

Client, Nominee and other Dealer Account Structures: Estate Planning and Creditor Protection Considerations

Introduction

Traditionally, a life insurance agent sells a life insurance policy or insurance based investment product to a policyholder who applies for and owns the contract which is recorded in the life insurance company books in his or her name. When dealing with someone who handles securities, the purchaser may not be recorded as such, but the product may be issued in the name of the dealer in "nominee name". The dealer buys the product from the insurance company and holds it for his client. This process is commonly used for the purchase of insurance products designed for accumulation to address investment and savings needs and goals and which provide guarantees and other unique features, rather than protection needs like life insurance. As such, accumulation annuities that include segregated funds are often purchased. From an administrative standpoint, the overall process results in delivering a single consolidated statement for the client.

A number of insurance companies distribute individual variable insurance contracts (IVICs), commonly known as segregated funds, through distribution partners that represent mutual fund dealers and securities brokers. As such, insurance companies have processes in place to access FundSERV, a network that electronically processes investment business in a uniform and efficient basis for these distribution partners.

Recognizing that segregated funds are not mutual funds, it's important to understand and appreciate the different relationships between an insurance company and insurance agent or agency on the one hand and between mutual fund managers and dealers on the other. There are certain aspects of the insurer, agent/broker and investor relationship that remain despite the fact that investment transactions are processed using a system designed for mutual funds.

The Canadian Life and Health Insurance Association published a document entitled; Electronic Processing of Individual Variable Insurance Contracts in 2011. The memorandum "clarifies the nature of the relationships and responsibilities of the insurer, the insurance agency, the client and a service



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Peter works with independent advisors and other professionals raising awareness on issues and concerns faced by affluent individuals, professionals and business owners. He supports efforts in researching and developing optimal solutions for clients aimed at improving their financial well-being and supporting their personal wishes and lifestyles. He has provided 1000s of workshops, seminars and technical support throughout the country on tax, retirement income and estate planning issues, concepts and strategies to both advisors and consumers. As an accredited Registered Financial Gerontologist, a good deal of his time is spent on building awareness and educating people of all professions who work with or specialize in the needs, expectations and issues of elders. Comprehensive lifestyle planning is an important element of these processes.

The Sales, Tax, Estate Planning, Underwriting & Product (STEPUP) team provides internal and broker support, including seminars, education, advanced concept illustrations & Client case technical consultations.

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provider providing back office services when electronically processing IVICs in "client name", in "nominee name" or when held in registered accounts. (pg.2)

Investors/clients working with dealers can hold units or shares of investments that may be held in one of three ways:

1. Client name
2. Nominee name
3. Trusteed registered plan (TRP)

Client Name Accounts

These accounts are recorded in the client's name. They are sometimes referred to as "off book" since they are not reflected or recorded as assets on the books of the dealer. The client can deal directly with the issuer of the investment or through the dealer. The insurance company maintains much of the records of the client's investments and communicates with the client including the provision of statements of accounts. Statements are generally not consolidated.

Nominee Name Accounts

These accounts are recorded by the issuer of the investment as being registered in the name of the dealer. They are thus referred to as "on book" investments. The issuer, an insurance company, records the client's name (dealer as nominee for particular client). The insurer takes instructions from the dealer regarding such things as purchases, transfers and redemptions. The dealer is responsible for maintaining records of the client's investments, deposit and trade confirmations and investment statements. The dealer is also responsible for communicating with the client and providing statements of accounts.

The holding of insurance based investment products in "nominee name" may have implications on certain important features of the life insurance product such as "creditor protection" and probate status. (see Investment Dealers Association of Canada (IDA), Notice FC98-29 Dec. 22, 1998)

Neither the life insurance industry nor the investment dealers have yet adopted a clear position on the legal status of the dealers holding insurance contracts in "nominee name".

The legal status of the account could make a significant difference. In any situation where one person holds or

deals with another's property, their legal status is either that of trustee or agent. The trustee holds legal title to the property while the agent simply has the authority to deal with the property on behalf of the client. Creditor protection and other valuable insurance features may or may not exist depending upon the nature of the contractual arrangements between the insurer and the dealer. The opening account agreement between the dealer and the client could also affect the result.

It is very important to understand the ramifications of the differences between the relationship of the dealer to the assets held in nominee account. The dealer may act as:

- trustee holding legal and not beneficial title or
- as an agent of the policyholder.

The policyholder is the legal owner for all insurance contracts, taking on the characteristics of a "client name" account except for trusteed registered plans. As such, the legal relationship is governed by the contract between the insurer and the policyholder. The client is the policyholder regardless of whether the account is set up in client name or nominee name.

In Quebec, the Civil Code only recognizes formal trusts where the legal ownership of the assets is transferred to the trust patrimony. (s. 1260 Civil Code of Quebec)

Trusteed Registered Plans

Registered investments like securities and mutual funds, including Registered Retirement Savings Plans (RRSPs), Registered Retirement Income Funds (RRIFs) and Tax Free Savings Accounts (TFSA) may be held in a trusteed registered plan, for the benefit of client investors. This may result in the investments receiving some creditor protection under the Bankruptcy and Insolvency Act and specific provincial rules and regulations. Trusteed registered plans permit the naming of beneficiaries across Canada outside the province of Quebec.

Segregated Funds

Segregated funds also permit the naming of beneficiaries. There is no need for a trustee. Provincial insurance laws state that the proceeds of these funds on the death of the annuitant, pass directly to the named beneficiary(s) and do not form part of the estate of the policyholder, bypassing both probate and creditors and claimants of the estate. It's important to note that the courts are divided on this issue, particularly with non-insurance based registered investments when a beneficiary has been named.

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Creditor Protection and Non-registered plans

Insurance based investments have historically benefitted from creditor protection in certain situations under provincial insurance legislation and in scenarios where the assets are held by the client, in "client name" using the parlance in the securities industry.

Segregated funds (and Guaranteed Interest Accounts or insurer issued GICs) that are held in a non-registered nominee account typically have the client recorded as owner. The client can name a beneficiary. Depending on who is designated as beneficiary, creditor protection may be available. It's important then, for the client to file, directly or via their agent/dealer, their beneficiary designation with the insurer. The naming of a beneficiary may allow the proceeds on the death of the annuitant to bypass probate and provide creditor protection both:

- during the lifetime of the annuitant in common law provinces and
- during the lifetime of the policyholder and in some cases, the beneficiary, in Quebec and
- on the death of the respective person.

Given then that the client is the owner, signs the contract and can designate a beneficiary under a nominee name structure, an argument can be made that creditor protection may be available just as it is if the contract was set up in "client name" or by the client dealing directly with the insurer (generally through a licensed advisor).

If no beneficiary has been named or there is no surviving beneficiary when the annuitant dies, the estate becomes the beneficiary and no creditor protection is available.

In common law provinces, we look to the relationship between the annuitant and the beneficiary. Subject to particular provincial legislation, if the beneficiary is the spouse, child, grandchild or parent of the annuitant or if anyone is named as irrevocable beneficiary and there is no evidence of a fraudulent conveyance, then creditor protection may be extended to the investment.

In Quebec, the relationship being assessed is between the owner of the investment and the beneficiary. The family class includes the owner's married or civil union spouse and any of the owner's ascendants or descendants. The other conditions required for common law provinces also apply in Quebec.

Creditor protection during the lifetime of the client may be available if someone in the protected/preferred or family class is named as beneficiary. This is possible under provincial legislation which is quite similar in common law provinces, like s.196 of the Ontario Insurance Act and under s. 2457 of the Civil Code of Quebec. Creditor protection is also afforded if the beneficiary is designated as an irrevocable beneficiary (default for legally married or civil union spouses in Quebec). The designation of a beneficiary as irrevocable does restrict the flexibility and decision making of the client since consent of the beneficiary is required for all transactions.

Potential creditor protection may be of particular concern for clients who are business owners or professionals since their assets may be exposed to creditors. They may be able to achieve potential creditor protection by naming a "preferred" or "irrevocable" beneficiary.

Creditor Protection and Registered plans

It's important to emphasise that while all RRSPs and RRIFs held by insurers, banks, credit unions, brokerages, dealers and self directed accounts enjoy the same creditor protection under bankruptcy, the same does not hold true for non-registered investments where only insurance based investments can continue to offer creditor protection benefits. In addition, insurance based investments offer creditor protection outside of bankruptcy. Creditor protection on Tax-Free Savings Accounts (TFSA) is still only available through an insurance company product with the same requirements as described earlier.

Nominee Accounts

Nominee accounts involve a trust arrangement and as such, there is less clarity and certainty of creditor protection. Technically, the trustee is the owner and beneficiary on record for RRSPs and RRIFs. The question that arises is whether the courts will look through the trust to the beneficiary of the registered nominee account. This has not been tested prior to the writing of this article.

The death benefit proceeds under registered plans held in nominee name are paid to the trustee (nominee name plan). The nominee name plan, which is a trust, in turn pays out the proceeds in keeping with the beneficiary designations they have on record.

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Trusteed Registered Plans

Here again, particularly in Quebec, when dealing with a trustee registered plan, the policyholder is the trustee and hence not part of the protected or family class. In common law provinces and in Quebec where no formal trust has been established, trustee registered plans are treated as property of the client and are exigible unless protected by statute. Trustee registered plans are potentially protected from creditors regardless of beneficiary designation.

Although there are rules offering creditor protection for RRSPs and RRIFs, those rules may not extend to TFSAs and they do not apply to non-registered, non-insurance based assets where the naming of a beneficiary is not possible.

Complications and confusion can arise when a segregated fund is held within a trustee registered plan. The trustee technically enters into a segregated fund contract with the insurer, holding the segregated fund as an asset of the trustee registered plan. The trustee is responsible for registering and administering the trustee registered plan consistent with the Income Tax Act (Canada). It is not the responsibility of the insurer. The segregated fund is not a registered investment. The trustee registered plan is registered.

The client and the trustee can designate a beneficiary of the trustee registered plan in common law provinces. The client cannot designate a beneficiary of the trustee registered plan in Quebec. The trustee has the power to designate a beneficiary of a segregated fund in Quebec, if a formal trust has been set up with authorization to designate a beneficiary other than a trust. Failing that, the trustee is an agent of the client only. If the terms of the trustee registered plan only allow the trustee to deal with the investment with prior instructions from the client, including routine transactions, then the trust may not qualify as a trust under the Quebec Civil Code notwithstanding that it may still qualify as a trust for income tax purposes (ss. 248(3)(b) and (d) Income Tax Act (Canada)).

Clients may consider holding a segregated fund in a dealer account provided they can name a beneficiary that offers creditor protection for them during their lifetime and on the death of the owner/annuitant.

Optimal protection may be available if the segregated fund set up as a registered plan is held in "client name" since the various designation wordings used for nominee accounts and trustee registered plans have not been tested in the courts, to the best of our knowledge currently. As with other matters, clients and the trustees of both nominee accounts and trustee registered plans should consult with their respective, independent legal and tax advisors regarding beneficiary designations and the specific wording that may be most appropriate in a given situation.

Other Creditor Protection Considerations in Quebec

If a segregated fund is held in a trust and payments are made to a trust, then the invested assets are no longer assets of the client who is the settlor of the trust. The settlor is not the owner of the invested assets and may remain a living beneficiary under the trust. Under a formal trust created in Quebec for a trustee registered plan, the trustee holds the assets and the segregated fund should be exempt from seizure and execution against the client. However, if the client is beneficiary of the trust and becomes entitled to receive income or capital of the trust, creditors of the client could seize upon the client's rights as beneficiary to payment. Funds remaining in the plan may continue to receive creditor protection.

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Potential creditor protection and estate bypass with named beneficiary in certain situations

Insurance-based investment held in:	Non-registered	Registered	Ability to bypass estate
Client name	Yes	Yes	Yes
Nominee name	Should be possible	Uncertain	Should be possible depending on particular institution's policies and procedures
Trusted registered plan	N/A	Should be protected; must be a formal trust in Quebec	Most likely

Clients are reminded and encouraged to consult their own legal advisor to discuss and confirm how the law may apply to their specific situation in a given jurisdiction.

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A description of the key features of the individual variable insurance contract is contained in the Information Folder for the product being considered. **Any amount that is allocated to a Segregated Fund is invested at the risk of the contract owner and may increase or decrease in value.**

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