Useful Comments on RRSP's

This series is furnished by R. Scott White, a life underwriter and a graduate of the Osgoode Hall Law School. They are written by him and other writers including lawyers, accountants and investment people exceptionally knowledgeable in their fields.

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Registered Retirement Savings Plans (RRSPs) have become big business for trust companies, banks and insurance companies. All wage vigorous campaigns for RRSP dollars, especially during the first 60 days of the new year within which payments must be made if tax credit is to be taken for the previous year.

Not only are the campaigns vigorous and even clamorous but they are highly competitive and sometimes, one suspects, rather perfunctory.

The subject has become something of a jungle for the taxpayer. This is at both ends - how he invests his money during the years before retirement and again when he plans his retirement. It is many sided and even the experts ponder the answers to some questions. And every federal budget seems to bring its tax changes as the government tries to wrestle the inequities to the ground and respond to the various rather trenchant lobbies.

In all this the taxpayer needs an objective, informed adviser in whom he can place his confidence. Presumably he is to be found amongst the branch office staffs of the banks or trust companies or the agents of the life insurance industry. Accountants have also had to become knowledgeable at least in regard to the tax ramifications. And because the subject matter is of widespread interest, self-proclaimed experts from consumer associations and the academic world have been out to make a name for themselves through various media.

Taken at random these representatives can be biased and surprisingly uninformed, partly because they haven't learned their subject for one reason or another and partly because they do not understand, or do not attempt to understand, the other fellow's business. The banking or trust company business is quite different from the life insurance and annuity business.

The government essentially wants to regard RRSPs as long-term undertakings by the taxpayer in the same way as an employee looks down the road to retirement and, hopefully, independence through the security of his pension plan. The insurance industry with its long-term investments and guarantees seemed a natural to carry out these objectives.

On the other hand the trust companies and the banks, as depositories of savings and as money lenders with their prospects ready at hand in their savings accounts, predictably wanted a share of the action and touted their shorter term guarantees with lower initial entry costs and easy withdrawal, which the tax department regards rather uneasily as self-defeating of the ultimate objective.

And "group" RRSPs have become widespread. Most professionals can invest their money through the auspices of their associations which enter into group contracts with investment institutions on behalf of their members. Similar arrangements are frequently made by employers for their employees.

All plans have their sponsors and promoters who have a direct interest in their success. The managers of the banks and trust companies actively promote their RRSP business because the success of their own operation, like everyone else's, is judged by their business growth. Competition between financial institutions for RRSP monies is private enterprise at work. And associations and employers certainly want their plans to be successful.

However, as a result of their economic forces, there is bound to be some switching being urged upon RRSP holders. There are transfers between banks, trust companies, insurance companies and mutual funds. Life insurance agents, mutual fund salesmen and trust company personnel sometimes "suggest" the transfer of monies from a trust company to a life insurance company or from one life insurance company to a different type of plan in another company or from a life insurance company to a mutual fund - exercises with many permutations.

These moves are not necessarily wrong but the arithmetic can be complex and they need to be analysed and understood by the RRSP holder. He should have confidence and have reason to have confidence in his adviser.

It is sometimes suggested that RRSP accounts be deregistered piecemeal over the years from say, age 65 to 71, paying tax on the amounts as received. This may keep the money where it is for a time but it is hardly complete information about the courses of action open to the man contemplating retirement and is contrary to the purpose of the Income Tax Act which wants lifetime protection for the taxpayer. And for the taxpayer and his family it may turn out to be the wrong thing.

Replacement of Policies

The life insurance industry has been increasingly concerned about the so-called "replacement" of policies which may not be in the best interests of policyholders. The industry is a dynamic one with a high profile and must carefully nurture a favourable public image by striving to give good service. Although policyholders are protected by complex laws regarding the investment of funds, the life-blood of the industry is good representation by its agents. This has led to stringent rules within the industry on the subject of switching policies. Replacement, one supposes, might be compared to the "churning" of accounts by a stock broker.

Under the replacement rules, if an agent suggests to a policyholder that there is some advantage in replacing a policy he must complete a detailed comparison statement on a form approved by the authorities of what the policyholder has with what it is proposed he buy. This form must be reviewed with the policyholder, signed by him and copies filed with the new company and with the company which now holds the funds, unless the policyholder indicates otherwise on the

form. Both companies are expected to review the circumstances and act in the the buyer's interest by seeing to it he is aware of all the facts pro and con.

Replacements initiated by parties who are on the periphery of the insurance business are not as yet required to follow these procedures as, in the writer's view, they should be. Fees are sometimes charged for the review of insurance policies and replacements suggested without exposure to these protective measures.

It must be emphasized there is nothing in the foregoing to suggest that an individual is not in complete charge of his own investment or that his wishes will not prevail. After all, it is his money.

Buying Annuities

Life annuities are long-term investments which by law must be issued by insurance companies. They are the only ones equipped with the personnel who know how to determine rates and put aside the legal reserves required to ensure that the commitment for lifetime income to the annuitant can be carried out over the years.

It is a highly competitive market within the insurance industry. At any one time certain companies for various reasons may offer better rates than others, and some companies are not really active in the annuity field. This range within the industry may come as a surprise to many laymen who may wonder why all companies don't offer the same return at a given time. But money has to be invested at high rates for long periods, and places to invest must be found which offer the proper return and the needed security. Each company is on its own and is constantly searching for places to invest in a competitive market. It may seem strange but smaller companies frequently stop taking in annuity money altogether for periods of time for lack of satisfactory outlets or to enable them to diversify their policy commitments with portfolios to match; in other words, not to have all their eggs in one basket.

For these reasons, especially if the amounts involved are of some size, the buyer should look at the rates of various companies. The only really practical and satisfactory way to do this is to have someone knowledgeable in the business secure rates for him from the half-dozen companies most competitive at the time. In this way the right companies are asked the right questions. The various quotations should be given to the taxpayer who can then make his selection. Choice, incidentally, is not always only a matter of rates. Accessibility to the insurance company's head office where the cheques are written and where rapid attention to hang-ups can be given, the insurance company's reputation and how well it is known are all factors, one or other of which may have special appeal to the buyer.

Annuities are sold on a commission basis. If someone is urging you to buy an annuity it is because he is an insurance agent, or is acting on behalf of one, who must be licensed with an insurance company which is in turn licensed to do business in Ontario. For reasons best known to himself this is not always apparent. This is rather odd since the public interest is behind all these government regulations.

A policyholder with his RRSP money with a particular life insurance company over the years may receive from that company a better annuity rate than it offers to new money coming in from the outside. If the company is competitive in the annuity field this may outshine the competitors. But the RRSP monies can usually be transferred and here also competitive quotations could be instructive.

It must be remembered that the insurance industry employs agents because they are essential to a viable industry. Without agents the companies would become unresponsive to the demands of the marketplace and not give the best return to their buyers. Reasonable volumes of premium income are needed for companies to operate efficiently. Any realist knows that the life companies would be delighted to place annuities and life insurance without agents if it would work. On the other hand, the agent is not generally given the credit he is entitled to. He wants business. Especially in Metropolitan areas, established agents will go to a number of companies to find what the buyer wants and will badger their own company and others to come up with better products and better ideas.

It is doubtful if there is another industry that reacts so quickly or so strongly, almost frantically, to a new product or new concept introduced by a rival company or by its enterprising, forceful and imaginative salesman. And in Canada this means concepts and products conceived not only in Canada but in the U.S.

And this up-front tautness in the life insurance business has much to do with keeping the banks and trust companies on their toes in those areas where their lines cross over.

Overpayments into RRSPs

One hears loose talk about how indifferent the tax department is about payments into RRSPs over and above what the law allows. It is suggested if they are small and unintentional, not to worry. For "experts" this is a rather fanciful notion of how our tax laws are supposed to work.

Suppose a taxpayer entitled to deduct $5,500 inadvertently or otherwise pays in, say, $6,000. Although he claims only $5,500 as tax-deductible, presumably the remaining $500 is in the RRSP quietly earning non-taxed interest over the years behind the tax screen.

The legislators have made this a costly, in fact punitive, exercise. Just how costly is illustrated as follows. An overpayment into an RRSP is penalized by a tax of 1% per month until it is withdrawn. That is 12% yearly. Futhermore, when the light dawns on the taxpayer and he withdraws his overpayment, the financial institution which holds his money is required by law to report the withdrawal to the Department of National Revenue as any normal payment out of of an RRSP. That is, the $500 originally non-deductible is taxed again even though he already had paid tax on it when earned, and this plus the 1% per month while in the plan.

Overpayments come readily to the tax assessor's attention when he lines up the RRSP tax receipts. If the total on the receipts exceeds the taxpayer's qualified contribution and it is reported, he is in trouble. A special tax form, T1-OVP, is designed to cover the overpayment tax for each month until the overpayment is withdrawn. This form is to be filed by March 31st of each year for overpayments of the preceding year.

It is interesting to note also that when such an overpayment is made by a taxpayer the institution which invests the funds is required by law to refund the overpayment to the taxpayer even though the form of investment being used does not permit refunds.

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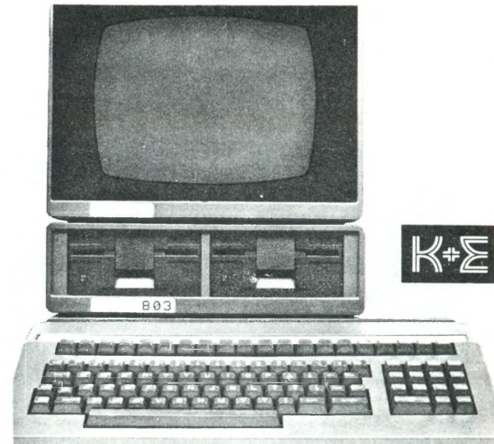

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