

Creditor protection for RSPs and RIFs



Throughout your life, many opportunities and choices will arise that have financial implications — both for the short and long term. Looking at these opportunities in the context of your overall financial situation and plan will help you ask the right questions so you can better understand the issues and make the best financial choices.

With the passing into law of Bill C-12 on July 7, 2008 of an amendment to the federal Bankruptcy and Insolvency Act (BIA), all registered retirement investment products (RSPs, RIFs, as well as deferred profit sharing plans or DPSPs) will now enjoy the same creditor protection in the event of bankruptcy as insurance and registered pension plan investments in the case of personal bankruptcy.

This article clarifies the changes that the new legislation has introduced as well as its limitations and impact on

creditor protection planning post Bill C-12. Although the new legislation covers RSPs, RIFs, and DPSPs, this article will focus exclusively on RSPs and RIFs for ease of reference.

An Overview of the Changes

Although a welcome change to anyone with an RSP and RIF, this new law has been of particular interest to small business owners and professionals such as lawyers, accountants, doctors, and dentists. If you are a business owner, you are likely concerned about

the risk of losing a lifetime of work and savings from unexpected legal action taken against you personally or against your business (especially if you pledged personal assets as collateral). Likewise, if you are a professional or officer of corporations, you are probably concerned about the risk of your personal assets being subject to personal liability claims.

Even with this good news, this new law has its restrictions. So don't be too quick to stop seeking for ways to safeguard your hard-earned retirement

assets against creditors. While addressing a long-standing concern regarding the risk of their seizure due to personal bankruptcy proceedings, it won't protect you against the risk of seizure in the event of a judgment against you arising from a lawsuit, subject to provincial legislation. This very important distinction to creditor protection is the subject of this article to help you become more informed about what this new law has changed and what it has kept status quo.

RSP and RIF Creditor Protection - BEFORE Bill C-12

Until July 7, 2008, your registered assets were exposed to claims of creditors in the event of personal bankruptcy. Self-employed individuals and professionals saw this treatment of RSPs and RIFs as unfair when contrasted against employees having automatic creditor-protection on their company or government-sponsored pension plans and locked-in RSPs and locked-in RIFs. As a business owner or professional in private practice, your only option to protect your RSPs and RIFs against bankruptcy claims was to invest your registered funds in insurance-based products, namely segregated funds.

However, if you lived in certain provinces, like Manitoba, Saskatchewan, Prince Edward Island, and Newfoundland and Labrador, you did not need to be concerned about sheltering your RSPs and RIFs from Trustees in Bankruptcy as these provinces enacted their own provincial legislation to exempt RSPs and RIFs from bankruptcy claims and other creditor claims in most circumstances.

The federal Bankruptcy and Insolvency Act (BIA), which is the Act that governs your rights and those of your creditors in the case of bankruptcy, has a special provision that exempts property that is protected under provincial legislation. Consequently, if you declared bankruptcy while residing in any of the provinces listed above, the BIA made an exception for you by allowing the provincial legislation, which exempted RSPs and RIFs from creditor claims, to also exempt those assets from seizure by your trustee in bankruptcy for distribution to your creditors under the BIA.

RSP and RIF Creditor Protection - AFTER Bill C-12

WHAT'S NEW?

Effective July 7, 2008, the BIA was amended to provide creditor protection to RSPs, RIFs and DPSPs of individuals declaring bankruptcy with no cap or ceiling on the amount of these assets that will be protected, but subject to a claw back, described below. However, the new rules apply to protect these assets from creditors only if you declared bankruptcy on or after July 7, 2008.

Another type of registered plan, the RESP, was not included in this new legislation. However, locked-in RSPs and RIFs continue to be exempt from bankruptcy claims.

If you reside in Manitoba, Saskatchewan, Prince Edward Island, and Newfoundland and Labrador, where RSPs and RIFs were already protected against bankruptcy claims under your provincial legislation, nothing will change as these provincial laws will continue to govern your rights in case of bankruptcy. What really has changed is that the new federal BIA law that exempts RSPs, RIFs and DPSPs from bankruptcy claims effective July 7, 2008 will now apply to other provinces and territories, subject to the claw back described below.

RESTRICTIONS TO THE PAYOUT OF FUNDS TO A TRUSTEE IN BANKRUPTCY – 12 MONTH CLAW BACK PERIOD

While the new law protects your RSPs and RIFs against bankruptcy claims, it does not necessarily protect 100% of their entire value. This is because the new law may entitle your Trustee in Bankruptcy to “clawback” a certain value of your RSP or RIF for creditors.

That claw back period is limited to the 12 months period prior to the date of bankruptcy. This means that any contributions you made to your RSPs and RIFs in the 12 month period prior to your declaring bankruptcy may be remitted to the Trustee in bankruptcy. Although contributions may not be accepted directly into a RIF, the claw back period is also relevant in the case of a RIF, as a RIF can hold funds transferred in from an RSP that has received contributions in the 12 month claw back period. Amounts transferred from other financial institutions during the 12 month period, however, are not considered to be contributions for the purpose of this claw back. Conversely, any contributions you made prior to the 12 month period are exempt from the bankruptcy claim.

For example, if you declared bankruptcy on October 10, 2009, then the claw back period will be from October 10, 2008 to October 10, 2009. If the value of your registered plan was \$200,000, and you contributed \$10,000 to your plan during this claw back period, then \$10,000 can be paid out to the Trustee in bankruptcy.

Note that withholding taxes apply to the amount withdrawn to pay out the Trustee in Bankruptcy. In the example above, this means that the Trustee in Bankruptcy would receive \$8,000, the net after-tax amount, or \$7,600 if you live in Quebec.

HOW IS THE CLAW BACK AMOUNT DETERMINED?

In bankruptcy, the Trustee in Bankruptcy steps into your shoes as the RSP or RIF annuitant. They have the right to

request for information about your contributions to your RSP in the 12 month claw back period from financial institutions concerned in order to determine the amount that they are entitled to receive from your RSPs and RIFs. In response, your financial institution has the obligation to provide such details, once they receive documentation evidencing the trustee in Bankruptcy's authority to act.

As administrative procedures may differ among financial institutions receiving notice of a bankruptcy of an RSP or RIF annuitant, if you declare bankruptcy, you should contact all financial institution concerned to inquire about their process for handling bankruptcy situations. Your financial institutions will likely put your RSP or RIF account under restraint at the time of receiving a notice of bankruptcy until such time that the claw back matter is fully resolved with the Trustee in Bankruptcy who will need to gather details from all financial institutions concerned and until you are discharged from bankruptcy.

This is because even if the trustee does not take possession of an exempt property, the property technically vests with them. This means, for example, that if you needed to withdraw an amount from your RSP after filing for bankruptcy, you would inform your trustee who would likely claim the withdrawal payment after taking the clawback amount, if any, into consideration.

WHAT'S THE SAME?

IF YOU DO NOT DECLARE BANKRUPTCY

If you do not declare personal bankruptcy, then Bill C-12 will not protect your RSPs or RIFs in the event of a personal or professional liability lawsuit for negligence or from a general creditor claim. Your RSPs and RIFs will continue to be exposed to creditors just as before the enactment of Bill C-12. As well, if you declared personal bankruptcy before July 7, 2008, your RSPs and RIFs will not be protected.

NON-INSURED RSPs AND RIFs UNDER CERTAIN PROVINCIAL LEGISLATION

If you live in Saskatchewan, Manitoba, Prince Edward Island, or in Newfoundland and Labrador, you will not need to be concerned about Bill C-12 limitations to bankruptcy proceedings as you will continue to enjoy bankruptcy creditor protection under your provincial legislation which exempt non-insured RSP and RIFs from bankruptcy claims during your lifetime under most circumstances.

Additionally, these provinces' legislation protects RSPs and RIFs against other creditor "enforcement processes" such as garnishment, attachment, executions, seizure or other legal processes.

CREDITOR PROTECTION ON DEATH

Certain provinces (British Columbia and Prince Edward Island) have also gone beyond giving you creditor protection from bankruptcy claims during your lifetime by enacting special legislation that exempts non-insured RSPs and RIFs from creditors of your estate.

Though there is no such legislation in Ontario, the province also appears to extend creditor protection to non-insured RSPs and RIFs payable to a designated beneficiary on death thanks to a 2004 Ontario Court of Appeal decision. Although it is possible that other Canadian provinces and territories might adopt a similar stance, this is no guarantee as there are known cases in provinces like Quebec and Manitoba where a contrary judgment was applied.

Is There Still a Use for Segregated Funds Post Bill C-12?

Since Bill C-12 will only protect you in the event of bankruptcy, you may still be concerned about protecting your registered assets in the event of a personal or liability lawsuit or even from a general creditor claim. While no one can guarantee absolute protection from creditors, an insured RSP or RIF (i.e. segregated funds in your RSP or RIF) will continue to offer you the most complete protection possibility against all creditor claims during your lifetime and on death, whether a claim arising out of bankruptcy proceedings or even from a professional liability or general creditor claim. You can also consider using segregated funds to protect your non-registered assets from creditors too.

Key Restrictions of Segregated Funds

If you choose to explore adding segregated funds to your registered, and perhaps even to your non-registered portfolio, then it's important to familiarize yourself with a few key restrictions as there are certain circumstances where creditor protection will not apply.

1. 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, then your funds will not be protected from creditors.

2. You must appoint a family class beneficiary (spouse, child, grandchild, parent) on your segregated funds in order to maintain the integrity of the creditor protection. In Quebec, a family class beneficiary must be either a spouse or an ascendant or descendant. 1
3. Creditor protection may not apply in the case of taxes owing to Canada Revenue Agency (CRA) in a non-bankruptcy situation as CRA is a Preferred Creditor. CRA also has the right to pursue the estates of RSP and RIF holders and beneficiaries for unpaid taxes.
4. Claims to provide for dependents under family law may take precedence over creditor protection in the court of law.
5. Segregated funds cannot be purchased by a corporation to protect corporate assets against a legal claim against the business.

Additional Creditor Protection Strategies - Beyond Segregated Funds

If you are concerned about protecting your assets in the event of non-bankruptcy related claims and/or if you are an incorporated business owner, then you may want to consider the following strategies in addition to adding segregated funds to your RSPs and RIFs.

1. **Incorporating your business:** if you were sued personally, your operating company and any holding company assets would be protected. This would limit your exposure than had you kept all your assets in your personal name.
2. **Sprinkle assets among family members and trusts:** assets transferred to family members will limit your personal exposure to only those assets that are in your name, subject to any claims of fraudulent conveyance. However, this also entails loss of ownership which may not reflect your current intentions and these assets are then exposed to their creditors' claims and marriage breakdown.
3. **Professional Liability Insurance:** investigate what coverage may be available in case of a successful lawsuit against you.
4. **Use multiple corporations:** if you accumulated significant cash in your corporation, consider making transferring the excess via a tax-free intercorporate dividend to a holding company to shelter these accumulate assets from your business creditors. You can also hold real estate and equipment assets in a leasing company that is either a sister or parent company of your operating company.

5. **Secure the funds you lend to your business:** consider having your lawyer registering a floating charge over the assets of your business. A floating charge is not specific to any particular asset providing you greater protection.
6. **Set-up an Individual Pension Plan (IPP) or Retirement Compensation Agreement (RCA):** if you are an incorporated business owner or professional, or even an officer in a company, such retirement savings vehicles as the IPP or RCA may offer you creditor-protection while also helping you accumulate greater savings towards your retirement. Note that if you are a sole proprietor or partner in a partnership, it will not be possible for you to set-up an IPP or RCA.
7. **Life Insurance:** if you have an insurable interest and are able to qualify medically, then you may want to investigate incorporating a life insurance strategy (or annuity) to accumulate wealth that could be protected from creditors. Life insurance policies are generally protected from creditors provided they have a designated beneficiary in place. The cash value may also be protected if the beneficiary is made irrevocably or is an eligible family member.

Summary

Although the new federal law protects your RSPs and RIFs against creditor claims, it will only protect you in the event you declare personal bankruptcy. Even then, the new law will not necessarily protect 100% of the value of your RSP or RIF due to the 12-month clawback provision, which entitles the Trustee in Bankruptcy to a certain portion of your RSP or RIF for creditors, subject to whether you have made any contribution to the RSP or RIF within the last 12 months prior to bankruptcy.

Since your RSPs and RIFs continue to be exposed to non-bankruptcy related creditor claims, the new law should not be viewed as a substitute for a complete creditor-protection plan. Consequently, there's still a place for traditional creditor-protection strategies such as insured RSPs and RIFs using segregated funds, incorporation, sprinkling assets among family members, IPPs and RCAs. These strategies offer creditor protection against creditor claims during your lifetime and on death.

If you have questions on any of the issues in this article, please speak with your advisor.



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