

# The Case and Space for **Segregated Funds**



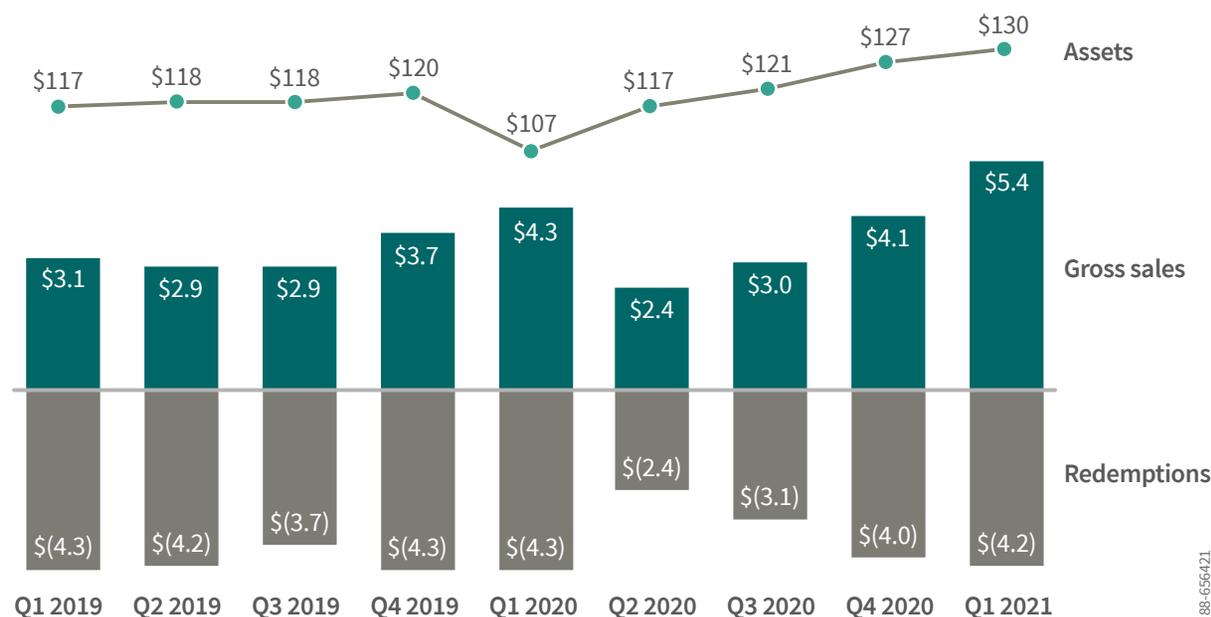
Investor Economics reports that in 2020, segregated funds staged a comeback with gross sales of **\$13.7 billion**, the highest level of sales reported in **12 years.**<sup>2</sup>

Since their introduction more than 60 years ago, segregated (seg) funds have experienced ups and downs in terms of their popularity. Today, they are once again experiencing a resurgence.

With the ongoing turbulence in global economic markets, investors are increasingly searching for a safe haven to shelter a portion of their investments. Seg funds provide that haven. They support the sentiment, expressed by Robert T. Kiyosaki in his bestseller *Rich Dad, Poor Dad*, “It’s not how much money you make. It’s how much money you keep.”<sup>1</sup> Seg funds offer investors the ability to do both. They allow participation in the stock market while providing guarantees to protect their principal investment.

### Segregated funds record positive flows in 2020

Assets, gross sales and redemptions in billions of dollars



Source: 2021 Household Balance Sheet Report – Canada. Toronto: Investor Economics, 2021.

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Along with the volatility of the markets, rising interest rates have also driven renewed interest in GICs. With the Bank of Canada's target overnight interest rate rising from 0.25% on July 31, 2020 to 2.5% on July 31, 2022, GICs have once again become an enticing option.<sup>3</sup> However, most require you lock in your money for a set period of time and their returns may not keep pace with inflation.

**John Yanchus, Director, Tax and Estate Planning at Canada Life,** says, “for risk averse clients, seg funds can offer advantages over guaranteed investment certificates (GICs). They don't require you to lock in your money – something not advisable when interest rates are rising or when you wish to maintain access to the funds. So, you have the principal guarantee that provides downside protection in a time of market uncertainty, plus, by enabling market involvement, clients also have some opportunity for growth.”



**As a life insurance product, seg fund policies also come with unique estate and tax planning options that can help facilitate a smooth transfer of wealth to the next generation.**

# Facilitate intergenerational wealth

**The total amount** expected to be transferred from one generation to the next within Canadian households over the decade ending 2030 is projected by Investor Economics to be **\$1,640 billion**.<sup>4</sup> This has cast a new spotlight on seg funds due to their unique advantages when it comes to intergenerational wealth transfer.

“Segregated fund policies are an ideal estate planning tool as their proceeds flow directly to a beneficiary without being subject to probate taxes,” says Yanchus. “This makes them an attractive option for those planning the transfer of their assets to the next generation.”

Another advantage of seg funds not being part of the overall estate is the speed with which they can be transferred to a beneficiary. It can be a huge benefit for those receiving the money to be able to do so quickly.

“Investments that fall into the estate are also often left to languish for a year or more,” says Yanchus. “While the estate trustee has the right to make adjustments based on market fluctuations, in reality, this is rarely done. The fact that seg fund policies would normally be transferred over within a couple of weeks provides a huge benefit in terms of financial planning.”

Because the principal investment is guaranteed at maturity, they can be a particularly good solution for clients looking to protect a portion of their portfolio during times of market volatility.

When selecting a beneficiary for a segregated fund policy (e.g., a spouse, child, parent or grandchild), both registered and non-registered assets also have the potential to be protected from creditors. This is also an important consideration for business owners looking for an ideal place to invest excess personal cash.





Seg fund policies give clients the opportunity to grow their wealth in the financial markets, while offering insurance protection to guarantee the money you invest.<sup>5</sup> Each fund is a professionally managed pool of money spread across a number of different investments.

## The next gen: These aren't your parents' seg funds

While seg funds have powerful estate planning applications, they are not just for retirees or those considering the future transfer of their estate. “There’s a whole generation of investors whose expectations and preferences have been shaped by living through the volatility and global economic uncertainty of two major market events – first the 2008 global financial crisis and now a global pandemic. For many investors, risk-conscious portfolio construction is critical,” says Steve Fiorelli, Senior Vice-President, Wealth Solutions at Canada Life.

Seg funds also are not the same product they were 20 years ago. Today’s seg funds offer a variety of options and features that can enrich an advisor’s toolkit and make it easier to help clients achieve their financial goals. They originated from the insurance industry, but today their evolution has proven that they are far more than an insurance wrapper.

One of the main criticisms leveled at segregated funds in the past has been the fact they have higher fees than mutual funds. However, advisors who regularly sell seg funds say their additional fees are rarely an obstacle to sales – when they explain their additional features and benefits, clients are typically willing to pay for them.

**“Today’s seg funds provide access to well-known, institutional-quality investment managers who are building and overseeing diversified portfolios. From standalone segregated funds to managed solutions and fee-based accounts, advisors can curate a portfolio to fit their clients’ needs at every stage of life, and every risk tolerance.”**

**Steve Fiorelli, Senior Vice-President,  
Wealth Solutions, Canada Life**

More comprehensive seg fund lineups are being introduced that include a variety of management styles, provide broader geographic coverage and are available in most major asset classes. Today’s seg fund managers are also investing in alternative asset classes, including direct real estate and private credit.

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Yet overall awareness and understanding of seg funds is low among Canadian retail investors.

**As of June 30, 2022, seg funds represented only 5.7% of total Canadian investment funds (\$125 billion out of a total of \$2.2 trillion).<sup>6</sup>**

This provides advisors with a unique opportunity to educate clients about their potential value in investment portfolios and how they can be an important tax and estate planning solution.

### Key benefits of seg funds

- ✓ **Guarantee:** A seg fund must guarantee a return of at least 75% (many provide 100%) upon death or maturity.
- ✓ **Estate planning:** Allows the private transfer of the money to a designated beneficiary outside of the deceased's estate.
- ✓ **Creditor protection:** Assets held in a seg fund – registered or unregistered – are potentially protected from creditors when an appropriate designated beneficiary is named.
- ✓ **Reset option:** Some seg funds provide the option of locking in investment gains by resetting the contract's guarantee value to the current market value. Others also allow the maturity date to be pushed out.

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## Seg funds support practice management efficiency

What many advisors may not be aware of is that, increasingly, seg funds are also becoming available within managed solutions. This marries the diversification and sophisticated investment management inherent in managed solutions with the guaranteed options and insurance benefits of seg funds.

This is an important advancement given how managed solutions are becoming increasingly popular. **They have grown from approximately 12% of the market in 2009 to 25% in 2019 and they are expected to surpass 31% by 2028.**<sup>7</sup>

“As market dynamics become increasingly complex, advisors are appreciating the ease of managed solutions,” says Fiorelli. As turnkey solutions that offer advisors simple, scalable ways to carry out portfolio construction and management responsibilities, managed solutions take some of the burden off the advisor. They provide access to broad diversification and sophisticated rebalancing that are vital in helping advisors scale up at a time when there are increasing demands on their bandwidth.

The one-two punch of seg funds and managed solutions provides a powerful tool in an advisor’s arsenal. It allows for greater flexibility when it comes to financial planning based on a client’s life goals, risk tolerance and income needs. Segregated funds allow advisors to extend the conversation to intergenerational wealth planning, enhanced by the ability of managed solutions to take clients from growth all the way to drawdown. They also free up an advisor’s time so they can focus on client relationships and growing their business.



## Access to diverse portfolio building blocks

The availability of more diverse types of seg fund options has helped make them relevant to a whole new generation of investors who prioritize ease, cost efficiency and customization.

In addition to managed solutions, the latest generation of seg funds includes exchange traded fund (ETF) options. These provide the protection of a segregated fund policy along with the value of a cost-efficient structure.

**ETFs can offer cost-efficient market participation.** Combined with the value proposition of seg funds, advisors have a growing array of building blocks with which to build diversified portfolios for clients – ones that are resilient enough to keep up with today’s complex market dynamics and an advisor’s unique business model.

So, if you thought seg funds were on the wane, think again. Fiorelli stresses that today, **“risk-conscious portfolio construction – along with the need to continuously manage risk and provide stability for clients – is critical.”** This makes seg funds more relevant than ever. They can help investors navigate volatile markets, provide clients with estate planning support and provide advisors with a valuable product to serve their client’s needs.



## There's strength in numbers. Canada Life segregated funds

**With 175 years of experience** under our belt, we've learned a few things. Like how to build one of the strongest segregated fund shelves in the industry. Our shelf brings you access to a leading market share, diverse selection and among top performing products. We know these are the metrics that matter to you when building portfolios that offer financial growth and protection for your clients. When it comes to Canada Life segregated funds, you get strength in numbers and in all market environments.



To learn more  
about Canada Life's  
segregated fund offering,  
including our suite of  
managed solutions,  
contact your Canada Life  
wealth wholesaler today.

<sup>1</sup> Robert Kiyosaki, *Rich Dad Poor Dad* (Scottsdale: Plata Publishing, 2017).

<sup>2</sup> *2021 Household Balance Sheet Report – Canada* (Toronto: Investor Economics, 2021).

<sup>3</sup> “Canadian Interest Rates and Monetary Policy Variables: 10-Year Lookup,” *Bank of Canada*, <https://www.bankofcanada.ca/rates/interest-rates/canadian-interest-rates/>.

<sup>4</sup> *Family Matters* (Winnipeg: IG Wealth Management), <https://www.ig.ca/content/dam/investorsgroup/pdf/ig-inter-generational-wealth-transfer-client-report-en.pdf>.

<sup>5</sup> Guarantees are less a proportional reduction for withdrawals, including taxes, short-term trading fees and any other applicable charges.

<sup>6</sup> *Investor Economics Insight—July 2022: Investment Funds Advisory Service—Canada* (Toronto: Investor Economics, 2022).

<sup>7</sup> Darren Matte, “Taking managed solutions to the next level,” *Wealth Professional*, July 15, 2021, <https://www.wealthprofessional.ca/investments/mutual-funds/taking-managed-solutions-to-the-next-level/358130>.



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Guarantees are less a proportional reduction for withdrawals, including taxes, short-term trading fees and any other applicable charges. In Saskatchewan, executors must disclose all known life insurance policies owned by the deceased, including segregated fund policies. They must list the insurance company, policy number, designated beneficiaries and the value at the date of death. Creditor protection depends on court decisions and applicable legislation, which can be subject to change and can vary for each province; it can never be guaranteed. Talk to your legal advisor to find out more about the potential for creditor protection for your specific situation.

A description of the key features of the segregated fund policy is contained in the information folder. Any amount that is allocated to a segregated fund is invested at the risk of the policyowner and may increase or decrease in value.