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## Segregated Funds Come with a Guarantee

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If you have discussed your investments with a financial planner from The Financial Advisors Association of Canada, chances are your advisor has suggested segregated funds. But what are seg funds and how do they differ from traditional mutual funds?

A seg fund is actually an insurance contract with two parts: an investment that produces the return and an insurance policy that covers the risk. The seg fund is like a mutual fund, because you are pooling your money with other people to share investment gains. But because life insurance companies issue segregated funds, there is a guarantee attached that protects the investor's principal from sudden market declines. Think of such an investment as a mutual fund with a safety net.

### A built-in guarantee

Insurance companies are required by law to build added protection into investment products. Seg fund policies guarantee that most of your initial investment is protected in the event of death or at the time of maturity. Depending on the provider, this guarantee may vary from 75 to 100 per cent of the principal amount.

For example, if you invested \$25,000 in a 10-year seg fund policy with a 100 per cent guarantee, you would receive your initial investment plus profits made from market gains at the time of maturity. If the value of the seg fund policy has fallen below \$25,000 at maturity, the principal remains protected. You can periodically "lock in" the protection on the principal when the policy has escalated in value. This resets your 10-year guarantee period.

### History of segregated funds

Seg funds were first introduced by insurance companies more than 30 years ago as a fixed income product for pension funds. Later they were offered to investors as a creditor-proof investment. Although they invested in stock markets, they were considered to be conservative products very prudently managed.

In the late 1990s, mutual fund companies began teaming up with insurers to boost the investment return potential. Seg funds began to look more like mutual funds, with sectoral funds, index funds, and foreign funds added to the mix of investments. As interest rates dropped, more conservative investors moved from term deposits and GICs into seg funds because of the guarantees.

### Seg fund or mutual fund

Whether a particular seg fund is any more or less attractive than a mutual fund, however, will depend on your personal circumstances, and the investment strategy that you have worked out with your Advocis financial advisor.

Like mutual funds, segregated funds contain a diversified group of solid investments. They come in various sizes and asset mixes, and benefit from the experience of a qualified portfolio manager. Where the two types of funds part company is in flexibility and the added cost of insuring the principal.

Entrepreneurs and small business owners may want to consider the potential creditor protection offered by seg fund policies. Because they are insurance policies, they enjoy creditor protection under provincial insurance legislation.

### The cost of a guarantee

While a disciplined, long-term approach to the market is always advised, a guarantee is not for everybody. Some investors may not want to incur the added cost of guaranteeing the principal invested in a seg fund. That cost varies depending on the insurance company.

Some seg funds have higher management expense ratios than mutual funds. Some guarantee only 75% of principal, to keep the MER lower. Some make the 100% guarantee an option that the consumer can pay for.

Some investors see such a guarantee as unnecessary since it is highly unlikely that market values will be lower than the principal investment over any 10-year period. Others view the added cost as an investment in peace of mind.

### Seg fund advantages

There are other advantages to a seg fund policy.

One is the reset option. As a seg fund investor, you can protect profits inside the fund. What it does is allow fundholders to lock in gains when market values are high. If, for example, your \$50,000 seg fund policy has increased in value by \$11,000, you can use the reset option to protect the full \$61,000. Once again, the reset option is not for everybody since it also resets the 10-year clock on the fund's guarantee.

Seg fund policies are also a solid estate planning tool. Upon death, the market value or the guaranteed principal is paid out directly to the beneficiary without being subject to provincial probate fees.

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