Manulife Investments

Quebec edition

Protect your legacy: Take advantage of segregated funds to empower your bequests

Arranging the smooth transfer of assets to heirs can be a challenge for a number of reasons. The first relates to time. Often, settling an estate requires time before a deceased's instructions can be carried out and their beneficiaries receive their inheritance, frequently taking between one to nine months.

Second, estate fees may significantly erode the value of an estate, diminishing the amount of money beneficiaries receive. Third, many investors want to protect the privacy of their bequests.

Finally, your heirs will likely be dealing with a powerful mix of emotions throughout the estate settlement process. It is very important to develop a plan that minimizes hurt feelings and family discord.

Failing to take into account one or all of these four factors – time, expenses, privacy and emotions – may lead to unnecessary delays, financial consequences and disputes. However, there are steps you can take to ensure that your loved ones receive their inheritance quickly, cost-effectively, confidentially and with a minimum of strife.

SARAH'S SITUATION

Let's look at a specific example. Sarah, a 70-year-old widow, makes a $200,000 investment in a regular mutual fund today. Two and a half years from now, she passes away at a time when the fair market value has declined by 10%. Her investment is now worth $180,000. Because Sarah bought the fund units using the deferred sales charge (DSC) option, her investment will be charged 4.5% on the value of her original deposit – or $9,000 – in fees.

Estate fees may vary and depend on the complexity of the estate. Executor, legal and accountant fees may range from 1.0% to 5.0% (see chart).

	Range	Average
Executor fee	1.0% to 5.0%	2.0%
Lawyer fee	1.0% to 5.0%	2.0%
Accountant fee	1.0% to 5.0%	2.0%
TOTAL		6.0%

Let's assume that an additional 2.0% must be paid to each of an executor, an estate lawyer and an accountant. Together, those expenses add up to about 6.0%, or $10,260.

So Sarah's beneficiaries will receive just $160,740 – or four fifths of her original investment and their inheritance will be paid to them months down the road.

LYNN'S LEGACY

On the other hand, naming a beneficiary other than one's estate directly within a segregated fund annuity contract means that the death benefit will flow outside of the estate. This preserves a client's confidentiality, allows for a quicker death benefit payout – usually within 2 weeks of written notification of death – and can result in significant savings to an estate.

For example, let's say that Sarah's twin sister Lynn chooses to invest $200,000 in GIF *encore* Series 2, a segregated fund, and names a beneficiary(ies) on the policy. She, too, dies two and a half years later and her contract's market value has also decreased to $180,000. Her investment bypasses the estate and Manulife, as a matter of policy, waives the DSC. Furthermore, Lynn's deposits have a minimum 100% death benefit guarantee, so any drop in fair market value won't affect the amount her beneficiaries receive. The death benefit guarantee is reset each year to the greater of:

- 100% of the deposit value plus 4% simple interest (if the annuitant is under age 80), or
- The market value, or
- The previous year's guarantee value

This means the amount guaranteed in the event of death will increase.

In Lynn's case, this amounts to a total of $216,000 (her $200,000 deposit plus $16,000 in simple interest). That's approximately $55,000 more than Sarah's $160,740, and Lynn's beneficiaries should receive this sum from the insurance company within a couple of weeks of written notification of death. Also, Lynn's privacy as well as that of her beneficiaries' will be protected, reducing the potential for family disagreements.

SPOUSAL ELECTION TO ROLLOVER

Assuming Lynn's contract is non-registered and she is the sole owner and annuitant with her spouse named as the beneficiary, her spouse may be allowed to continue the contract as owner and annuitant upon her death. This election must be made by her spouse at the time of notification of death to the insurance company.

If the market value is greater than or equal to the death benefit guarantee, her spouse could elect the rollover to take advantage of the spousal rollover rules in the *Income Tax Act*. These rules permit a transfer to a surviving spouse at an amount equal to the adjusted cost base and therefore defer tax. If the market value is less than the death benefit guarantee, her spouse could elect not to rollover but to receive the death benefit as beneficiary under the contract and take advantage of the guarantee "top-up".

INTERESTED IN LEARNING MORE?

By incorporating segregated funds into your estate plan, you can protect the confidentiality of your beneficiaries and help them realize significant savings.

Moreover, the simple interest feature on the death benefit guarantee offered by the GIF *encore* segregated funds makes these insurance products competitive with GICs in today's low interest rate environment. And the death benefit guarantee and capacity to bypass the estate ensure that more assets are transferred to loved ones – which is often the most important objective of many estate plans.

Beyond what was mentioned in this article, segregated funds offer a number of other benefits. For example, if a beneficiary other than the estate is named, the death benefit is generally protected from the owner's creditors.* The death benefit is excluded from the owner's estate as it is paid directly to the beneficiary, placing it beyond the reach of the owner's creditors. **For more information on this and other benefits, make the time to talk to your financial advisor today to find out whether segregated funds have a place in your estate plan.**

ARE YOU EXPECTING TO GIVE OR RECEIVE AN INHERITANCE?

	Sarah's Mutual Fund Investment	Lynn's Segregated Fund Investment
Original Investment	**$200,000**	**$200,000**
Fair Market Value in Third Year	$180,000	$180,000
Value of Death Benefit "Top up"	N/A	$20,000
Increase in death benefit guarantee in two years[1]	N/A	$16,000
Deferred Sales Charge Fee (4.5%)	–$9,000	N/A
Estate Fees (6.0%)	–$10,260	N/A
Net Proceeds	**$160,740**	**$216,000**

[1] Applicable only to the death benefit. Not available on any market value or maturity benefits.
*Creditor protection for amounts payable to beneficiaries is not absolute and may be nullified where a fraudulent settlement or claim for dependant's relief has been made.

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