

Segregated Funds Simplified

Integrating segregated funds into your investment plan

If you are looking for a way to reap rewards of financial market gains while protecting your capital against losses, segregated funds could be an appropriate investment for you.

Most people have a pretty clear idea of where they want to go with their investing, but may be less clear on how to get there. Understanding the benefits of investing in segregated funds within your financial plan will help you recognize if they are the right choice for you.

Segregated funds offer many inherent benefits, including professional money management, diversification, simplicity and choice. Segregated funds are offered by insurance companies, and, like mutual funds, segregated funds pool money from investors and invest in a variety of individual securities. Segregated funds combine the diversification element of mutual funds with the protection of life insurance to provide an investment product that guarantees some or all of the purchaser's original investment.

Potential Creditor Protection

A segregated fund's unique features are often suitable for business owners, self-employed individuals and professionals who may require creditor protection.

If your work exposes you to professional liability or business risk, segregated funds may help you protect your assets from creditors. This applies only when the segregated fund is owned personally and not when it is owned by a corporation.

Some conditions apply, the most important being that the transfer to segregated funds should not be made with a fraudulent intent to defeat your creditors. Your financial solvency, or lack thereof, is one of the most important factors in determining fraudulent intent. The best time for business owner to transfer his or her investments to segregated funds is when the business is going well – not when the business is in financial difficulties.

Segregated funds generally cannot be seized by creditors if you name a spouse, child, grandchild or parent as the beneficiary. This group of beneficiaries is described as being in the "family class" or "protected class" of beneficiaries. In Quebec this group also includes a grandparent. Keep in mind, creditor protection is not certain in all circumstances and is generally not available against any claims made by the former spouses and Canada Revenue Agency regardless of who has been designated the beneficiary.

Talk to your lawyer to find out more about the potential for creditor protection and current legislation in your province.

Beyond potential creditor protection segregated funds have many other features that set them apart from mutual funds:

Investment Protection

If you leave the money invested for the duration of the contract, you're usually guaranteed to get back 75 – 100% (depending on your contract) of the amount you originally invested. Even if current market conditions have significantly reduced your actual value, when the contract matures you will receive either the investment's current market value, or its guaranteed minimum, whichever is greater.

Segregated funds may also be suitable for some retirees. As the transition to retirement takes place, preserving a nest egg takes on a greater importance and you may no longer be willing to expose your savings to the uncertainties of investment markets.

In this sense, segregated funds offer the return potential of traditional mutual funds while effectively reducing most of the investment risk.

Segregated funds can allow cautious investors to participate in equity

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markets with less worry that volatility could affect their investments. It can also provide some comfort to know, in advance, the minimum amount of money you will have when the contract matures.

Now, over the long term equities generally have positive returns, so the cost of those guarantees may not seem worthwhile. If that guarantee provides you with some peace in mind, however, and helps you remain invested through turbulent markets, they may be worth it. It is important to note that management fees of segregated funds are sometimes higher than their mutual fund counterpart. If the added protections are not important to you then mutual funds might be more suitable.

Estate Preservation

In addition to the maturity guarantee, segregated funds offer a guaranteed death benefit. Should you die before the contract matures, your heirs will receive the segregated fund's market value or, if higher, the guaranteed minimum.

The ability to designate a beneficiary on non-registered segregated funds makes them particularly valuable. This allows proceeds from segregated funds held both inside and outside of an RSP or RIF to avoid probate costs, since they are generally not considered part of the deceased person's estate. Because probate fees are minimal or may not apply at all in Quebec, there is no financial benefit from this feature in this province.

Estate bypass i.e. avoiding probate will, however, both speed up payment to beneficiaries and keep the amount left to loved ones from being disclosed to the public.

Once you have decided whether segregated funds are right for you, your decisions are not over. Whether you choose segregated funds, regular mutual funds or a combination of both, the next step is to examine your objectives, time horizon and tolerance for variability of returns. Once you know your personal investment profile, you can work with your financial advisor to design a portfolio that has the right mix of funds to allow you to achieve your goals within the context of an overall financial plan.



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[07/2007] MP1038

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