

Fixed Income Report

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GUARANTEED INVESTMENT CERTIFICATES (GICs)

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Guaranteed Investment Certificates are deposit instruments issued by Canadian banks guaranteeing investors a predetermined rate of interest for a stated term, while offering security of the principal. In general, these are non-redeemable and non-transferable prior to maturity, but there can be exceptions depending on the type of GIC being held.

WHY INVEST IN GICs

This product works similar to a savings account in many ways, while offering an enhanced rate of interest as compensation to the investor for locking in the funds for a period of time. GICs are classified as "Senior Debt" of Canadian banks and rank the highest (along with client deposits, banker's acceptances, bank deposit notes, senior deposit notes and step-up extendible notes) in terms of investor protection and when considering the universe of fixed income instruments issued by Canadian banks. Further, GICs with an original date to maturity of 5 years or less are insured for an amount of up to \$100,000 (principal and interest) by CDIC per member institution.

- Non-Redeemable GICs generally yield a higher return because the funds are locked-in until maturity. They can be selected with terms to maturity of 1 to 10 years for minimum amounts as low as at \$1,000 with interest being earned on a monthly, semi-annual, annual, or compounding basis. Non-redeemable GICs are available for non-registered and registered accounts for personal clients, as well as non-registered accounts for businesses and other organizations.
- Cashable GICs are one-year term investments that can be cashed out at any time after 30 days (or after 60, 90, 120 or 180 days depending on the products offered by the issuer) with full interest to the date of redemption. Cashable GICs can also be redeemed within 30 days (or within 60, 90, 120 or 180 days) without any interest. Cashable GICs are available for non-registered accounts for personal clients, as well as non-registered accounts for businesses or other organizations. Cashable GICs are NOT available within retirement income plans (i.e.: RRSPs, RIFs and LIFs).
 - The earliest Cashable GICs can be redeemed is five business days after purchase. Partial redemption requests have to be in \$1,000 increments and not take the remaining balance below \$1,000. In the case of a partial redemption, the full redemption amount requested will be taken from the principal and the balance of the principal plus all accrued interest on the blended principal will be paid at maturity.

In the event that a GIC holder passes away, the GIC can be redeemed at par (\$100) or re-registered to another account upon submitting the necessary documents in settling the estate. In a joint account with the right of survivorship, the surviving member can either choose to redeem the GIC at par or have it re-registered to another account.

GICs AND THE CANADA DEPOSIT INSURANCE CORPORATION (CDIC)

CDIC is a federal Crown corporation created by Parliament which insures Canadians' savings in case their bank or other CDIC member institution fails or goes bankrupt. The CDIC insures your GICs with member institutions from \$1 to \$100,000 (including principal and interest). To be eligible for deposit insurance protection, your GIC must be payable in Canada, in Canadian currency and the GIC must be repayable no later five years after the date of deposit.

CALCULATION OF CDIC INSURANCE

Many people deposit money into more than one account or financial product. For example, you might have a GIC held in your personal investment account, a GIC held in joint investment account with your spouse, as well as a GIC that is registered in an RRSP. CDIC takes this into account and to be insured, the GIC must be held in eligible accounts. For example, one individual could have a \$100,000 GIC from one issuer in an account in his own name, another \$100,000 GIC of that same issuer in a joint account and another \$100,000 GIC with that same company in an RRSP to get a total CDIC coverage of \$300,000. CDIC covers up to \$100,000 (including principal and interest) for EACH of the following:

- GIC held in one name (personal, business or other organization)
- GIC held in an RRSP
- GIC held in a RRIF
- GIC held in an account in more than one name (i.e. joint account)
- GIC held in trust
- GIC held for paying realty taxes on mortgage payments¹

However, please note that if you buy a \$100,000 GIC one issuer in an account held in one name at a particular financial institution and buy another \$100,000 GIC of that same issuer at another financial institution in an account held in one name, you are only covered for up to \$100,000. The coverage of \$100,000 is a function of the issuer who is a member institution.

¹ Some people pay monthly installments into a mortgage tax account. Their financial institution draws money from that account to pay municipal taxes on their property.

RISK FACTORS

Although fixed income investments (GICs) are generally considered to be safe, they are subject to two types of risk. The first is interest rate risk. Once you have purchased a GIC, and you are locked in to a set rate of interest for a specific term, there is always the chance that rates will rise and the rate you are earning may no longer be competitive. The longer the term of your GIC, the greater the chance that rates will rise at some point.

The second type of risk is credit risk, the possibility that your principal will not be repaid or that the issuer will default on the interest payments. This becomes a concern when buying a GIC over \$100,000, which is the maximum amount covered by CDIC. Although yields are normally higher to reflect the increased risk, issuers may fail to pay interest or be unable to make required principal payments, resulting in a loss of capital or a delay in the receipt of funds. An easy way to compare the quality of various GIC issuers is by referring to the bond ratings of their senior debt published by firms such as the Dominion Bond Rating Service, Standard & Poor's Investing Service, and Moody's Investor Service.

TAXES

When investing outside of the tax-sheltered environment of an RRSP or RRIF, it is important to consider the investment's after tax rate of return. Interest income earned from investments such as T-Bills, bonds, and GICs are generally taxed at the highest marginal tax rate. The marginal tax rate is the rate applied to each additional dollar of income you earn.

NON-RESIDENTS

Non-residents are able to buy GICs as a Social Insurance Number (SIN) is not required for a GIC purchase. Further, non-residents now have another incentive since the Government of Canada eliminated the withholding tax on arm's length interest paid or credited to non-residents.