

# Financially Speaking

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## Plan for the high cost of higher education with RESP

### *Get the Facts About RESPs Before You Invest*

If you have children, grandchildren or are expecting a child, you may be thinking about saving for their post-secondary education. Tuition rates are rising, and the best way to ensure that your child can afford an education is to start saving early. The financial services industry offers a range of products to help you save for your child's education, but as with any purchase you should shop around.

Registered Education Savings Plans (RESPs) have become a popular way to save since 1998, when the federal government introduced the Canada Education Savings Grant (CESG). The CESG program grants up to \$400 per year (lifetime maximum of \$7,200 total per child) as an additional RESP contribution for anyone investing in these products. RESP contributions are not tax-deductible; and the growth is tax-free. If you would like more information about the CESG program, Human Resources Development Canada (HRDC) publishes a list of Frequently Asked Questions about RESPs and the CESG on their website: [www.hrdc-drhc.gc.ca](http://www.hrdc-drhc.gc.ca).

### What Types of RESPs Are Available?

#### *Self-directed RESP Accounts*

A self-directed RESP is a registered account at a financial institution or dealer where your contributions can be invested in RESP-eligible securities including T-Bills, GICs, corporate or government [bonds](#), [mutual funds](#), or [stocks](#).

*Risk and Return:* Investments like stocks and mutual funds are riskier than T-Bills and GICs, because they do not guarantee your investment. GIC products are low risk, but tend to have lower returns. This is something you need to consider if you have less than five years before you'll need the money.

*Costs:* You make the investment decisions for the self-directed account, so prepare to spend time managing your investments. You can hire an adviser to manage your investments for you, but you may pay adviser fees. The fees charged depend on the investments you choose. Expect to pay sales charges if you purchase mutual funds, as well as management fees. If you purchase securities expect to pay transaction costs, unless you are strictly purchasing GIC products.

*Cancellation:* If your child does *not* attend an eligible post-secondary school, you receive your contributions back, less the fees. The earnings on the investment may be rolled into your RRSP provided there is contribution room, or withdrawn with tax consequences. You must repay the CESG.

#### *Pooled Group Scholarship Trust Plan*

A pooled scholarship trust plan is a registered account with a scholarship plan dealer, where your contributions are pooled with those of other investors and are used to purchase plan units. At maturity you share in the pooled earnings of investors with children the same age as yours, if your

child goes on to eligible post-secondary education. Salespeople may get incentives like vacations for selling a certain number of plan units. The returns for pooled group plans depend on attrition. If you drop out of the plan, others benefit because you forfeit your earnings to the plan.

*Risk and Return:* Pooled group plans can be risky - **if you miss a contribution, your account may go into default and you may lose your plan** membership. If you miss a contribution and are allowed to stay in the plan, you will have to pay interest on the missed payment. The interest owing can grow over time to an amount that is difficult to repay.

Scholarship plans are limited in their investment options. They generally must invest in fixed income securities such as bonds, T-bills and GICs. While low risk, these investments also tend to have lower returns.

*Costs:* The pooled plan's investment managers make the investment decisions, giving them full control over your investment. You can expect to pay **enrolment fees, administration fees, investment management fees, depository fees and trustee fees**. Fees are paid up front from your contributions, which decreases the amount you have invested.

*Cancellation:* Pooled group plans are riskier because you have less flexibility in the way you make your payments. If you terminate your plan, or your child does not pursue post-secondary education according to the rules of the Scholarship Trust company, you forfeit your earnings. You only get back your contributions, less any fees. As most of the fees are paid up front, the amount of money you get back may be less than what you put in. The CESG generated by your contributions is either repaid to the federal government, or used to assist other students.

## **RESP Tips**

- Make sure you know what happens if you miss a payment, terminate your plan, or want to transfer the RESP between plans or beneficiaries.
- Read the prospectus - if you don't understand it, don't invest. If you change your mind after reading the prospectus of a Scholarship Trust Plan, you have 60 days to cancel your purchase at no cost to you.
- Understand how salespeople are paid, and where those payments come from.
- Know what fees you are expected to pay, and when you will pay them.
- Don't make investments based on verbal representation - get it in writing.
- Check the registration and qualifications of your investment representative.
- Don't fall victim to aggressive marketing techniques - take your time and do your research.
- Review the rules for the types of post-secondary education that are eligible under the RESP that you choose.
- How much work is being done to earn the management fees? If your money is being invested only in simple, low-risk instruments like GICs and T-Bills the management fees should be relatively low.

# Take matters into your own hands with your RESPs

By **ROB CARRICK**

*Globe and Mail*

*Tuesday, August 17, 2004*

Financial adviser Mike Morrow has noticed a difference in the way people invest for themselves and for their children through registered education savings plans. "They say, I don't mind losing my money, but I don't want to lose my kid's money," says the proprietor of Morrow Financial in Thunder Bay.

Backing up this insight is the more than \$5-billion invested in RESP scholarship trusts, which are the savings vehicle recently targeted by the Ontario Securities Commission because of their sales practices.

Scholarship trusts are a relatively safe, conservative way to invest for your child's university education. And yet, **most people would be better off with a simple self-directed plan available from financial advisers**, brokers and do-it-yourself on-line brokers. The problem with scholarship trusts is partly the sales practices mentioned by the OSC, which include inadequate disclosure or misrepresentation of fees, lack of supervision of sales staff and exaggerated claims about zero risk. Worse still are the many fees, rules and conditions that scholarship trusts impose on their investors. "I don't want to beat up on scholarship trusts, but I just think they're too confusing," Mr. Morrow said.

Scholarship trusts have been around for more than 40 years and now claim a little more than one-third of the total assets invested in RESPs. The sales pitch is folksy -- lots of pictures of shining-faced graduates and babies wearing mortarboards, plus scary numbers showing how expensive a university education is becoming.

These trusts differ somewhat from product to product, but generally they consist of a pool of investor money that is invested in safe securities such as government bonds, Treasury bills, guaranteed investment certificates and insured first mortgages. Annual returns in recent years have been in the 5-per-cent range, which isn't bad in the current low-rate environment.

As an investment, Mr. Morrow likened scholarship trusts to a bond fund. But you'd have to work hard to find a bond fund with the same level of fees and complex rules as scholarship trusts. **The fees are so onerous that even scholarship trust salespeople don't like to talk about them. The OSC listened to these sellers in action and too often found that salient details about fees were missing.** For this practice, and for others that included inadequate supervision of sales staff, the OSC imposed terms and conditions on five scholarship trusts, including the three largest players -- **Allianz Education Funds Inc.**, **CST Consultants Inc.** and **USC Education Savings Plans Inc.** The OSC said the issue of fee disclosure mainly concerns enrolment costs that people must pay when they join a scholarship trust. One trust has an example in its prospectus where someone invests \$95 a month and pays \$1,070 in enrolment fees during the first year, or almost 94 per cent of the total invested. An example of the lack of fee disclosure found by the OSC: In some cases, people weren't told that if they withdrew early from a trust, they were in a position to lose some of their contributions because they had not yet covered all their enrolment fees.

If the fees don't put you off scholarship trusts, then check out the rules. **Bowing out or making changes in your contributions can't be done without triggering all kinds of consequences, some of them potentially costly.** It's no wonder that scholarship trusts have seen their share of the money invested in RESPs drop to 36 per cent as of mid-2003 from 53 per cent in 1998, which is the year that Ottawa announced that it would match RESP contributions of up to \$2,000 a year with a grant of 20 per cent. Banks and brokers appear to be picking up market share at the expense of scholarship trusts, and that's just fine. **The best approach is a self-directed plan held with a bank, broker or financial adviser** that allows you to mix funds, stocks and bonds. .. Annual administration fees are usually charged on smaller-sized self-directed RESPs, but that's a fair price to pay for the sort of freedom you'll never have in a scholarship trust.



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