Manulife Investment Management

Tax, Retirement & Estate Planning Services

Investment Insight

Protect your legacy[1]

Take advantage of segregated fund contracts to empower your bequests

Arranging the smooth transfer of assets to heirs can be a challenge for a few reasons. The first relates to time. Often, probate is required before a deceased's instructions can be carried out and their beneficiaries receive their inheritance – and the process of obtaining probate can be a lengthy one, frequently taking between three to nine months, or longer if it is contested.

Second, probate and 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, but the probate process leaves the details of an estate open to public scrutiny. In addition to disclosing one's financial assets, this may expose beneficiaries to fraud and provoke conflict among loved ones.

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 consider 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 help your loved ones receive their inheritance quickly, cost-effectively, confidentially and with minimum strife.

Sarah's Situation

Let's look at a specific example. Sarah, a 70-year-old widow, makes a $1,000,000 investment in a mutual fund today. Ten years from now, she passes away at a time when the fair market value has increased to $1,628,895. Sarah bought the fund units using a deferred sales charge (DSC) option but, in this case the DSC period has ended. As a result, there is no DSC at Sarah's death.

Probate and estate fees vary by province and depend on the complexity of the estate. Let's assume that the probate fees and the amounts that must be paid to an executor, an estate lawyer and an accountant will cost $61,511 combined. Income taxes due at death will be $125,779. So, Sarah's beneficiaries will receive $1,441,604, and their inheritance will be paid to them months down the road.

[1]This article applies to all provinces other than Quebec. For Quebec residents, refer to the Quebec edition, MK1938.

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Through the probate process Sarah's will becomes available to the public. In addition to the lack of privacy, heirs may end up arguing among themselves about what was given to whom leading to potential family conflict or litigation. This is a real concern for Sarah. Her will divides her estate equally between her son and daughter but Sarah knows that her daughter won't be happy to share the estate proceeds with her son. This is because her daughter has been the sole primary caregiver for Sarah while her son has moved away.

Lynn's Legacy

On the other hand, naming a beneficiary other than one's estate directly for a segregated fund contract means that the death benefit will flow outside of the estate and avoid probate. This helps preserve a client's confidentiality,[2] allows for a quicker death benefit payout – usually within two weeks of written notification of death and claims documentation having been provided in good order – and can result in significant savings to an estate.

For example, let's say that Sarah's twin sister Lynn chooses to invest $1,000,000 in a segregated fund contract, and names a beneficiary(ies) on the policy. She, too, dies ten years later and her contract's market value is $1,582,949. This is less than Sarah's mutual fund because the segregated fund has an incremental cost of 0.30% relative to the mutual fund, reducing its return by that same amount on an annual basis. Her investment bypasses her estate and probate and is paid directly to her beneficiary(ies). The DSC period has expired so there is no DSC, but even if there had been, Manulife, as a matter of policy, waives any DSCs on death.

In Lynn's case, there are no estate administration related costs. Her income taxes are $116,590, also less than Sarah's. As a result, Lynn's beneficiaries receive $1,466,359. That's $24,755 more than Sarah's beneficiaries. In addition, they should receive this sum from the insurance company within a couple of weeks of written notification of death and provision of claim documents in good order.

Also, Lynn's privacy as well as that of her beneficiaries should be protected from the curiosity of strangers and other heirs, reducing the potential for financial abuse by unscrupulous individuals and family disagreements. If a will is challenged it can delay the distribution of an estate for months or even years. It can also be very expensive and significantly reduce the value of an estate and what is left to distribute. As mentioned earlier, this is a concern for Sarah knowing that her daughter won't be happy with her share of the estate. A beneficiary designation on a segregated fund contract on the other hand is not impacted by a will challenge.[3]

[2] In Saskatchewan the advantage of preserving a client's confidentiality does not apply as jointly held property and insurance policies with a named beneficiary are identified on the application for probate even though these assets do not flow through the estate and are not subject to probate fees.

[3] A beneficiary designation can also be challenged but this doesn't happen as often because people are often unaware or find out too late to do anything.

Comparing Sarah’s mutual fund with Lynn’s segregated fund

Sarah’s Mutual Fund	
Rate of return	5.00%
DSC charges DSC is calculated based on the projected market value amount at death.[4]	0.00%
Market value at death	**$1,628,895**
Legal fees	$2,500
Accounting fees	$2,500
Executor fees	$32,578
Probate fees	$23,933
Total estimated fees	$61,511
Income taxes	$125,779
Net market value at death	**$1,441,604**

Lynn’s Segregated Fund	
Rate of return	5.00%
Segregated fund incremental cost	0.3%
Net rate of return	4.70%
Market value at death	**$1,582,949**
Total estimated fees	$0
Income taxes	$116,590
Net market value at death	**$1,466,359**
Savings	**$24,755**

[4] The method of applying DSC may vary from one company to another. Many fund companies, including Manulife Investments, may waive the DSC or low-load sales charges on the death of the owner.

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Segregated fund contracts offer additional benefits. For example, if a beneficiary of the family class[5] is named, the segregated fund contract is generally protected from the owner's creditors during his/her lifetime. Also, the death benefit is excluded from the owner's estate as it is paid directly to the beneficiary, usually placing it beyond the reach of estate creditors.[6]

Interested In Learning More?

By utilizing segregated fund contracts with beneficiary designations that are not your estate, you can better protect the confidentiality of your beneficiaries. In addition, this provides them with a quick death benefit payout and realizes cost savings by avoiding probate and estate administration fees. All of this ensures that more assets are transferred to loved ones – which is often an important objective of estate plans.

[5] In provinces other than Quebec, a family class beneficiary is the spouse, child, grandchild or parent of the annuitant. In Quebec, it is the spouse, descendants or ascendants of the owner.

[6] Creditor protection, while alive or after death, is not absolute and may be nullified where a fraudulent settlement or claim for dependant's relief has been made.

For more information on this and other benefits, make the time to talk to your advisor today to find out whether segregated fund contracts have a place in your estate plan.

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