

Designating Beneficiaries - Life Insurance Policies and Registered Plans¹

Naming an individual, a charity, a trust, or a corporation to receive the death benefit of your life insurance policy ("Policy" or "Policies") or the funds in your registered plans ("Plan" or "Plans") at death, is called *designating a beneficiary*. This type of beneficiary designation is different from making a gift in your Will to a named beneficiary or to a specified class of beneficiaries.²

One of the effects of a beneficiary designation is that the payment of proceeds or funds is made by the insurer or provider directly to the named beneficiary, bypassing your estate, and without involving the executor (liquidator in Quebec) of your estate. In most provinces, the designation can be made by completing a Beneficiary Designation Form within the Policy or Plan³ application, by executing a stand-alone declaration, or, if properly drafted, by a declaration contained in a Will². With respect to Policies and Plans³, there are two kinds of beneficiary designations – revocable and irrevocable. In Quebec, unless a contrary intention is expressed, designation of a married spouse is deemed irrevocable. In all other provinces, a designation is revocable unless otherwise stipulated. Revocable designations can be changed without the beneficiary's knowledge or consent. A Policy or Plan³ with an irrevocable beneficiary designation cannot usually be altered or revoked without the written consent of the beneficiary. Policies and Plans should be made irrevocable only if the interest of the beneficiary needs to be fixed and determined for the life of the Policy or Plan such as cases involving a divorce settlement. It is the owner of the Policy or Plan, not the life insured (where they are not the same person), who designates the beneficiaries.

Advantages

There are several potential benefits to using a beneficiary designation as part of the overall estate plan. These include the ability to:

- Reduce or eliminate probate fees where applicable
- Protect against creditors of the estate (depending on the circumstances)
- Protect against family law claims (depending on the circumstances)

- Maintain privacy
- Avoid the probate process in court, if any
- Expedite payment of proceeds, or funds, to beneficiaries
- Equalize beneficiaries with funds outside the estate

Instead of allowing the proceed/funds to fall to your estate and into the hands of your executor (liquidator in Quebec), a beneficiary designation is one way to transfer part of your wealth after your death while protecting the assets from potential estate creditors and reducing probate fees, if applicable.

The direct payment to named beneficiaries is usually more expedient than the distribution of an estate since there is no time delay waiting for the probate process in court or the estate settlement process in Quebec, and the direct payment is a private matter, not in the public domain. It is important to ensure that both a primary and a contingent beneficiary are designated to avoid the funds being paid to the estate in the event that the primary beneficiary has predeceased the insured or the policy/plan owner.

Enhancing the Estate

It is important to keep in mind that the payment of proceeds at death under life insurance Policies does not trigger an income tax liability for the estate. The payment of funds under Plans does potentially trigger an income tax liability, unless the beneficiary⁴ is a married spouse, common-law partner, a minor child or a dependent child or grandchild, in which case the tax might be deferred if all tax conditions are met. A beneficiary designation to a specific person may not always be the best option if, for instance, probate is not an issue and the client wants to use their Will to co-ordinate all distributions. The beneficiary designation can instead be to the estate, or if no express beneficiary designation is provided, the

estate of the Policy or Plan owner becomes the default beneficiary. A Policy or Plan payable to the estate might be one way to provide for your unpaid taxes and other estate debts that may arise. Additionally, in the event that there is insufficient liquidity in the estate for other liabilities or gifts, a Policy or Plan payable to the estate might provide funding without having to sell assets such as real estate or investments.

Designating Minors as Beneficiaries

Minor children may be designated as beneficiaries of Policies or Plans; however, a minor is not legally competent to manage property. While a parent of a minor child is automatically the guardian of the child's person, the parent is not the guardian of a minor child's property. Where the value of the funds exceeds the provincial threshold (e.g. \$10,000 in Ontario), and absent the appointment of a trustee, an arm of the provincial government (e.g. Office of the Children's Lawyer) will be the statutory guardian of the child's property, until the child attains the age of majority⁵.

Typically, a Trustee is named in the Will or other document which designates the child as a beneficiary, to manage the child's funds until age of majority, or beyond⁶. The funds must be received by the appointed Trustee on behalf of the child and kept invested for the child's benefit. Proper documentation of the creation of a Trust for the benefit of the minor child and under what terms the child is to receive distributions, as part of the designation, is critical. Without a proper Trust document outlining the terms of Trust, there is no ability to access the funds for the child's needs (for example, for sports, camps, orthodontics, music lessons, counseling, education, etc.) other than, in some circumstances, by way of application to court. Furthermore, without terms of Trust there is no authority to hold the funds beyond the age of majority.

Creditor Protection

In most provinces and depending on the circumstances, Policies and Plans which are designated to named beneficiaries (not the estate) are protected from estate creditors. In general, registered Plans are protected in the context of bankruptcy with the exception of the contributions made to the Plan in the 12 months preceding the date of bankruptcy. In Common Law provinces, insurance products (Plans and Policies) may also be creditor protected so long as at least one named beneficiary is a spouse, child, parent, or grandchild ("creditor protected class") of the insured of the Policy or annuitant of the Plan. With respect to corporately owned Policies and segregated funds that are held in a nominee-registered account, protection from creditors may be lost⁷.

Other Considerations

In some common-law provinces, divorce nullifies appointments of, and gifts to, a former spouse, made in a Will. However, divorce does not cancel beneficiary designations on Policies and Plans in favour of the former spouse. The designation remains intact and, as a result, the former spouse would be entitled to the proceeds or funds, although that may not have been the intention of the deceased⁸.

Where a marriage or common-law relationship ends, clients should be advised to make appropriate changes to any beneficiary designations they may have made, in addition to changing their Wills. Typically, the last document signed which is a valid beneficiary designation (or testamentary disposition in Quebec under certain circumstances) trumps previous designations. The onus is on the owner of the Policy or Plan to inform the insurer or provider of any re-designation.

Recent court cases add confusion

Provincial courts have recently provided inconsistent rulings⁹ with respect to statutory designations and resulting trusts. Case law in British Columbia, Alberta and Manitoba support the presumption of resulting trust applying to statutory designations. Ontario has two cases resulting in conflicting law. If the rulings which support the creation of a resulting trust apply to beneficiary designations, the beneficiary would need to prove that the intention of the contract holder was to have the Policy or Plan funds transferred to them directly, or the presumption would be that the funds should flow to the estate of the Policy or Plan holder. Various industry and professional associations are advocating for legislative changes to avoid this confusion and clarify that beneficiary designations are not resulting trusts. In the interim, it is prudent for advisors and clients to document intent behind a beneficiary designation to satisfy the courts should a case arise challenging the designation.

Successor Annuitant versus Beneficiary Designation of Registered Segregated Fund Plans

Many clients ask what the difference is between a successor annuitant and a designated beneficiary, with respect to registered Plans. A beneficiary is a person who gets the funds in case of a death. In general, an annuitant (life insured in Quebec) is the measuring life for payments on an annuity contract. A successor annuitant can only be a surviving spouse, and, only with respect to payments from a Registered Retirement Income Fund ("RRIF"). The effect of a successor annuitant appointment is that the funds are NOT rolled over to the RRIF of the surviving spouse. In fact, the surviving spouse "takes over" the existing RRIF account of the

deceased. The account itself remains the same and no funds are moved out of the deceased's account. The name and Social Insurance Number (SIN) are simply changed to that of the surviving spouse. The payments will continue to be calculated on the date of birth of the deceased spouse.

All other types of registered plans (including the RRIF) can be designated, either by Form or Will, by naming a beneficiary who is to receive the entire Plan funds.¹⁰ In the case of a surviving spouse or common-law partner who elects to fund their own RRSP/RRIF plan without cashing out the deceased spouse's Plan, there can be a rollover (tax deferral) of the deceased's Plan. In that case, taxes would be payable on the second death of the recipient beneficiary. If a financially dependent child or grandchild receives RRSP or RRIF proceeds, the amount can be included in the financially dependent child's or grandchild's income. A minor child can then choose to buy an annuity to reduce the tax impact. In addition, a deceased individual's RRSP proceeds can be rolled over to the registered disability saving plan of the deceased individual's child or grandchild who was financially dependent because of an impairment in physical or mental functions. Whether this transfer is done directly between financial institutions or indirectly by having the deceased plan pay out to the beneficiary who subsequently deposits those funds into their registered plan, will dictate what tax slips are issued and to whom. In either case, if properly structured, taxes can be deferred on such transfers.

It is critical that clients consult with a professional in their jurisdiction before making or changing a beneficiary designation on a Plan or a Policy.

It is also important to keep a detailed list of Plans and Policies where beneficiary designations have been made and to review these every few years to ensure that the designations are consistent with the overall estate plan, and that they reflect the current intentions and life circumstances.

Note: The ideas presented in this guide should be reviewed for suitability to individual circumstances. The information contained in this guide is general in nature and should not be construed as legal or tax advice. You and your clients are encouraged to seek the advice of other professionals such as legal and tax experts to ensure that the ideas presented are appropriate for the circumstances of the individual(s) for whom this plan is being considered.

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- 1 In Quebec, beneficiary designation for registered plans can only be done with segregated funds.
- 2 In Quebec, the designation of beneficiaries can be made in the policy or in another written document which may or may not be in the form of a Will. This type of beneficiary designation is different from testamentary provisions such as universal, by general title and by title legacies.
- 3 Only insurance segregated fund Plans allow an irrevocable beneficiary designation
- 4 In Quebec, one can get the same result by either a beneficiary designation or testamentary provisions.
- 5 In Quebec, parents of a minor child are automatically the guardian of the child's person and properties. In administering the property of their minor child, fathers and mothers are not bound to make an inventory of the property, furnish security for their administration, render an annual account of their management, or obtain any advice or authorization from the tutorship council or the court unless the property is worth more than \$25,000 or the court so orders upon the application of an interested person.
- 6 In Quebec, a trust results from an act whereby a person, the settlor, transfers property from his patrimony to another patrimony constituted by him which he appropriates to a particular purpose and which a trustee undertakes, by his acceptance, to hold and administer. The trust agreement will provide under what terms the child is to receive income and capital distributions.
- 7 In Quebec, where the designated beneficiary is the married or civil union spouse, descendant or ascendant of the policyholder or of the participant, the rights under the contract are usually exempt from seizure until the beneficiary receives the sum insured. In addition, as long as the designation remains irrevocable, the rights conferred by the contract are exempt from seizure.
- 8 In Quebec, divorce or nullity of marriage or the dissolution or nullity of a civil union causes any designation of the spouse as beneficiary or subrogated policyholder to lapse. In addition, a legacy made to the spouse before a divorce, or the dissolution of a civil union is revoked unless the testator manifested the intention of benefitting the spouse despite that possibility.
- 9 Calmusky v Calmusky, (2020) ONSC 1506, Mak Estate v. Mak (2021 ONSC 4415), and Simard v. Simard Estate 2021 BCSC 1836.
- 10 In Quebec, beneficiary designation for registered plans can only be done with segregated funds. However, clients can also bequest their registered funds using testamentary provisions such as universal, by general title and by title legacies.

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