

Plan Conversion Can Optimize Group RESP

Add Value to an Existing RESP

This article is going to teach you how to increase the potential value of your existing group RESP without having to invest any additional funds. The technique is called a “Plan Conversion” and for it to be effective you would need to have made steady RESP contributions for a period of at least 7 1/2 years or more. But before I go on to explain the details and benefits, we need to lay down some groundwork first.

If you’ve been contributing to a group RESP plan for your child’s education, it’s probable that you set up either a monthly or an annual contribution schedule. If your child was less than a year old when the plan was started, then your contribution period will cover about 18 years until the plan reaches maturity.

The money you’ve been contributing to the RESP will also have been combined together with the monies from other parents contributing for their children into one large investment or pooled account. Typically the investments held in such an account are guaranteed securities, long term federal and provincial government bonds, principal guaranteed bank notes, and guaranteed investment certificates.

After maturity, an eligible student is entitled to draw money from the pool, the amount being determined by the number of shares or units that a plan holds. The units attached to an account are factored in from the beginning, but can be modified later either by changing the contribution method or the contribution amount. Initially when calculating the number of units on a plan, the following factors would have been taken into consideration:

- **Age of the child**
- **Deposit method (monthly, annually, etc.)**
- **Contribution schedule (5yr, 10 yr, etc.)**
- **Optional deposit insurance (death and disability coverage)**

Calculation of Units

Let’s look at an example, but for the sake of simplicity we’re going to round off some of the numbers. A popular group plan, [Heritage Education Funds](#) offers units of their investment pool (about \$2 Billion) at a cost of \$5 per month over an 18 year period to parents with children under a year old.

In other words if you only contributed \$5 per month over an 18 year period your total contribution would be equal to equal \$1080 (\$5 x 216 months) and your account would hold 1 unit.

On the other hand, if your RESP contributions were \$100 each month then your account would hold 20 units (\$100 ÷ \$5) and your total contributions would amount to \$21,600. (\$100 x 216 months)

Seems simple enough, but what do you think would change if you had invested the entire \$21,600 into the RESP right from day one and not bothered with a monthly contribution at all?

On a one time deposit paid in advance, Heritage Education Funds offers units of their investment pool to parents with children under a year old at a rate of \$437 per unit. Therefore an RESP account with an investment of \$21,600 paid up front would hold almost 50 units. (\$21,600 ÷ \$437) That’s 30 units more than the monthly deposit schedule, yet the total contributions to the RESP are exactly the same. Why such a difference?

Power of Compounding Interest

Let's step away from RESP's all together for a moment and take a look at a simple formula called:

"THE RULE OF 72"

It states that if you have an investment generating an annual return of 10% then your money will double every 7.2 years. If the annual return is higher then it will double in less than 10 years and if return is lower than it will take longer than 10 years to double.

If you invested \$100 every month over 18 years with a steady annual return of 6% your total investment would equal \$21,600 (\$100 x 216 months) but your account balance would have grown to \$38,000. That's a total return of \$16,400 on your investment.

But what if you had taken the same \$21,600 and invested the entire amount right from day one? Using the same annual return of 6% your account balance would have grown to nearly \$62,000! That's \$24,000 more than in the previous example, yet the total amount invested remains the same.

The difference in the 2nd example is that you have the full earning power of the investment working for you right from day one, whereas in the 1st example it takes 18 years before you reach the full earning power of your investment. So what has all of this got to do with optimizing group RESP's you ask?

Group RESP Plan Conversion

Most group RESP companies have an option that allows you to convert a plan from one deposit method to another, this is simply called a "Plan Conversion." You probably won't find much information written on this subject in the prospectus, but it can effectively increase the potential value of your RESP.

Let's say you've been contributing \$100 monthly to a group RESP for a 7 1/2 years,(90 months) and your account holds 20 units. Your total contributions up to this point would therefore be equal to \$9000.

Suppose for a moment that instead of contributing the \$100 every month you had just made a one time contribution of \$9000 at the very start. If the unit rate for a single deposit was \$437 then your account would still hold 20 units (\$9000 ÷ 437)

Now I know what you're thinking"The reason you started the monthly contribution in the first place is because you didn't have the \$9000 to make a one time contribution." The truth is that neither do most young families when they're just starting out, but that's o.k.

A "Plan Conversion" allows you to take advantage of the lost earning power on the \$9000, by converting your existing plan from a monthly (or annual) deposit into a lump sum or single deposit account.

After conversion your account should still hold the same 20 units that you started with, while at the same time freeing up \$100 per month. If you are happy with your current RESP provider you could reinvest the \$100 by starting a new plan, and if not then simply invest the money somewhere else.

If you were to start a new plan the units rates would have increased according to the age of the child, but at age 8 let's say, you could probably expect another 6 units or so. If you add that to your existing 20 units you now have a total of about 26 units which increases the overall value of your RESP by 30%!

Before going ahead with a plan conversion first ask your RESP provider for a plan adjustment quotation. This will show you the exact number of units your plan will hold after conversion, and may also indicate a small transfer of funds from principal to interest. This will account for potential interest the investment pool would have earned on your remaining deposits, but should be relatively insignificant compared to the financial benefits you receive.