



# Finance Forum



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## FOCUS ON INSURANCE



## How much life insurance does your family need?

**H**ow do you determine exactly how much life insurance you should have? There's no standard formula. Simple one-size-fits-all methods, such as using a multiple of your household income, fail to take into account your individual obligations and personal wishes.

Accurately assessing your family's insurance needs is not so much a science as an art. Instead of focusing solely on numbers, it may be helpful to consider the specific purposes for which you require insurance, and then to rank them in terms of priority. These purposes typically include:

- **Income replacement.** In the event of your or your spouse's death, not only will income need to be replaced for regular expenses, extra income may be needed to hire outside help for child care, home maintenance, and so on.

- **Repayment of debts and taxes.** When one spouse dies, many expenses continue at the same level. Mortgage and car payments are prime examples.
  - **Estate settlement costs.** Your family will need sufficient cash to cover final expenses, which can include funeral costs and probate fees.
  - **Special bequests.** Life insurance can be used to leave a legacy to children, grandchildren, or a favourite charity.
  - **Equalization of estate assets.** If you have major assets that differ in value, such as a house, vacation property, and an RRSP, insurance can be used to ensure that each of your children receives an inheritance of equal value.
- Professional advice can help you and your spouse set priorities and find the appropriate amount of coverage. ■



# Look beyond pensions and RRSPs for your retirement income

**P**ensions and Registered Retirement Savings Plans (RRSPs) get most of the attention in retirement planning, but a sound financial plan will take into account all possible sources of income — and help maximize the benefits of each.

## Government programs

There are two main government programs that comprise the base of retirement income: Old Age Security (OAS) and the Canada and Quebec Pension Plans (CPP and QPP). Pooled together, the maximum benefits pay just over \$15,000 (in 2004), replacing about 40% of the average national wage. These payments are automatically indexed for inflation, unlike most company pensions and all RRSPs.

OAS starts at age 65 and is based on how long you've lived in Canada. This year's maximum is about \$5,600, which is gradually reduced for those with net income above \$59,790. When net income reaches \$96,843, the entire amount is "clawed back." OAS may face future cost-cutting, since it is one of the fastest growing federal program expenditures. For example, the high-income clawback might be based on joint income for couples.

The Canada/Quebec Pension Plans pay retirement benefits to those who contributed while working. This year's maximum, just over \$9,700, is payable at age 65. A reduced pension can begin as early as age 60, the reduction currently being 0.5% for each month you start early. Alternatively, the pension increases by 0.5% for each month you wait after age 65, until you are 70.

The QPP is considering increasing its reduction to 0.7% for pensions starting in 2010, while boosting the bonus for those who wait past age 65. If the changes take place, this would be the first substantial difference between the two plans, and could prompt CPP to follow.

## Part-time work

Pollsters say as many as 74% of baby boomers expect to work after retiring from their full-time jobs. Employers may develop "phased retirement" programs that encourage people of retirement age to stay on part time, collecting a mix of salary and

## The retirement income mix



pension. Pension tax rules discourage this, but there is pressure for change, as part-time work is one way to meet a looming labour shortage.

Continued work can have a big impact on your retirement planning, since every dollar earned lets you keep one dollar of savings invested in a registered plan, increasing your tax-sheltered compound growth.

## Non-registered savings

Do you have investments outside of your RRSP? A widely used strategy is to draw on your non-registered assets before tapping your RRSP. That keeps the RRSP investments compounding on a tax-sheltered basis. But it may not always be the best solution. If you let your RRSP run, it might grow so large that you will face high tax bills and the OAS clawback once you start mandatory withdrawals after turning 69.

It all depends on how much you have in your plan at retirement, how the money is invested, and what your income needs are. The goal is to get the most tax-effective mix of income from investments inside and outside your RRSP.

## Selling your business

Do you own an incorporated business or farm? Don't forget the \$500,000 lifetime capital gains exemption that's available when you sell—perhaps to your adult children. Business owners can also structure a sale to include a "retiring allowance" that's payable tax-free to their RRSPs.

There might also be an opportunity to collect ongoing director's fees, which are considered "earned income" for RRSP purposes. If you're 69 or younger, or if your spouse is, you can contribute these to an RRSP.

## Lifestyle changes

Another way to free up cash in retirement is by changing certain aspects of your lifestyle. Will you and your spouse both need cars as retirees? The annual cost of owning a mid-sized car, including depreciation, averages \$9,234 according to the Canadian Automobile Association (assuming replacement every four years). A subcompact costs \$1,728 less.

Downsizing your home, perhaps by moving to a condo, may or may not free up money. The same goes for retiring to a small town or rural area, where house prices are lower but other costs are higher.

Professional advice can help you build an income plan that includes the full range of your potential income sources. ■

## RETIREMENT PLANNING

### Turning 69? It's RRIF time

If you were born in 1935, you have until December 31 to convert your RRSP to an income vehicle. The most popular choice is a Registered Retirement Income Fund, or RRIF.

Converting your savings to income is a big step. Effective planning is necessary in order to minimize the tax bite in coming years.

Proper planning also ensures that your money will be accessible when it's time to make each required withdrawal.

Don't wait until the last minute. Discussing your options this summer will allow time to settle all the details for implementation just before the year-end deadline. ■

## EDUCATION SAVINGS

### The federal government wants to give you money

With all the concerns about the cost of post-secondary education, you might be surprised to learn that 40% of parents surveyed recently by Ipsos-Reid have not heard of the Canada Education Savings Grant (CESG). The CESG is a federal subsidy for Registered Education Savings Plans (RESPs), where Ottawa matches 20% of your contribution, adding up to \$400 to the value of your RESP, per child per year, to a lifetime maximum of \$7,200. Additional rules and requirements apply, but the RESP/CESG combination is a powerful education savings tool. ■



## RRSPs

### Divorced or separated? Review your beneficiaries

Couples who split up often forget to change their RRSP or RRIF beneficiary designations. That can be a very costly and unfair oversight.

In most provinces, divorce does not automatically revoke such designations, meaning that when the planholder dies, the ex-spouse could get the deceased's full RRSP or RRIF balance — while the estate gets the associated tax bill. The situation is even more problematic when a will names different beneficiaries than the plan document filed with the RRSP/RRIF administrator. It's always a good idea to review your will and beneficiary designations after any important change to your family. ■

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## ESTATE PLANNING

### Caring for Fido after you're gone

Should your will include your pet? That can be tricky, lawyers warn. One option is to name a guardian and leave money for the pet's care. But what if the pet dies before the money runs out? What if the guardian dies before the pet does? Should your executors be directed to oversee the arrangement?

Another option is to create a formal trust to hold the money, but that can be complex and costly. Alternatively, some animal shelters offer lifelong care in return for a bequest.

Clearly, providing for a pet demands much thought and sound advice. ■



## Short selling

*Recently, industry regulators have allowed certain mutual funds to "short sell" to a limited extent. While selling short is not a generally accepted procedure for mutual funds under securities regulations, it's a good idea to understand the potential risks and rewards of short selling (whether by an individual investor or a mutual fund).*

What it is

Short selling is a sophisticated strategy aimed at making money when the shares of a company fall in value.

How it works

In short selling, as with any market transaction, the goal is to "buy low and sell high." The difference is that, with short selling, the "selling high" occurs before the "buying low."

Suppose an investor — in this case a mutual fund manager — believes the shares of XYZ Corp., now \$50, are really worth just \$30. She arranges with a brokerage firm to borrow XYZ shares and sells them for \$50. Soon afterwards, the stock does indeed fall, and the fund manager can purchase shares to replace the ones she has borrowed from the brokerage. If the new price is \$30, the fund has made \$20 per share, less fees and borrowing costs.

Of course, no one can know for sure which shares are going to go down and when — which is why short selling can be quite risky and requires substantial expertise.

Why it matters

Prudent short selling can potentially boost returns in volatile markets, but it may change a fund's risk profile. A mutual fund's prospectus will indicate whether its managers use short selling techniques, and will explain the related risks.

# Financial security is good preventive medicine

**M**oney worries represent one of the biggest sources of stress today. In fact, about 38% of Canadians recently told Statistics Canada that financial problems stress them out. And new information is showing just how unhealthy stress can be.

According to a 2004 report from Statistics Canada, there's a direct correlation between stress and the likelihood of developing a chronic condition such as arthritis, back problems, emphysema, and chronic bronchitis for both sexes, as well as heart disease for men and asthma and migraines for women.

Not only does stress contribute to the onset of illness, it can also slow recovery or compound symptoms. A new U.S. study out of Ohio State University found that women with breast cancer are more likely to report symptoms of depression if they have other stressors in their lives, especially financial stress.

## A vicious circle

If you or your spouse were to become ill, the added worries and caregiving responsibilities for the ailing spouse and children would in themselves create a major emotional burden. This could lead to anxiety, depression, sleeplessness, exhaustion, and other health problems.

Financial concerns would only exacerbate the situation. If you or your family had to worry about a loss of income, medical expenses, and caregiving costs, this would create additional stress that might compound existing health problems and affect the health of other family members.

Provincial health plans will cover only basic medical care. To help you and your family deal with the financial and emotional stresses associated with a serious illness or injury, proper disability and critical illness insurance provide vital safeguards.

Disability insurance offers protection during the period when an income earner is disabled due to a serious health problem. It's designed to provide ongoing income to cover monthly expenses and meet important savings goals.

Critical illness insurance provides a lump-sum payment, usually \$25,000 to \$2 million, 30 days after the diagnosis of one of many medical conditions stipulated in the policy, such as heart attack, stroke, or life-threatening cancer.

## Freedom to choose

Benefits from both disability insurance and critical illness insurance can be used as you choose, to pay for whatever would serve to increase peace of mind for you and your family.

For instance, hiring a registered nurse or personal care worker not only provides professional care for the ailing spouse, but also gives the healthy spouse time to spend with the children. You might also choose to put the insurance benefits toward alternative medical treatment, housing changes to accommodate special needs, or a vacation to aid recovery.

Professional advice can help ensure that your family will be able to minimize financial stress in the event of a serious health problem. ■

## Why you need a power of attorney

IF AN INCAPACITATING accident, injury, or illness left you unable to manage your financial affairs yourself, your loved ones wouldn't be able to make those decisions on your behalf without a power of attorney.

An essential part of a complete estate plan, a power of attorney (or its equivalent in your province of residence) is a written document that allows you to designate a person you trust to make decisions for you in the event that you cannot. Without a power of attorney, a spouse or other loved one must apply for this right through a potentially time-consuming and costly court process.

Having powers of attorney in place for yourself, your spouse, and your parents is essential because incapacity is not a rare occurrence. For example, the Alzheimer Society of Canada estimates that one in 13 Canadians over 65 will develop Alzheimer Disease or related dementia.

Under a continuing power of attorney for property, your representative has the authority to pay bills from your bank account, sign documents on your behalf, and make investments or sell assets in your name. Different provinces have different terms and rules. For instance, in Quebec the document you need is a mandate in anticipation of incapacity.

With a power of attorney in place and professional advice, you can rest assured that your family's financial affairs will be handled appropriately in any eventuality. ■

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