



SAVINGS

CREDITOR PROTECTION

Protecting one's investments in segregated funds,
an unrecognized advantage that could make all the difference



For advisor use only

Creditor Protection

Over the course of their life and regardless of their situation, your client may be faced with professional or personal litigation that has the potential to jeopardize their personal assets.

Did you know that investments held in a segregated fund, regardless of the series selected, may be protected from seizure by creditors in the event of bankruptcy or lawsuits?



Individual Contract held by an individual

1. RRSP/RRIF, TFSA, FHSA, Non-registered contracts (as per applicable provincial legislation)

Bankruptcy

FULLY EXEMPT FROM SEIZURE provided that an appropriate beneficiary designation has been made, well before the policyholder is declared insolvent (time limits are mentioned later in the document). There are two ways to make an appropriate beneficiary designation to take advantage of bankruptcy protection:

- 1- an irrevocable beneficiary must be designated, or
- 2- the beneficiary must be “preferred”.

Special features of Manitoba’s prescribed RRIFs, Saskatchewan’s prescribed RRIFs, and Newfoundland’s LRIFs: EXEMPT FROM SEIZURE even if there is no appropriate designation.

Lawsuit

FULLY EXEMPT FROM SEIZURE provided that an appropriate beneficiary designation has been made. There are two ways to make an appropriate beneficiary designation to take advantage of creditor protection:

- 1- an irrevocable beneficiary must be designated, or
- 2- the beneficiary must be “preferred”.

Who are preferred beneficiaries based on the province of residence?

In Quebec

- Spouse (married)
- Spouse in a civil union
- Ascendants/descendants without limitation as to level (mother/father, grandparent, great-grandparent, child/grandchild)

The relationship is established with the policyholder.

Outside Quebec

- Spouse (married)
- Common-law partner
- Mother/father
- Child/grandchild

The relationship is established with the annuitant.

Special features concerning the designation of preferred beneficiaries

In Quebec

- Broad definition of ascendant/descendant
- The common-law partner is not considered “preferred” and must be appointed as the irrevocable beneficiary in order for the contract to be protected.

Outside Quebec

- Limited definition of ascendant/descendant
- The common-law partner is considered “preferred”.

2. LIF/LIRA/locked-in RRSP contract

Bankruptcy and seizure by a creditor

LIF/LIRA/locked-in RRSP contracts are EXEMPT FROM SEIZURE regardless of whether or not an appropriate beneficiary designation has been made.

3. Registered education savings plans (RESP) contract

RESPs are not eligible for creditor protection either in the event of bankruptcy or in the event of seizure by a creditor.

Individual Contract held by a company

1. Non-registered contracts (as per applicable provincial legislation)

Bankruptcy or lawsuit

In the event of bankruptcy or lawsuit, the contract held by a company will be COMPLETELY EXEMPT FROM SEIZURE given an appropriate beneficiary has been designated.

For a company contract to have a beneficiary other than the company itself:

1. The designation must be mentioned in the company's resolution;
2. The insurance company issuing the segregated fund contract must be provided with proof of such resolution;
3. Depending on the province in which the company's head office is located, the beneficiary designation must take into account these characteristics:

In Quebec

An irrevocable beneficiary must be designated.

Outside Quebec

- An irrevocable beneficiary must be designated, or
- The beneficiary must be "preferred".

Special features concerning the designation of preferred beneficiaries

In Quebec

Since the "preferred" relationship must be with the policyholder (the company), it stands that there cannot be a family relationship established between the corporation and the beneficiary.

A beneficiary must therefore be designated as irrevocable in order for the contract to be considered exempt from seizure.

Note that this is also the case when the policyholder is a partnership since there can be no family connection between the partnership and the beneficiary.

Outside Quebec

The "preferred" relationship is easier to establish since it must be with the annuitant, who must be a person.

The contract is therefore exempt from seizure if there is a "preferred" relationship between the annuitant and the beneficiary or if the beneficiary is irrevocable.

* Irrevocable beneficiary designation by a corporation may result in a taxable benefit to shareholders. It is recommended that the client's tax advisors be consulted in advance to determine the actual consequences, if any, of such a designation.

Exceptions and Deadlines

Creditor Protection may not apply in the following cases:

A transfer of unprotected funds within one year prior to the date of bankruptcy

Under the Bankruptcy and Insolvency Act, if a person transfers unprotected creditor funds into a protected segregated fund contract and then declares bankruptcy within one year after the transfer, the trustee in bankruptcy may request seizure of the sums that would have been available had the transfer not taken place.

Fraud

In any case, and without time limit, if a creditor/trustee in bankruptcy can prove that the structure was set up with fraudulent intent to shelter the assets from the latter's rights, then the creditor protection provided by the segregated fund contract may be challenged.

Likely situations where protection does not apply

Facts, legislative changes or court decisions could make the sums seizable if the client:

- owes money to the Canada Revenue Agency or another provincial government entity, such as income tax;
- is the subject of a claim for support or other claims by dependants (e.g. spouse, child, etc.);
- has assigned the contract as security for an outstanding debt.

It should be noted that these are just a few examples of likely situations, but this list is not exhaustive.

Three situations where choosing segregated funds is beneficial

Julie, 32

Owner of a small business

Julie's company is growing, but in a highly competitive and risky industry. Being one to plan for the future, Julie's main objective is to protect a portion of the assets in her small business in order to build up a retirement fund for herself.

Julie therefore invests a portion of her company's liquid assets in segregated funds annually.



Marc, 45

Doctor

Marc is well aware that, in the event of a lawsuit, the liability waiver clause in his professional insurance may not cover all of the amounts he would be asked to pay in a potential lawsuit by a patient.

Marc therefore invested in segregated funds to protect a portion of his assets from lawsuits.



Gilles, 68

Retired police officer

Gilles is retired and is proud to be a "Snowbird." For the past few years, he has been spending his winters in Florida in an RV. Unfortunately, he caused a serious road accident there last year where he was found at fault.

Fortunately, Gilles had maximized his protection from litigation by investing his retirement funds in a segregated fund.



Here's how:

Most life insurance products, including segregated funds, are protected from the policyholder's creditors when:

1. At least one "preferred" or irrevocable beneficiary has been designated
2. Investments are made in good faith, without intent to defraud potential creditors.

In such circumstances, the entire contract, including the market value of the assets held, is protected from the policyholder's creditors during their lifetime and on their death.

 **Important note**

It is important to note that for a contract held by an individual or a company, it is recommended to consult a legal or tax specialist for advice on the specific situation of the client and that of the company. The client should not act solely on the basis of the above information.

This independent advice may specify in which situation an insurance contract is exempt from seizure under provincial and federal bankruptcy and insolvency legislation. However, in all cases, the onus is on the creditors and the trustee to challenge beneficiaries' protection against their creditors.

The information contained in this document is for information purposes only and does not represent an exhaustive list. Although every effort has been made to ensure the accuracy of the information provided, the examples should be considered theoretical scenarios. Advisors and clients should not rely on these examples or information without a thorough examination of any tax and legal implications with the relevant professionals.



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