

THE NAVIGATOR

WEATHERILL WEALTH
MANAGEMENT GROUP



BRAD WEATHERILL, CIM
Vice President
Wealth Advisor
(403) 341-8868
brad.weatherill@rbc.com



SUE SENIO
Associate Wealth Advisor
(403) 341-7400
susan.senio@rbc.com

RBC Dominion Securities
4900 50th Street, Suite 300
Red Deer, AB, T4N 1X7

CREDITOR PROTECTION OF RRSPs AND RRIFs

Your RRSP or RRIF may be protected in the event of bankruptcy

The federal Bankruptcy and Insolvency Act (BIA) provides creditor protection to certain registered retirement plans (RRSPs, RRIFs and DPSPs) in the event of bankruptcy. This article explains the circumstances under which RRSPs and RRIFs are protected, the limitations of this protection and strategies for your consideration. Although DPSPs are also protected, this article focuses exclusively on RRSPs and RRIFs for ease of reference.

The information in this article is not intended to provide legal or tax advice. To ensure that your own circumstances have been properly considered and that action is taken based on the latest information available, you should obtain professional advice from a qualified legal advisor before acting on any of the information in this article.

RRSP AND RRIF PROTECTION UNDER THE BIA

The federal BIA provides creditor protection for assets held in RRSPs and RRIFs in all provinces and territories of Canada in the event of bankruptcy. There is no cap on the amount of assets that are protected, subject to certain exceptions. Additionally, the BIA does not provide protection for other registered plans such as Registered Education Savings Plans (RESPs) and Tax Free Savings Accounts (TFSA).

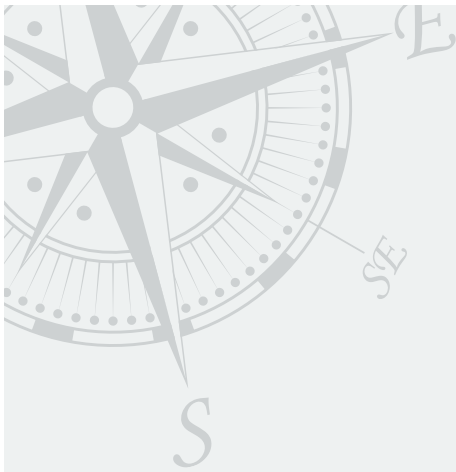
On the other hand, locked-in RRSPs and other locked-in plan RRIF assets are exempt from many creditor claims (in and outside of bankruptcy) under pension legislation.

12-MONTH CLAWBACK PERIOD

It is important to note that the BIA may not protect the entire value of your RRSPs and RRIFs from your creditors. This is because there is a 12-month clawback provision that allows your trustee in bankruptcy to recover any contributions you made during the 12 months before you declared bankruptcy.



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Since the federal BIA only protects you in the event of bankruptcy, it's worth consulting your provincial or territorial creditor protection legislation as it may extend your protection outside of bankruptcy (e.g., to a professional liability lawsuit) or at death.

For example, if you declared bankruptcy on October 10th of the current year, the clawback period would begin October 10th of the previous year. If the value of your registered plan is \$200,000 and you contributed \$10,000 to your plan during this clawback period, then the \$10,000 would be subject to clawback. The amount paid to the trustee is subject to withholding tax. The trustee in bankruptcy will receive \$8,000 (\$10,000 less 20% withholding tax) or \$7,400 if you were living in Quebec (\$10,000 less 26% withholding tax).

Although you cannot make direct contributions to a RRIF, the clawback may still apply to a RRIF. A RRIF may be subject to clawback if it receives funds transferred from an RRSP where contributions were made during the 12-month clawback period.

DETERMINING THE CLAWBACK AMOUNT

In bankruptcy, the trustee in bankruptcy steps into your shoes as the RRSP or RRIF annuitant. They have the right to request information from financial institutions concerning your contributions to your RRSP during the 12-month clawback period. They can use the information they obtain to determine the amount that they are entitled to receive from your RRSPs and RRIFs. Your financial institution is obligated to provide such details once they receive documentation evidencing the trustee in bankruptcy's authority to act.

INFORMING THE RRSP OR RRIF PLAN ADMINISTRATOR

Procedures for handling bankruptcy differ among financial institutions, so when declaring bankruptcy, you should contact all financial institutions you deal with to determine their process. Your financial institutions will likely freeze your RRSP or RRIF account upon

receiving the notice of bankruptcy until you and the trustee in bankruptcy are both discharged from bankruptcy. This is because the RRSP or RRIF technically vests with the trustee, who will now need to consent to withdrawal requests and may claim the withdrawal.

WHAT HAPPENS IF YOU DO NOT DECLARE BANKRUPTCY?

If you do not declare personal bankruptcy, your RRSPs or RRIFs will not be protected under the BIA in the event of a general creditor claim or a personal or professional liability lawsuit for negligence. It is important that your creditor protection plan consider both bankruptcy and non-bankruptcy-related risks.

PROTECTION UNDER PROVINCIAL AND TERRITORIAL LEGISLATION

Some provinces have their own legislation protecting some registered plans. Since the federal BIA only protects you in the event of bankruptcy, it's worth consulting your provincial or territorial creditor protection legislation as it may extend your protection outside of bankruptcy (e.g., to a professional liability lawsuit) or at death. Currently, legislation in Alberta, British Columbia, Manitoba, Newfoundland and Labrador, Prince Edward Island, and Saskatchewan provide creditor protection outside of bankruptcy.

Notwithstanding the provincial and territorial statutory creditor protection, it's important to note that children and ex-spouses have special rights with respect to making a claim against you to enforce support and maintenance orders. Similarly, the Canada Revenue Agency may have a priority in regard to unpaid taxes. As always, it is important to get legal advice based upon the plans that you have in your own relevant jurisdiction to ensure that they meet your needs.

Segregated funds registered as an RRSP or RRIF offer protection against creditor claims during your lifetime and on your death.

CREDITOR PROTECTION AND SEGREGATED FUNDS

Certain investment products, such as segregated funds, are structured as insurance contracts, which have creditor protection separate from the BIA. While there is no guaranteed absolute protection from creditors, segregated funds registered as an RRSP or RRIF offer protection against creditor claims during your lifetime and on your death. This protection may be superior to that of other investment types as it applies whether the claim arises from bankruptcy proceedings, professional liability or a general creditor. You can also use segregated funds to protect your non-registered assets from creditors.

If you are exploring adding segregated funds to your portfolio, it's important to keep the following in mind:

- In order to provide creditor protection, segregated funds must be purchased in good faith. If there is any suspicion that you purchased the funds as a shelter while you were facing financial difficulty, your funds may not be protected from creditors.
- For the optimal structure supporting creditor protection, the segregated funds should be purchased in your own name and not in nominee name.
- To ensure creditor protection, the beneficiary named on your segregated funds contract must be

a family class beneficiary (e.g., a spouse, child, grandchild, or parent). In Quebec, a family class beneficiary must be either a spouse or an ascendant or descendant.

- Segregated funds cannot be purchased by a corporation to protect corporate assets against a legal claim against the business.
- Although segregated funds are creditor protected, they generally have fees that are higher than mutual funds and other investment products.

OTHER CREDITOR PROTECTION STRATEGIES

If you are concerned about protecting your assets in the event of non-bankruptcy related claims, you may also want to consider the following strategies:

- **Purchasing life insurance:** If you qualify medically, then you may want to consider a life insurance strategy to accumulate wealth. Life insurance policies are generally protected from creditors, provided they have a designated beneficiary in place. The cash value may also benefit from protection if the beneficiary is irrevocable or is an eligible family member.
- **Sprinkling assets among family members and trusts:** Assets transferred to family members (including contributions you make to your spouse's spousal RRSP) will limit your personal exposure to creditor claims to only assets that

are in your name, subject to any claims of fraudulent conveyance. However, if you transfer assets to family members, you will lose both control and ownership of the assets and expose these assets to the family members' creditor claims. Additionally if you transfer assets to your spouse, family law matters may be complicated upon any future relationship breakdown.

- **Setting up testamentary trusts:** A testamentary trust may provide protection to your estate from potential claims of your beneficiaries' creditors. If you would like to protect your estate, consider setting up a testamentary trust in your Will.

BUSINESS OWNER CREDITOR PROTECTION STRATEGIES

If you operate your own business, you may want to consider the following strategies to protect your assets from business creditors:

- **Incorporating your business:** If you operate a business, you may benefit from additional creditor protection for your personal assets. Since a corporation is a separate legal entity, the creditors of the corporation generally cannot sue the shareholders for debts incurred by the corporation or seize the shareholders' personal assets, subject to certain exceptions. For example, if you have personally guaranteed the

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corporation's debts, you will be liable for the debt you guaranteed. Please note that if you are sued personally, your creditor may be able to seize your company assets.

- **Using multiple corporations:** If you accumulated significant cash in your corporation, consider transferring the excess cash to another corporation. You may be able to make the transfer via a tax-free inter-corporate dividend to a connected holding company. You can also hold real estate and equipment in a leasing company to protect these assets from the creditors of your operating business.

- **Setting up an Individual Pension Plan (IPP) or Retirement Compensation Agreement (RCA):**

If you are an incorporated business owner or professional, retirement savings vehicles as IPPs and RCAs may offer you creditor protection while helping you accumulate greater savings toward your retirement. Note that if you operate your business as a sole proprietor or through a partnership, you cannot set-up an IPP or RCA.

- **Purchasing professional liability insurance:** Depending on your profession, you may be able to obtain insurance coverage to protect your assets. Consider looking into what coverage or options are available to you.

SUMMARY

In the event of bankruptcy, your RRSPs and RRFIs are generally protected against most creditors under the BIA. However, the protection may not apply to contributions or transfers made in the 12-months before bankruptcy. In the case your assets are not protected under the BIA, you may still be protected under provincial or territorial legislation.

Speak to your qualified legal advisor regarding your situation and the strategies that may make sense for you.