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FINANCIALPLANNING

Live long and prosper

Options...

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Enjoying a long, healthy and productive life after retirement is a lofty goal shared by most Canadians. For many people, especially those hoping to enjoy a long and comfortable retirement, concerns about finances, investing and taxes usually grow when they stop working.

Many retirees, especially those over 80, fear being long on life but short on money. After all their years of hard work, they don't want to outlive the fruits of their labours and prefer to preserve their estate (as much as possible) to pass on to their family and favourite charities. In addition to protecting their money from too much taxation, they want their financial affairs structured in a manner that protects their beneficiaries from costly probate fees and related costs that will surely eat away at their final estate.

While life insurance is the most cost-effective and tax-effective way to erase some of those fears, most people aged 80+ don't qualify for new life insurance policies, due to their age or health condition.

Many young people don't buy insurance products because they think they don't need them. I've lost track of the number of older people who really need them but can't get them for the reasons cited above.

This article describes two important financial instruments worthy of your consideration.

A new solution for people aged 80 to 90

One of Canada's oldest and most respected insurance companies has introduced a new product developed specifically for people aged 80 to 90. It offers many of the benefits associated with life insurance, including upside growth opportunities and a guarantee that you won't lose money when you pass away.

The innovative product is a unique segregated fund with special attributes that will appeal to people who want to leave a meaningful legacy. Yes, segregated funds have been around for several decades, but this investment product, that looks like a mutual fund, comes with a guarantee. While a mutual fund is at the centre of this product, it is accompanied by a life insurance wrapper (insured against the owner's life) that transforms the segregated fund into a life insurance product.

A recent case

A married couple, both in their eighties, sought our advice. Linda and Allan, as we'll call them, have been together for almost sixty years and comfortably retired for more two decades. They are extremely proud of their three adult children, one with special needs, and four grandchildren.

They were seeking a way to structure a legacy so that when one of them dies, the survivor will not have to worry about making financial decisions on his or her own. They were painfully aware that interest rates are at historical lows and

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have avoided bonds and other interest rate-sensitive investments. At the same time, they shared a desire to grow their estate's value and wanted to participate in any upside in the stock market.

We discussed the new segregated funds and the many benefits they offer, especially for people with their financial profile and in the 80-90 age bracket.

Available guarantees

These segregated funds are complemented by certain guarantees that will help safeguard their original investment. With the death benefit, when the policy owner(s) - annuitant(s) - passes away, 100 percent of their investment is protected (less an adjustment for any amounts withdrawn) regardless of economic conditions. Beneficiaries will receive either the investment's market value or the guaranteed amount, whichever is greater.

Designated beneficiaries

Designated beneficiaries usually receive their inheritance in as little as 2 weeks. This compares to a waiting period of several months - and in some cases, years - for a will to go through the estate process. During that long waiting period, the costs of settling an estate (which include legal and accounting fees, estate administration and probate fees) can quickly erode an estate's value and diminish what's ultimately left behind.

Because a segregated fund bypasses the estate process, the savings on professional fees and probate costs usually amount to several thousand dollars.

A wide variety of fund choices are available, including conservative, moderate and balanced portfolios with diverse asset allocations like bonds, equities and fixed-income. The entire spectrum of options and costs can be best understood by working with a trusted and experienced estate-planning professional.

Other Considerations

Joint policies - For non-registered policies, segregated funds allow for two people to be named as policy owners/annuitants on a joint and last-to-die basis. The death benefit becomes payable on the passing of the second spouse.

Every couple's circumstances are unique. If you choose joint ownership, several tax and legal issues should be considered. Get professional advice to ensure an orderly succession upon death. This may take into account other planning tools, like a trust.

Privacy - Wills that go through probate are public documents, allowing any interested person to see the finer points of the deceased's wishes. Parents often don't leave the same amount to each of their children. In the case of Allen and Linda, their special needs adult child will receive more than his siblings, and since the proceeds of a segregated fund do not flow through the estate, they can keep their financial matters private. And because it remains a private matter, there is far less likelihood that their decision will be challenged or contested.

Flexible Settlement Options - Many people are concerned that their beneficiaries will not be able to manage their inheritance prudently if it is received as a lump sum. Segregated funds allow you to determine how you want your beneficiaries to receive their inheritance. If you are concerned about a beneficiary receiving a lump sum, you can select monthly or annual payments. You can also choose for those payments to continue for the life of the beneficiary, or for a set number of years. Finally, if you have more than one beneficiary, you can specify how you want each beneficiary to receive the payment. In the case of Allen and Linda, their special needs child will receive monthly payments for as long as he lives and their other two children will receive a lump sum.

Tax reporting made easier - Segregated funds also make for fair and simple tax reporting on death. The insurance company will keep track of information dealing with dividends and capital gains, and then issue a T-3 slip – another benefit that can help save a lot of money on accounting fees.

Estate bypass - After death, an executor typically obtains a tax-clearance certificate from the Canada Revenue Agency before distributing any assets. That process can take several months or years. Using segregated funds bypasses the executor altogether, sharply reducing the time it takes for the funds to reach the intended beneficiary.

Business benefit - Segregated funds, as insurance products, also offer creditor protection when held personally, an important bonus for business owners and professionals.

Name your beneficiary - It is essential that a beneficiary be named when buying a segregated fund. It should be updated on occasion, as circumstances change. Without a named beneficiary, the death benefit is paid to the estate of the deceased policy owner, which quickly eliminates many of the advantages described above: the death benefit may become subject to probate fees, estate administration costs, taxes, professional fees and other costs; the funds may not be distributed until the will has been probated, and unless there are clear instructions in the will, the benefit may not be distributed the way the deceased intended.

Costs - With all their benefits, it's no surprise that segregated funds cost a bit more than mutual funds. After taking into account the capital protection, estate bypass and the absence of deferred sales charges at death, they make for a particularly attractive estate-planning option.

Annuities

Annuities are another life insurance product that can provide an important plank in your estate planning process, because they provide predictable and guaranteed income during your lifetime.

Similar to a pension plan, an annuity is a pooling of cash from thousands of Canadians to an insurance company, which invests the funds conservatively. Annuities can provide a monthly income for life or a fixed period time. A life annuity, for example, will enable you to receive funds for the rest of your life, no matter how long that may be.

Annuity payments are based on several factors, but most important are interest rates and the length of time you are expected to live. Because interest rates are now historically low, waiting until you are 80 to buy one means your payments will be greater than if you had bought the annuity in your early 70s.

Linda and Allan decided to get a joint annuity, which is like a pension plan for a couple. It will pay the couple a fixed amount for as long as they live. When one of them dies, the survivor will continue to receive payments.

Many people also use annuities for other purposes. These include providing your grandchild with a birthday gift every year for as long as they live or funding a specific expense such as quarterly tax installments, insurance premiums or car payments.

If you know you are going to need income for only a certain period of time, you can choose a term annuity that provides a fixed number of payments over a stipulated time frame.

You can choose to delay the start of income payments for up to 10 years after the annuity policy is issued, to increase the amount of income payments, or add a cashable feature to allow you to cash out some or all of the guaranteed-income payments.

Estate planning is a process, not an event. The tax rules are often complex, subject to change, and vary from province to province. Get the advice you need from an impartial and experienced estate-planning professional. Their due diligence will include an evaluation of your personal situation and determining whether a product, like segregated funds or annuities, is appropriate for you.

Ensuring a hassle-free and tax-friendly flow of funds to your future generations and favourite charities takes careful thought and preparation. Your heirs and charities will be forever grateful. ❒

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