

## Seg Funds Minimize Investment Risk

### What Are Segregated Funds?

Segregated funds or seg funds are essentially mutual funds that have been wrapped in a blanket of guarantees, benefits, and features. Investors are not issued units or shares as in a mutual fund but rather become holders of a segregated fund contract.

Contracts can be registered or non-registered depending whether they are held inside of an RRSP or outside. As required by law, the funds are completely isolated and held outside of the provider's general investment fund, hence the name [segregated funds](#).

### Guarantees, Benefits, and Features

Segregated funds combines the growth potential of mutual funds with the additional security of an insurance policy. The insurance company provides 5 key elements that remove the majority of risk for the investor. It is the combination of these 5 elements and the duration of the [segregated fund](#) contract that make them a perfect fit in our **B2I** or Borrow to Invest strategy. These elements include:

1. ) **75% Principal Guarantee at Maturity**
2. ) **100% Death Benefit Guarantee**
3. ) **Exemption From Probate**
4. ) **Protection From Creditors**
5. ) **Reset Option**

### 75% Principal Guarantee

A typical seg fund contract is held for 10 years although certain conditions allow funds can be withdrawn sooner. As markets move up and down so does the value of a segregated fund.

This same principal will apply to funds held in a stock or mutual fund portfolio. The difference being that stocks and mutual funds have no guarantees whereas segregated fund contracts have a built-in 75% maturity guarantee. So let's look at example of how this might apply in real life:

1. ) Mr. Smith invests \$100,000 with his broker in couple of small cap stocks and an aggressive growth mutual fund. His plan is to hold the investment for 10 years before cashing out and putting the funds toward a major renovation on the family home. His portfolio performs very well over the next few years but in the 8th year the markets collapse and his share values are cut in half. The value of his portfolio drops from \$100,000 down to \$50,000. Not willing to risk any more losses he decides to cash in the portfolio and is left with \$50,000.

**Total Amount Invested in the Portfolio = \$100,000**

**Subtract the investment losses     -\$50,000**

**Investor is left with = \$50,000**

2. ) Mr. Jones invests \$100,000 into a [segregated fund](#) contract that matures after 10 years. During the first 8 years the funds performed very well and he was able to draw out about **\$30,000** in profits, but in the 8th year the markets suffer a complete meltdown. The losses amount to 80% so the value of the seg fund is reduced to \$20,000 and never has time to recover. But because of the maturity guarantee Mr. Jones still receives \$75,000 when the contract is cashed in.

**Total Amount Invested in the Portfolio = \$100,000**

**Subtract the investment losses     -\$80,000**

**Investor is left with =     \$75,000**

Both Mr. Smith and Mr. Jones experienced a dramatic downturn in the financial markets. In Mr. Smith's case the downturn was 50% and he lost 1/2 of his investment. In Mr. Jones's case the downturn was even more severe causing an 80% loss of his investment, but due to the maturity guarantee he still walked away with **\$75,000**. Plus he was able to withdraw **\$30,000** in profits over the first few years so he actually came out ahead by **\$5,000**.

### **Death Benefit Guarantee**

If the holder of a segregated fund contract should pass away while the contract is still in effect, then the designated beneficiary would receive a minimum of 100% of the original investment.

Let's assume that there is \$100,000 invested in a seg fund, the markets crash and the investment drops to \$10,000. The investor forgets there is a 75% maturity guarantee, panics needlessly causing his blood pressure to soar, and triggers a fatal heart attack.

Even though the value of the seg fund is now \$10,000, the designated beneficiary will still receive \$100,000. On the other hand, what if the investment increases in value to \$150,000 and the investor unable to contain the excitement suffers a fatal stroke?

Then the designated beneficiary would receive the full value of the account which is now \$150,000.

### **Exemption From Probate**

Probate is the legal process of administering the estate of a deceased person by resolving all claims and distributing the deceased person's property under the valid will. A surrogate court decides the validity of a testator's will.

A probate interprets the instructions of the deceased, decides the executor as the personal representative of the estate, and adjudicates the interests of heirs and other parties who may have claims against the estate.

The cost to administer the estate of a deceased person can add up to several thousands of dollars and may include executor fees, probate fees, legal fees, and accounting fees.

In the case of a segregated fund, if a beneficiary has been named then the entire investment will pass directly on to the beneficiary and bypass probate. The seg fund is not subjected to any probate or executor's fees and neither can it be contested as part of the will.

## Protection From Creditors

Granted certain qualifications are met, segregated fund investments may be protected from seizure from creditors. This is an important feature for business owners or professionals whose assets may have a high exposure to creditors.

Unless it can be proven that the seg fund was purchased to deliberately avoid potential known creditor actions it is fully protected. This may also include seizure from Revenue Canada.

## Reset Option

The reset option is a feature that allows the contract holder to lock in any investment gains on the account. The investor is allowed to take advantage of this feature up to a maximum of twice per year.

Again using an example of a \$100,000 contract, if the investment were to increase to \$130,000 then the contract holder could exercise the reset option and lock in the \$130,000.

Now the maturity guarantee increases to **75% of \$130,000** which translates into **\$97,500** and the total death benefit guarantee for the beneficiary increases to **\$130,000**. How good is that?

For more information about the benefits and features of segregated funds [contact us today](#).

- ✓ Manulife GIF Select
- ✓ Equitable Pivotal Solutions
- ✓ IA Pacific Ecoflex / Ecoflextra
- ✓ Canada Life Generations II Series
- ✓ RBC Guaranteed Investment Funds
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