Creditor Protection

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Creditor Protection[1]

Beneficiary designation and creditor protection are among the most significant features that make life insurance products distinctive and valuable for clients. The notion of creditor protection has changed over the years as the various *Insurance Acts* were revised and modified. Simultaneously, the Courts had the opportunity to examine these provisions and to establish guidance in determining the extent of creditor protection.

Actually, life insurance legislation is consistently uniform throughout the Common Law jurisdictions including the provisions relative to creditor protection. Special attention must be paid, however, when dealing with Québec legislation. The provisions regarding the beneficiary designation and creditor protection are very different in a way that protection that exists under common law legislation is divergent under the Civil Code.

Creditor protection has long been taken for granted as a benefit of life insurance products, including fixed-rate and segregated funds accumulation annuities. While these products can provide creditor protection, the protection is not complete, nor is it available in all cases. This paper reviews the limitations of this creditor protection, and provides guidance on how the client's affairs can be arranged to maximize the chances that this protection will be effective. The basics refer to Common Law principles. A special section examines the particular Québec issues.

General rules

Generally speaking, a basic principle states that all assets of a debtor are security for his debts when he does not reimburse them, whether or not he is bankrupt. However, there are a few exceptions to this basic principle, particularly when statutes provide for creditor protection or exemption from execution and seizure. Insurance Acts in force for each Canadian province and territory and the Québec Civil Code establish such protection against the claim of the policyholder's creditors for life insurance products when specific conditions are met.

Insurance Rules

There are many circumstances where the owner of a life insurance product could take advantage of protection against the creditors' claim during the lifetime or on death of the

[1] This information/material/presentation is intended to provide general examples/information about Creditor Protection. It does not necessarily reflect the views of Sun Life Assurance Company of Canada or any related company, or their officers and directors. Every effort has been made to ensure the accuracy and currency of the information provided, but any examples/information are/is presented for illustration purposes only. No one should act upon the examples/information without a thorough examination of the legal/tax situation with their own professional advisors, after the facts of the specific case are considered.

life insured. Both the life insurance money (claim proceeds at death) and the life insurance contract (cash value during lifetime) could be protected.

The basics are as follows:

During lifetime neither the policyholder's nor the beneficiary's creditors could seize the life insurance money as long as there is a beneficiary designation in place that meets the requirements of the various provincial legislation. The definition of insurance money is the amount payable by the insurer under a contract and includes all benefits, surplus, profits, dividends, bonuses, and annuities payable under contract either during the lifetime and at the death of the life insured.

At the death of the life insured, the policyholder's creditors could not seize the life insurance proceeds payable to a beneficiary of any class. However, the beneficiary's creditors could seize the same proceeds at the moment they are paid out to him.

According to law, creditor protection could be in place for an insurance contract during the lifetime of the life insured when an eligible family-class member is the beneficiary or when an irrevocable beneficiary is designated. In such circumstances, the entire contract including the cash value is protected against the claim of the policyholder's creditors during his lifetime as well as on his death. On the other hand, the beneficiary has only a future right in the death proceeds including the cash value, so his own creditors have no entitlement during the lifetime of the life insured.

Definition of Life Insurance

In Common Law, the definition of life insurance is large enough to encompass insurance money that is payable on death, on the happening of an event or contingency dependent on human life at fixed or determinable future, for a term dependent on human life including an annuity payable for a term of years or the duration of one or many human lives[2]. Practically, it means that all forms of life insurance including annuities issued by a life insurance company, registered and non registered accumulating annuities such as segregated funds (individual variable insurance contract) and life annuities constitute life insurance[3].

The inclusion of annuities and particularly of accumulating registered products, such as RRSPs among the life insurance contracts that are eligible to take advantage of creditor protection has been challenged many times in case law. The jurisprudence from the Appeal Courts of the Common Law Provinces consistently dismissed challenges to insurance creditor protection, however they do indicate clearly that they will rely on fraudulent conveyance principles to prevent injustice to creditors. Further amendments to

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[2] *Ontario Insurance Act.* R.S.O. 1990, c. 1.8, Section 171, Definition « Life insurance ». (The definition of life insurance in force in the other provinces could be different.)

[3] Rothberg Edward A.J., Life Insurance and Creditor Protection : Review and Update, 2001, Ontario Bar Association, September 26, 2001, p.26

the *Income Tax Act*[4] allow an annuity contract, which designates beneficiaries, as a qualified investment of a registered plan. The result is greater protection for the owner of an RRSP or RRIF when a family-class member beneficiary or an irrevocable beneficiary is designated, as long as it meets the rules of conveyance and the other applicable bankruptcy and family law rules.

Therefore the list of products that may provide for the life insurance creditor protection also includes insurers' segregated funds (individual variable insurance contracts) the closest thing to a mutual fund that insurance companies offer. They qualify as life insurance because of the undertaking to pay an annuity[5].

Beneficiary of Family-Class Member

As stated above, the protection of the contract and the insurance money against the execution and the seizure of the policyholder's creditors depends on certain legal conditions to be met[6]. One of these conditions is to have a proper and valid beneficiary designation of a family-class member or an irrevocable beneficiary of any class with the exception of the policyholder himself.

The family-class members are defined as being the spouse, the child, the grandchild or the parent of a person whose life is insured[7]. In the recent past, the "spouse" that qualifies to provide the creditor protection was the married spouse of the life insured. Challenge of this notion based on the Charter[8] led to significant changes to who could be considered as a spouse in Canada. Some Canadian provinces have changed their Insurance Act[9] definition of "spouse" to include common law spouses and same-sex partners. However, not all of the provinces acted this way, so special attention must be paid to particulars of any provincial legislation.

In Trust or Trustee Designation

There are certain circumstances where the appointment of a trustee is important, for instance, to protect a beneficiary who is a minor child or a disabled person. If the designation is for the benefit of a family-class member as stated above, and while there has been no case law on the subject, it is probable that this designation made will provide for a protection against the policyholder's creditors. When a trust is in place, the life insurance proceeds will be protected against the creditors of the beneficiary(ies) at the moment it will be payable, as long as no money is paid directly to the beneficiary. In

[4] Section 146(1) and 146.3(1) « qualified investment » ITA Section 4900(1) ITR
[5] An undertaking to provide an annuity is a clause in an accumulation contract that causes it to become a pay-out annuity at a future date.
[6] For Québec, please refer to the section : Québec Particular Issues below.
[7] Sect 196(2) Ontario Insurance act.
[8] Canadian Charter of Rights and Freedoms
[9] Ontario and Alberta.

Québec Civil Law, however, this type of designation would not provide for any planning opportunities as it will not create a trust or creditor protection. Only setting up an inter-vivos trust that holds the life insurance policy will create the creditor protection during the lifetime of the policyholder and the life insured. However, this type of trust will never retain the tax advantages of a testamentary trust that could be properly created only through a Will[10].

The Bankruptcy Act

The Bankruptcy and Insolvency Act (BIA) excludes from property divisible among a bankrupt's creditors any property that is exempt from execution or seizure under any laws applicable in the province within which the property is situated and within which the bankrupt resides[11].

The decision of Supreme Court of Canada in *Ramgotra*[12] clarifies the trustee in bankruptcy's "seisin" by ruling that the "seisin" applies to all the bankrupt's assets, both seizable and non-seizable, upon bankruptcy. The term "seisin" refers to a formal legal ownership as opposed to mere possession or beneficial interest. This way the bankruptcy trustee acts as the owner of the bankrupt properties for the benefit of the creditors as long as the bankrupt is not discharged. Nevertheless, there may be no realisation on the property in favour of the body of the creditors if the property is exempt from execution or seizure for a reason set out by legislation such as in the Insurance Acts. As a result, when the trustee in bankruptcy deals with a policy that was exempt from execution at the moment the bankruptcy occurred, he cannot change the beneficiary designation to remove the exemption or otherwise realise the cash value for the benefit of the creditors as long as the protection remains. However, if the protection ends before the protected assets were given back to the bankrupt, the trustee could exercise the rights attached to the policy. This could occur when the beneficiary designation in favour of a family-class member is released because of death of the beneficiary when there is no contingent beneficiary of a protected class designated. It should be noted that while a client is bankrupt, he could not access any assets, including those that are exempted from execution, until discharged.

Exceptions to the Exemption from Execution or Seizure

There are circumstances where the exemption from execution and seizure of the creditors is not effective although there is an appropriate beneficiary designation in place.

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[10] For more details see : Insurance Planning and the Civil Code of Québec, OBA Continuing Legal Education, Insurance to die For , Sept 26, 2001, p 16
[11] The *Bankruptcy and Insolvency Act (BIA),* R.S.C. 1985, c B-3, as amended, Subsection 67(1).
[12] Ramgotra (Trustee of) v. North American Life Insurance Co., [1996] 1 S.C.R. 325

Settlement within One Year or Five Years Preceding Bankruptcy

Under the BIA, the definition of settlement, in addition to a conveyance of property, includes among other things, a designation of a beneficiary in an insurance contract, when the designation is gratuitous or made for merely nominal consideration.

It should be noted that in *Ramgotra,* the Supreme Court of Canada does not consider a *self-settlement* as a conveyance of property that could lead to void the protection against the trustee. To the contrary, the Court maintains the protection in favour of the beneficiary interest in certain circumstances related to good faith and absence of fraudulent conveyance. For example, the conversion of an RRSP into a RRIF at maturity of the contract is a self-settlement as the policyowner is the same person. However, changing the beneficiary designation will be a settlement although the policyowner is the same, because a designation of beneficiary is defined as a settlement.

Before the decision of the Supreme Court of Canada in *"Ramgotra"* was rendered, the usual position that settlement of an asset under particular circumstances within the year or, in other circumstances, the five years preceding the bankruptcy could be void with regard to the bankruptcy trustee. This applied even if the asset was exempt from execution in accordance with a provincial legislation. After *"Ramgotra",* it appears that it is now the burden of the creditors and the bankruptcy trustee to contest the validity of the settlement under the provincial legislation when it occurs within the period provided by the BIA. As long as the disposition is considered valid in regard of the provincial legislation, the exempted status is maintained.

Fraudulent Conveyances

Usually, there are fraudulent conveyances or an assignment and preference when a creditor can satisfy the Court that a debtor made a life insurance beneficiary designation or transferred a policy with the intent to defraud the creditors[13]. During the last decade, the Courts ruled in a way to strengthen the scope of the creditor protection in force under the provincial insurance legislation. On the other hand, the same Courts stated that special attention would be paid to any transaction or settlement that could be considered as a fraudulent conveyance, in a way to keep balance with the rights of the creditors. In this way, they want to avoid making it easy for a debtor to convert a non-exempt asset into an exempt one, simply by having a life insurance policy or an annuity policy (including a segregated fund policy) in place with a proper beneficiary designation or owned by a new owner without creditors.

[13] Fraudulent Conveyances Act, R.S.O. 1990, c.F.29. Similar provisions are in place in every province including in the Québec Civil Code, art. : 1631.

Family Law

Depending on the provincial legislation, the creditor protection of the Insurance Act and the rights of the deceased's dependants to proper support can generate conflicts. In such cases the special legislative provision for dependants' relief will prevail. For example in Ontario, even though the *Insurance Act* provides for the proceeds of the life insurance to by-pass the estate when there is a beneficiary designation in place, the provisions in the *Succession Law Reform Act* [14] affect the proceeds of insurance policy owned by the deceased on his own life. The proceeds will be included in determining the value of the estate where the deceased has not made adequate provision to support his or her dependants and will then be made available to satisfy that obligation. In addition, the creditor protection will not protect the policies of owners that are behind in their court-ordered support payments to their children or ex-spouse[15].

Canada Customs and Revenue Agency (CCRA)

CCRA being a federal Agency, it pretends to immunity against provincial legislation that exempts assets from execution and seizure. The jurisprudence tends to maintain the position that provisions under provincial insurance statutes for exemption from execution or seizure do not bind CCRA unless those provisions have been incorporated into the ITA by specific reference to provincial law or by federal statutes that bind CCRA such as the BIA. Paradoxically, it could result in a life insurance policy that would have been seizable by CCRA outside of a bankruptcy being protected when the policyholder is bankrupt. For example, before the bankruptcy occurs CCRA could seize a life insurance contract bearing protected beneficiary designation and force the surrender to pay off the debt because of the Agency's position that is not to be bound by a provincial statute. But when the same debtor is bankrupt the policy is exempted under the *BIA,* a federal statute that binds CCRA.

Protection Associated with Various Holding Methods

As life insurance planning may involve more than family-class members or irrevocable beneficiary designations, financial planning professionals have developed other methods of holding life insurance contracts. We will take a brief look at the implications on creditor protection and the advantages and disadvantages of the most popular modes of holding: nominee accounts at investment dealers, corporations, partnerships and trusts.

[14] R.S.O., 1990, c. S.26.
[15] Section 32 of Family Responsibility and Support Arrears Enforcement Act, 1996.

Investment Dealers “Nominee Account”

The advent of the investment dealers in the distribution channels of life insurance products obliges us to compare their usual business process with those traditional to life insurance industry and particularly the holding of clients’ assets in “*nominee name*”.

Traditionally, a life insurance agent sells a life insurance product to a policyholder that applies for, owns the contract and is recorded in the life insurance company books in his or her name. When dealing with a member of the Investment Dealers Association of Canada (IDA), the purchaser may not be recorded as such, but the product may be issued in the name of the dealer in “nominee name”. The purchaser pays the dealer who pays the insurer. In reality, the dealer buys the product from the insurance company and holds it for his client. This process is commonly used for the purchase of insurance products designed for accumulation rather than protection needs: accumulation annuities that include segregated funds. From an administrative standpoint, the overall process results in delivering a single consolidated statement for the client.

Actually, both mutual funds dealers and securities dealers have applied this administrative process to the fixed term annuity contracts and insurer segregated funds that they hold for their clients. The holding of these products in “nominee name” may have implications on certain important features of the life insurance product such as the “creditor protection” and the probate status [16].

Neither the life insurance industry nor the investment dealers have yet adopted a clear position on the legal status of the dealers holding insurance contracts in “nominee name”. However, the legal nature of the account could make a significant difference. In any situation where one person holds or deals with another’s property, his legal status is either that of trustee or agent. The trustee holds legal title to the property while the agent simply has the ability to deal with the property on behalf of the client. The “creditor protection” and other valuable insurance features could exist or not depending upon the nature of the contractual arrangements between the insurance company and the dealer. In addition, the opening account agreement between the dealer and the client could affect the result.

This way, when the dealer status “in nominee name” is one of trustee, the insurance contract takes place between the dealer and the insurer. This relationship between the parties could jeopardize the application of the creditor protection on the insurance product because the dealer has larger powers than an agent only acting on behalf of the client’s instructions. When the insurer considers the contract to be between itself and the client, the dealer acting as an agent for the client, legislated creditor protection should be available if appropriate beneficiary designation and other requirements are in place. Please note segregated funds held by a trustee within a self-directed RRSP could usually not provide such protection. However, attention must be paid when the dealer, as an agent, signs the application on behalf of the client. There are legal arguments that an

[16] Investment Dealers Association of Canada (IDA), Notice FC98-29 on December 22, 1998.

attorney cannot designate a beneficiary on behalf of another person. Actually, the various Insurance Acts require that a beneficiary designation be an instrument signed by the insured. Therefore, if an agent or attorney completes an application on behalf of the applicant, the beneficiary must be the estate. No creditor protection is then available. The client and not the dealer must physically execute any document naming or changing the beneficiary.

In summary, the status of insurance product held in "nominee name" is not set yet. Because of this, it is very difficult to confirm or deny any creditor protection to an insurance contract held in such a way. Nevertheless, according to the most recent developments, when an insurance product is sold through the IDA channel, it is in fact the insurance arm of the dealer that sells the insurance to the client. There are many variations in these areas from one dealer to the other. Those that are interested in more details should contact their own dealer.

For now, it would be prudent for everybody interested in protection against creditors to deal directly with the insurer in the traditional manner rather than through a "nominee account". It is advisable to obtain the opinion of the client's own legal counsel to make sure the proposed arrangement will meet the objectives.

Holding Life Insurance within Corporations

Shareholders can hold insurance products such as life insurance policy, annuity contracts including segregated funds. The conventional methods of insuring buy-sell agreements usually do not shield all the risks with respect to the rights of the creditors. This way, an individual criss-cross[17] structure does not provide any creditor protection. Unless all of the shareholders are part of the family-class members, only an irrevocable beneficiary designation can provide some sort of protection in the event of bankruptcy or against the individuals' general creditors. This ownership method makes this type of protection even more important because the insurance contract is part of the policyholder's assets. It is available to all the policyholder's creditors. Thus, a reversal of personal fortune in no way affecting the corporation's business could threaten the life insurance contract since its values could possibly be swallowed up in the bankruptcy or seized by an individual's creditors in payment of his/her outstanding debts, leaving the business with lower or no insurance protection.

Having the corporation own the life insurance allows the insurance contract to be protected against the personal creditors of the shareholders. However, for a contract with cash values, these values will be part of the company's assets, and in the event of financial difficulties, such values could be seized or be swallowed up in the corporation's bankruptcy. As the company must be both holder and beneficiary of the insurance policy

[17] In a criss-cross buy-sell funding arrangement, each of the company shareholders is holder or co-holder of a policy on the life of one or more shareholders, and is also beneficiary or co-beneficiary of the insurance contract in proportions set out under the agreement.

in order to meet the criteria that make the life insurance proceeds available for a credit to the company capital dividend account (CDA)[18], in order to pay a tax-free dividend, a preferred beneficiary designation is not possible. It remains to be seen how the courts will treat an irrevocable beneficiary designation.

Many business people prefer that a holding company be the owner of the life insurance contract. One of the reasons most commonly cited is the protection offered against creditors of the shareholders and the operating company. This is true provided the holding company does not guarantee loans or other transactions negotiated by the operating company and does not itself carry out transactions that may jeopardize its economic health. However, the likelihood of these scenarios is slim if the investments are sound and diversified or if the holding company does not hold any asset other than the shares of the operating company and the life insurance contract. Comments concerning the operating company may also apply when the holding company has creditors or falls bankrupt.

Holding Life Insurance within Partnerships

Assets held by a partnership are part of the fair market value of the partnership interest held by each of the partners. A situation of personal insolvency in such circumstances would not necessarily compromise the survival of the insurance contract as long as the partnership itself remains economically sound. It is obvious that there would be "seisin" by the trustee in bankruptcy of the insolvent partner's interest and that the terms of the agreement between partners would subsequently determine the fate of the assets to which such partner has rights.

Holding Life Insurance within Asset Protection Trusts

There is an increasing trend for the shares of a corporation and life insurance policies to be held by a trust, especially in light of the advantages of this method e.g. protection against the creditors of various parties concerned and the possibility of transferring property to one or more beneficiaries without triggering a taxable disposition under the Income Tax Act. Since a life insurance contract is not capital property as defined by the Act[19]., the "21-Year" rule requiring periodic deemed disposition of capital property does not apply. By providing protection against the creditors of individuals and the corporation(s), regardless of the beneficiary's status, the trust/policyholder offers major advantages.

An Alter Ego Trust or a Joint Spousal Trust settled by individuals over 65 of age on a rollover basis of their capital properties could provide satisfactory protection of valued assets in the wake of a bankruptcy. However, a life insurance policy is not capital

[18] Section 89(1) ITA
[19] Section 54 «capital property » ITA.

property. Therefore, the transfer to the trust of an existing policy with significant cash value could trigger an immediate taxation on the disposition[20].

Québec Particular Issues

The Québec Civil Code enacts specific rules related to the relationship of the beneficiary with the policyholder and creditor protection. Such as for the Common Law, the basic principle is to the effect that a debtor is charged with the performance of his obligations, and all his property is a common pledge to his creditors[21]. The protection of certain assets from creditors most often results from specific provisions of the law. The Québec Civil Code section dealing with insurance exempts the rights under a life insurance contract from execution and seizure of the policyholder's creditors in certain circumstances.

As in common law, the creditor protection is related to the beneficiary designation, but the similarity ends at this point. Actually, the beneficiary must be a family member, the spouse, the ascendant or the descendant of the policyholder or an irrevocable beneficiary[22]. This class is larger than the one prescribed in common law that limits the list to the spouse, child, grandchild or parent of the life insured. In addition, the beneficiary relationship must be between the policyholder and the beneficiary instead of between the life insured and beneficiary. On the other hand, the definition of spouse is much more restrictive as it still includes only "married persons of opposite sex". There are technical points that might be mentioned. The beneficiary designation in favour of the spouse of the policyholder is automatically irrevocable unless otherwise stipulated while the opposite is true for any other person. This could be important regarding family law issues.

A judgement from the Supreme Court of Canada called hereafter "*The Malenfant Case*[23]" resulted in certain clarifications regarding the extent to which a Québec issued life insurance policy is exempt from seizure in case of bankruptcy. The Supreme Court with Mr. Justice Gonthier presiding, ruled all the rights conferred by the contract are seizable unless a specific legislative rule governing unseizability is in place. Therefore, this rule prevails over any other and establishes the standard. Among other rulings, the Court states that there is no restriction for a creditor to exercise the policyholder's rights under the life insurance policy of his debtor unless the appropriate beneficiary designation is in place. This position ends a legal debate that has lasted for years with respect to the fact that the right to surrender an insurance policy by withdrawing the cash surrender value is a personal right that could be executed only by the policyowner.

[20] Subsection 148(7) ITA and Alinea 251(1)b) ITA.
[21] Art : 2644 Q.C.C.
[22] Art : 2457 and 2458 Q.C.C.
[23] Perron-Malenfant v. Malenfant (trustee of) [1999] 3 S.C.R. 375

Life and Fixed-term Annuities

In addition to life insurance policies, the same protection applies to life and fixed term annuities sold by insurers when meeting all the criteria set out by the Code[24]. Once again, the Québec Superior and Appeal Courts[25] recently examined the question of the unseizability of annuities, particularly in respect of registered retirement savings plans (RRSPs).

Up to now, at every level the Courts were unanimous to rule that the first test to be met is the definition of annuities as stated in the Codes[26]. According to the Courts, the key element of this definition is the word "*alienation of capital* ". Regarding RRSP and RRIF sold by a Life Insurance Company; the debate is not over, although some very recent decisions tend to refuse the creditor protection[27] because the capacity for the policyholder to withdraw contributions is not consistent with the criteria of "*alienation of capital*" required to create an annuity. Therefore, it may be that any accumulation annuity, including both fixed-rate and segregated fund policies, will not be exempt from seizure in Québec, but payout annuities will. There are some other cases that are on stand by for now and the industry is working on a proposal to clarify the legislation.

Exception to the Exemption from Seizure

Family Law

These provisions are very particular to Québec. They do not exist under common law. Assets that are included in the definition of the family patrimony could not be fully protected against the seizure by the spouse. In this way, benefits or annuities payable under a supplemental pension plan to which an employer contributes on behalf of his employees, are exempt from seizure by the spouse to the extent of fifty per cent only, in the case of effecting partition of family patrimony or a debt for alimony.[28] On the other hand, RRSPs, RRIFs and LIFs are fully included in the partition and are not protected against the spouse or ex spouse's seizure in any way. Neither a life insurance policy nor a non-registered annuity contract that includes segregated funds are a divisible asset of the family patrimony. As such, a spouse's or a ex-spouse's seizure for the partition of the family assets or support obligation does not affect them as long as a valid protected beneficiary designation is in place. In case of death, the life insurance proceeds attributed

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[24] Art. 2393, 2nd par. Q.C.C.: Life or fixed-term annuities transacted by insurers are assimilated to life insurance but remain also governed by the chapter on Annuities. However, the rules in this chapter relating to unseizability apply to such annuities with priority.

[25] Bank of Nova Scotia vs. Guy Thibault and Scotia McLeod and the Caisse centrale Desjardins du Québec and the Caisse populaire Desjardins-Terrebonne, (Appeal Court Montreal 500-09-008724-999 2001-08-28) J.E. 2001-1654. C.S. J.E. 99-2329, Lacroix (Syndic de) [2001] R.J.Q. 400

[26] Art : 2367 Q.C.C.

[27] Thibeault, Lacroix and Dostie v. Raymond Chabot inc. et al.(J.E. 2001-271) Scotia McLeod Inc. v. Bank of Nova Scotia and Thibault et al. (JE 1999-2329 SC) (J.E. 2001-1654 AC)

[28] Article 553 Code of Civil Procedure of Quebec (C.C.P.) [R.S.Q., c. C-25]

directly to a beneficiary designated within the three years preceding the death are considered to be part of the succession for fixing the contribution in the obligation to provide support. To be effective the claim must be introduced within six months following the death.[29] The dispositions regarding family law do not apply to common law spouses and same sex-partners[30]. So if the client absolutely wants the policy protected against creditors, then make sure no change in beneficiary designation is made within three years before he dies!

Separation from Bed and Board

Separation from bed and board does not affect the rights of the spouse as revocable or irrevocable beneficiary or as subrogated policyholder, but the Court may declare them revocable or lapsed when granting a separation[31]. Thus, the final judgement rendered on the matter of separation from bed and board determines whether a spouse or former spouse still has any beneficiary rights under a life insurance or annuity contract. When the revocation of the spouse as beneficiary occurs at the time the judgement is granted without any replacement of such a beneficiary within the "protected class", creditor protection is no longer in place.

Divorce and Nullity of Marriage

When the Court grants a divorce or a nullity of marriage after December 1st, 1982, it causes the designation of the spouse as revocable or irrevocable beneficiary and subrogated policyholder to lapse automatically[32]. Then, once again, the life insurance policy or annuity contract is left without any protection against the seizure of creditors or bankruptcy trustee. It is one of the situations where the designation of a contingent beneficiary of a protected class could maintain the creditor protection.

Conclusion

Life insurance policies, including annuities and segregated fund policies, can provide for the accumulation of funds that are exempt from seizure by the policy owner's creditors. Careful planning must be done to ensure the policy owner, insured and beneficiary are properly selected. However, even with the proper beneficiary designation, there are many situations in which the creditor protection will not be upheld, particularly in relation to CCRA as a creditor, deposits made within 5 years of a bankruptcy, corporate-owned policies, policies held in nominee accounts, family support obligations, and some situations specific to Québec.

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[29] Art 684, 687 and 691 Q C.C.

[30] A proposed Bill is currently uinder study to allow same sex-partners civil marriage that will give them the same rights than married couple. There are no provisions however that will extend the rights of common law spouse.

[31] Article 2459, 1st par. Q.C.C.

[32] Article 2459, 2nd par. Q.C.C.: Divorce or nullity of marriage causes any designation of the spouse as beneficiary or subrogated policyholder to laps. – Article 2555 C.C.L.C. was to the same effect.

Financial advisors should take care to ensure their clients understand the limitations of this creditor protection, lest they expose themselves to claims from their clients on the basis of errors and omissions.