SEGREGATED FUNDS
Summary on Creditor Protection

Creditor protection is a benefit that makes segregated fund (seg funds) products particularly valuable for:

Business Owners, Directors or officers of companies, because they face financial risks.

Professionals: Accountants, Lawyers, Doctors, because they face malpractice litigation.

A segregated fund can **protect investors' personal assets** from seizure by creditors, while providing growth potential similar to mutual funds. Their individual investment assets, future retirement income and estate may be protected regardless of what happens to their business.

LEGAL FRAMEWORK FOR THIS SPECIAL KIND OF PROTECTION

Insurance Acts in each Canadian province and territory and the Quebec Civil Code set out the criteria that must be met in order to preserve this special protection.

Generally speaking, most life insurance products are protected from creditors of the policy holder when:

1 Products are set by Insurance Legislation
2 Proper beneficiary designations are made,
3 Investments are made in good faith, that is, the investor has not tried to use the seg fund as a shelter while facing financial distress.

The protection applies during the lifetime of the annuitant and on his/ her death, as his/her creditors cannot go after the beneficiary. In general the law protects the beneficiary's interest from creditors of the annuitant, but not from the beneficiary's own creditors, who can seize the proceeds at the moment they are paid out to the beneficiary.

1. PRODUCTS THAT OFFER THIS BENEFIT

The products that are covered by the special protective blanket set by Insurance Legislation fall into three separate categories:
• Life insurance;
• Segregated funds; and
• Other annuities issued by life insurance companies.

All of these products contain "an undertaking to provide an annuity" which is the main criteria that has come out of years of court cases in which the issue in dispute was "what is an insurance product".

2. PROPER BENEFICIARY DESIGNATIONS

All the provinces have similar legislation relating to the types of beneficiary designations that will qualify an insurance contract for creditor protection
• Family Class beneficiaries
• Irrevocable beneficiaries

Family Class Designation

The allowable family beneficiaries of the annuitant creditor protection are set out in most provinces' legislation (other than Quebec as noted below) and are as follows:
– Spouse
– Child
– Grandchild
– Parent

Although contested by the courts, it is likely acceptable, when naming anyone from the above group of family members, to have a trustee named as well, i.e. to Jane Doe in trust for (spouse's name, or child's name, etc.).

In Quebec, where the Civil Code applies, the class of relatives is wider and includes all descendants and ascendants of the owner of the policy. The relationship in Quebec is between the owner and the beneficiary.

Irrevocable Beneficiary Designation

This type of designation should be well thought out before being implemented.

- There is no restriction as to whom the beneficiary can be, other than the policy holder or the policy holder's estate. An irrevocable designation of one's self is not permitted.
- But, the policy-holder surrenders effective control over withdrawals while keeping the ability to make investment decisions and take advantage of other features (e.g. resets) within the terms of the contract.
- The investor/owner cannot revoke or alter this type of beneficiary without the beneficiary's consent.

This designation may work well in a situation where there is total certainty, but it can create many problems where there is a change in circumstances. (e.g. Breakdowns occur in many sorts of family relationships, whether they be spousal, parental or otherwise)

A few final words on Beneficiary Designations

When designating one of these family members, the insured has greater control than with an irrevocable beneficiary in that the beneficiary can be changed, but only to another person from one of the four classes as outlined above.

3. EXTENT OF PROTECTION

The above examples of beneficiary designations will, in most cases, prevent creditors from seizing the insurance product during the life of the insured. Once the designation has been made, the protection is in place (subject to a few exceptions set out below).

When the insured dies and the insurance becomes "payable" to the beneficiary, then, the beneficiary's property cannot be claimed by creditors of the insured.

EXCEPTIONS

They are as follows:
Beneficiary Designation within one year or five years preceding bankruptcy.

The Bankruptcy and Insolvency Act provides that where a policy owner designates an irrevocable or preferred beneficiary which in turn creates a "protected policy" or transfers non-creditor-protected funds into a creditor-protected policy, and then goes bankrupt

- **within one year**, the Trustee in Bankruptcy **can move to seize the money** that would have been available had that transaction not occurred.
- **between one and five years before**, the Trustee in Bankruptcy **can move to have the transaction voided** if the Trustee can prove that at the time of the transaction the policy owner would have been unable to pay all debts without those said funds

It is the burden of the creditors and the bankruptcy trustee to contest the protection in favor of the beneficiary

THE CROWN and CANADA REVENUE AGENCY (CRA)

With a few exceptions, the Crown, both federal and provincial, is not bound by the creditor protection provisions in provincial legislation. There have been some cases, however few, where CRA has been able to seize insurance products for unpaid taxes. Despite the legal and practical difficulties that the Crown would face in forcing a surrender of a life insurance policy or segregated fund contract, it can happen, and sometimes does.

Remember, there are always exceptions to the rules but, if your client invests in good faith, and has not tried to use his/her investment as a shelter in financial difficulty, the investments are generally protected.

For more detailed information, read the Reference Paper on Business Creditor Protection published by Sun Life Financial available at http://www.sunlife.ca/advisor/pcrefmaterialtools.html/