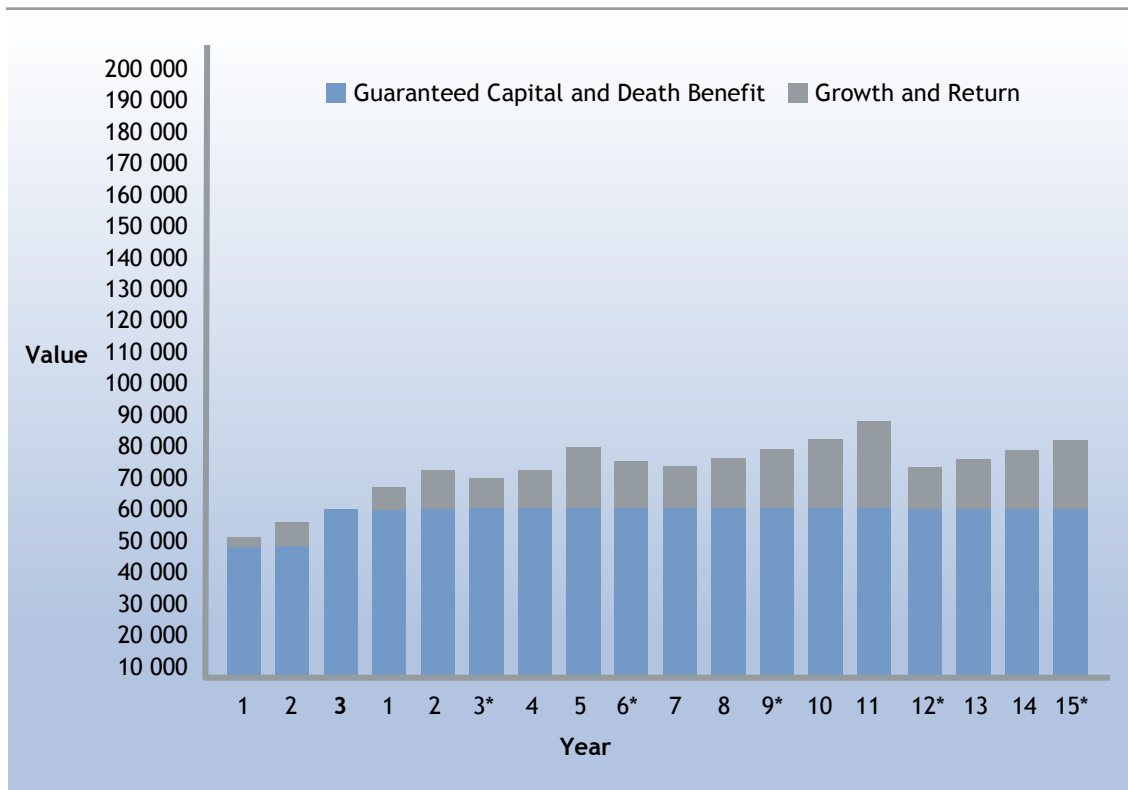
- Maturity and death benefit guarantees
- The ability to bypass probate
- Potential creditor protection

An additional benefit of some segregated fund contracts is the option to periodically “lock-in” (reset) the protection on principal when the market value has increased above the initial investment or last reset value (whichever is higher).

Example:

If you were to invest \$50,000 in a 15 year segregated fund policy with a 100% maturity and a 100% Death Benefit Guarantee, you would receive your initial investment plus any investment gains at maturity. Assuming the funds inside the policy grow by \$12,000 by year 3 and the option is available at the time, you could then reset the Maturity and Death Benefit Guarantee at \$62,000. You have now “Locked-in” the guaranteed protection by the increase in market value.

Note: Resetting the Maturity and Death Benefit Guarantee will create a new 15 year term.



*Lock-in option is available every 3 years. Some segregated funds may offer more frequent reset options.

THE VALUE OF A SEGREGATED FUND

Estate Bypass

With segregated funds, the death benefit is paid directly to your named beneficiary rather than to your estate. This means that the value of your segregated fund investments may bypass probate, a costly and lengthy process. So, in addition to receiving more funds, your named beneficiary will receive the proceeds faster.

The following charts compare the net estate value between a traditional investment portfolio. With any combination of GICs, bonds, stocks or mutual funds with a comparable portfolio within a segregated fund.

Initial Deposit:	\$100,000
Investment Duration (yrs.):	15
Seg. Fund Death Benefit Guarantee:	100 %

Bull Market Yield (Average):	5.00 %	Mutual Funds		Segregated Fund	
		%	\$	%	\$
Market Value ¹			207,893		207,893
Probate fees ²		0.53	1,094	0.00	0
Accounting fees		2.00	4,158	0.00	0
Executor fees		4.00	8,316	0.00	0
Legal fees		2.50	5,197	0.00	0
Surrender fees		0.00	0	0.00	0
Left for heirs, before taxes			189,128		207,893
Amount saved					18,765

Bear Market Yield (Average):	-2.00 %	Mutual Funds		Segregated Fund	
		%	\$	%	\$
Market Value ¹			73,857		73,857
Death benefit guarantee		0.00	0	0.00	100,000
Probate fees ²		0.57	424	0.00	0
Accounting fees		2.00	1,477	0.00	0
Executor fees		4.00	2,954	0.00	0
Legal fees		2.50	1,846	0.00	0
Surrender fees		0.00	0	0.00	0
Left for heirs, before taxes			67,155		100,000
Amount saved					32,845

¹ Market value ignores variances that could occur because of differing management fees and/or investment performance.

² Probate fees are estimated based on the current fee schedule in the province of Newfoundland and Labrador.

Segregated Fund vs. Mutual Fund

	Segregated Fund	Mutual Funds
Overview	Your net premiums are invested in the segregated fund of an insurer which, in turn, invests in stocks, bonds and money market investments. Segregated Funds are insurance products.	Money is pooled and invested on behalf of unit holders in stocks, bonds and money market investments.
Regulated By	Provincial Life Insurance Acts	Securities Legislation
Investment Growth Potential	Yes	Yes
Ability to Track Unit Value	Yes	Yes
Investment Diversification	Yes	Yes
Financial Protection	At death and maturity, premiums minus withdrawals prorated are usually guaranteed between 75% and 100%	There are no guarantees on investment performance. No limit on potential loss.
Death Benefit	The named beneficiary will receive the greater of, either the guaranteed death benefit or the market value of the policy.	The estate or beneficiary will receive the market value of the mutual fund. There are no guaranteed minimums.
Probate Protection	At death, the named beneficiary will receive proceeds avoiding the estate administrative process and the cost of probate.	At death, proceeds are an asset of the estate and are subject to the estate administrative process and legal fees. It may take some time for the estate to distribute the funds.
Creditor Protection	Designation in favour of a spouse, parent, child or grandchild may result in moneys being exempt from seizure. This is referred to as "creditor protection"*	No. Assets are open to claims from creditors.

*Money cannot be deposited as:

- Part of a fraudulent conveyance (transferring money to keep it out of reach of existing creditors).
- Within a specific time period before bankruptcy

Note: Mutual Funds deposits may have the ability to avoid bankruptcy proceedings if certain elements are maintained.

Segregated Fund vs. Mutual Fund

	Segregated Fund	Mutual Funds
RRSP Eligible	Yes	Yes
TFSA Eligible	Yes	Yes
Taxation Implications for Non-Registered Investments	<p>You are only taxed on the income you actually receive. Taxation is based on how long you own the Segregated Fund units within the income period.</p> <p>e.g. if you buy units one day before the fixed date, you are only assessed for the one day's income.</p> <p>You can use the capital losses to offset the capital gains from other sources.</p> <p>For accounting purposes, acquisition fees are excluded from the Adjusted Cost Base (ACB) and treated separately.</p>	<p>There is the potential to be taxed on income never received. Taxation is based on who owns the mutual fund units on a given date at the end of the income period.</p> <p>e.g. if you buy units one day before the end date, you are assessed for all income earned in that period, even though you did not benefit from that income.</p> <p>Capital losses must be carried forward and are not allocated to you, the unit holders.</p> <p>Acquisition fees are included in the Adjusted Cost Base (ACB).</p>
Under what circumstances might these be more suitable?	<p>Non-Registered and Registered Funds.</p> <p>Investors approaching or in retirement.</p> <p>Investors who are more risk adverse and prefer security and guarantees.</p> <p>Business Owners who want creditor protection.</p> <p>Depending on the insurance company and the segregated fund selected the ability to create a guaranteed lifetime withdrawal benefit (GLWB) is available through the addition of a special feature.</p>	<p>Non-Registered and Registered Funds.</p> <p>Investors who want a wide variety of specialized funds.</p> <p>Investors who are willing to give up guarantees for potential increased returns.</p>

Special Features

Ability To Track Unit Values

The ability to track unit values compared to Exempt Market Securities allows the policy holder to know the value and liquidity of the investment at any time, for the purpose withdrawal, estate value, taxation reason.

Regulation

Regulation by the Provincial Life Insurance Acts offer consumers the special protection provided within The Provincial Life Insurance Act's such as a Guaranteed Death Benefit, the funds pass directly to named beneficiaries at death (with appropriate named beneficiaries designated) avoiding the cost and delay of probate, and protection from creditors (with appropriate named beneficiaries designated.)

Some Important Notes

The features and benefits described in this document are for informational purposes only. Readers should seek independent tax, accounting and investment advice with regards to the individual products in this document. Any numbers illustrated are provided as examples and are to be used as estimates only. Specifics features and guarantees will differ and are not specific to any one life insurance company or segregated fund policy.