From MoneySense magazine, October 2008

Segregated funds: A cracked nest egg

"Seg" funds no longer make much sense.

By Julie Cazzin

If you're a senior citizen, a small business owner or simply a cautious investor, you've probably heard sales pitches for what are known as segregated funds. Our advice? Steer clear.

"Seg" funds are offered by insurance companies; at first glance, they look much like mutual funds. But seg funds impose very high fees — as much as 4% a year, which is substantially more than the 2% to 2.5% that most mutual funds charge, and four to 10 times what index funds bill you.

So why would anyone buy a seg fund? A major appeal used to be that creditors could not seize seg funds if you went bust. So if you had concerns about your financial health, or ran a small business in a risky industry, seg funds provided you with a lockbox that your creditors couldn't get into if things went wrong.

But that rationale for buying seg funds has just disappeared. Thanks to recent changes to the Bankruptcy and Insolvency Act, creditors can no longer get at any money you hold in your registered retirement savings plan (RRSP), registered retirement income fund (RRIF) and deferred profit sharing plan. As long as you placed your money in one of those plans 12 months or more before declaring bankruptcy, it's off limits to the people you owe. So you no longer need seg funds to build a firewall between you and the bill collectors.

The companies that sell seg funds aren't going gently into the night. They are touting other benefits from seg funds. For instance, most seg funds come with a guarantee that ensures you or your beneficiaries get back your initial investment at the end of 10 years or when you die. That can be attractive to people worried about a stock market plunge. In addition, seg funds don't have to pass through probate when you die, which means that your heirs save on probate fees.

But none of those benefits is worth the high fees, says Marc Lamontagne, a certified financial planner with Ryan Lamontagne Inc. in Ottawa. He notes that the stock market nearly always rises over the

period of 10 years, which makes the 10-year guarantee on most seg funds of dubious value. “I don’t think there’s one 10-year period in history when paying the extra fees for segregated funds would have been worth it,” he asserts. “You get better returns using a mix of low-fee mutual funds and index funds. That gives you the best of both worlds, especially for anyone under60.”

The death guarantee and the lack of probate fees is most attractive to investors over the age of 70. But Norm Rothery, chief investment strategist at Dan Hallett & Associates Inc. and the founder of StingyInvestor.com, wouldn’t recommend seg funds even to the elderly. “The guarantee is useless and can be obtained much more cheaply,” says Rothery. “Just buy a GIC and put the interest you receive in riskier investments. That will guarantee your principal. You don’t need seg funds for that.”