

Savings & Investments

As you move through life, you will likely encounter a variety of reasons to save money. Sometimes you may have your sights set on a short-term goal such as saving for a car or for that dream vacation or ensuring you have a rainy day emergency fund to back you up when you need it. And sometimes you'll find yourself saving for a long-term goal such as saving to make a down payment on your first home or saving for retirement. Ideally, your money will not only be protected while you save but will also grow.

Saving vs. Investing

And that aspect of growing your money is an essential difference between simply saving money and investing money. You can save money by burying it in a hole in the back yard or tucking it under your mattress. However, while that may allow you to protect and save your money, it won't grow your money.

If you want your money to grow, you have a variety of options:

You can deposit your money into a savings account at your financial institution. This will allow you easy access to your money at any time and you will likely earn a small amount of interest on your money. This involves little to no risk and provides a small amount of guaranteed growth if you leave the money in your savings account over time.

Most financial institutions will also offer some forms of guaranteed investments that will allow you to grow your money in a safe way with little to no risk. These investments usually offer a higher interest rate than a regular savings account but the trade-off is in your ability to access the funds. Your funds are often locked in for a set term or at the very least, are not a quick, simple withdrawal as with a savings account. In most cases, for these investments, the principal (the amount you invested) is protected and the interest is often guaranteed.

If you are someone with some tolerance to risk and want to see potentially higher returns on your money, you can ask your financial institution or a knowledgeable and qualified financial planner about other forms of investments such as mutual funds or stocks and bonds.

Kinds of Investments

For the purposes of this topic, we'll discuss the standard, low-risk options offered by most mainstream financial institutions. However, keep in mind that most of these options have higher risk counterparts with potential for higher returns and you can get more information about those options by contacting your financial institution or a qualified financial planner.

GICs / Term Deposits

The basic investment type offered at most financial institutions is called a Term Deposit or a GIC (Guaranteed Investment Certificate). Essentially, a term deposit is an investment that promises a guaranteed return at a fixed interest rate over a specific term or set period of time. Usually, you can choose between a redeemable or a non-redeemable option. As the name suggests, a redeemable term deposit allows you to take your money out before the end of the term, though you may receive a lower interest rate for that convenience. And a non-redeemable term deposit, will usually offer a slightly higher interest rate but you may be completely unable to access the funds before the end of the term or

you may be charged an early withdrawal penalty if you do have to take out your money early. It's also important to understand the terms and conditions of your term deposit. Are you able to cash in your redeemable term deposit at any time or only on specific dates such as the anniversary date of your term? If you redeem early, will you receive the full rate or a reduced rate? How and when is the interest calculated and paid on your term deposit?

Most FIs will offer a variety of terms ranging from as short a time frame as 30 days up to terms of 5 or more years. As a general rule of thumb, the longer the term, the higher the interest rate. Though, from time to time FIs may offer special promotional interest rates on a specific shorter term so be sure to compare all the terms and rates to ensure you are getting the best rate you can. When choosing a term, the interest rate is an important consideration. You should also consider what you intend to use the money for and pick a term that works with that end goal. For example, if you are saving for a vacation you intend to take in 2 years, be sure to pick a term that will finish in enough time for you to access the funds when you are booking your vacation and need to pay for everything and not just for when you plan to leave on vacation. However, if you are saving for retirement 20 years down the road, a 5 year term may make the most sense. Another consideration is what the overall market and economy is like when you are ready to start your term deposit. If interest rates are low, you might want to pick a shorter term and hope that they go up when your term renews. If interest rates are high, you may be better off locking in your money for a longer period of time to ensure the best return on your money.

Your financial institution may also offer some more specialized term deposits with slightly different features than the standard term deposits. Some longer-term deposits, often called Escalators, may offer a tiered interest rate that increases as you move through the term. For example, for the first year you might receive 1% interest and for the second year you might receive 1.25% interest and for the third year you might receive 1.75%. Usually these term deposits are redeemable but, of course, the longer you leave it in, the more interest you earn.

Your FI may offer a term deposit with an interest rate that is linked to the prime rate. For example, the rate you earn may be the same as the prime rate or even prime plus a certain percentage. So, your rate of interest on your term deposit will fluctuate throughout the term depending on what the current prime rate is. If the prime rate goes up, so does your interest rate. If the prime rate goes down, so does your interest rate.

Some FIs will offer term deposits that are linked to certain stock market indexes. Usually, when you invest in these term deposits, your principal is guaranteed and protected but the growth you receive is linked to the performance of the stock market index linked to the term deposit. If they do well, you could receive a high rate of return over your term. However, if the linked index does not do well, you will receive a very low rate of return or even none at all. Be sure you understand the terms and conditions of the term deposit when you make your investment. These market-linked GICs or term deposits are usually based on the performance of a specific stock market index but you may have several different market-linked GIC options to choose from. Often they will focus on a certain industry or specific national or international stocks. They may even have a responsible investing option that selects stocks based on environmental and social considerations such as human rights, resource development and conservation, sustainability, etc.

RRSPs

Registered Retirement Savings Plans or RRSPs are a form of retirement savings vehicle with some additional features. As the name suggests, RRSPs are intended to be used specifically to help you save money for retirement. They are registered with the Canada Revenue Agency and there is a limit to how much you are allowed to contribute to your RRSP each year which is determined and confirmed by your Notice of Assessment.

There are some advantages to an RRSP, the biggest of which is that it reduces your taxable income when you contribute to your RRSP and it defers or puts off the taxes on the growth you earn until you withdraw the money. The basic theory behind RRSPs is that they allow you to pay lower taxes when your earning potential is highest and you may be in a higher tax bracket. Then, when you retire and withdraw the money, you have less income and may be in a lower tax bracket when you have to pay taxes on the money in your RRSP. When you make a contribution to your RRSP, you can claim it as a tax deduction which will reduce the amount you pay in taxes that year. RRSPs also allow you to defer the taxes on the growth your RRSP earns until you withdraw the money so they can grow tax-free as well. While RRSPs are intended to be used as savings for retirement, you can usually withdraw the money prior to retirement within the limits of the terms and conditions of the RRSP investment vehicle you chose. However, you will be taxed on the money when you withdraw it so most people find it beneficial to wait until they retire, when their income is usually lower and therefore in theory, their income tax rates are lower.

Besides all the tax benefits RRSPs provide, they are also simply a great vehicle for saving for retirement. The money is less accessible than when you put it in a savings account which can help to ensure the funds don't get used for other purposes. And if you start investing money when you're young (which is highly recommended), you are able to invest over a longer period of time which, depending on your RRSP investment vehicle, has potential for a much higher rate of return than a simple savings account or shorter-term investments.

There are also specific programs that the Government of Canada has set up that allow you to access the funds from your RRSP for specific purposes without having to pay the taxes on the money. The Lifelong Learning Plan (LLP) is a program that allows you to withdraw money from your RRSP tax-free. Under this program, you can withdraw up to a certain amount from your RRSP tax-free to finance full-time training or education for yourself or your spouse or common-law partner. You then have up to 10 years to repay the funds to your RRSP.

The Home Buyers' Plan (HBP) is another way you can withdraw money from your RRSP tax free. Under this program, a first-time home buyer can withdraw up to a maximum limit set by the government from their RRSP tax free to use to buy or build a qualifying home and they have up to 15 years to repay the funds to their RRSP.

A Spousal RRSP is another way you can use RRSPs and income splitting to save money in taxes. If one spouse earns more than the other and is in a higher tax bracket, the higher earning spouse can set up a Spousal RRSP in the name of their spouse. The higher earning spouse then contributes to the RRSP and receives the immediate tax benefits. Then, when they retire and withdraw the money, their tax bracket will hopefully be lower when they withdraw from two smaller RRSPs than it would if they had withdrawn the money from one larger RRSP.

You can open multiple RRSPs but you do need to be careful because there is a limit to how much you can invest in an RRSP each year. Be aware that this limit is not per RRSP but is per person and applies across all of your RRSPs combined. The limit is currently 18% of your previous year's earned income or a yearly maximum amount set by the government, whichever is lower. If you don't use all of your RRSP room in a given year, that amount will carry forward and you can contribute that unused amount in a future year. If you contribute more than your RRSP deduction limit by more than \$2,000, you will have to pay a tax which is calculated per month until you withdraw the excess amount.

Most FIs will offer a variety of RRSP options similar to their standard GIC or term deposit options. These offer little to no risk and usually offer a guaranteed but relatively low rate of return. Mutual funds, stocks or bonds are also possible RRSP investment options. These are not insured or guaranteed and any potential growth will depend on your tolerance for risk.

You can contribute to your RRSP until December 31 of the year you turn 71 or, in the case of a Spousal RRSP, until December 31 of the year your spouse turns 71.

You can choose to withdraw the money from your RRSP at any time until the end of the year you turn 71, at which time you will need to convert it into a Registered Retirement Income Fund (RRIF).

RRIFs

A RRIF is essentially the opposite of an RRSP. Where an RRSP allows you to make regular contributions to save for retirement, a RRIF allows you to receive regular withdrawals to fund your retirement. You will also have similar investment options for your RRIF as you had for your RRSP whether you choose to invest in GICs or term deposits, mutual funds, stocks or bonds.

Converting your RRSP to a RRIF allows you to continue to grow the funds in your plan while allowing you to receive money from your RRIF. When you contributed to your RRSP, you were able to reduce your taxes as well as defer the taxes on any growth within your RRSP. However, when you withdraw money from your RRIF, you will now have to pay taxes on that money. Ideally, you will be in a lower tax bracket when you are withdrawing your money than you would have been when you contributed the money. You do not pay taxes on your money when you convert it to a RRIF, you only pay taxes on the amount that is withdrawn each year and then it is treated as income for tax purposes. The rest of the money in your RRIF will continue to grow tax free until you take it out.

You are required to start taking RRIF income by the end of the year in which you turn 72. The amount you are required to take out of your RRIF each year is a percentage of the total value of your RRIF plan at the beginning of the year. The required withdrawal percentage starts low and increases each year as you age. You must withdraw the minimum amount required each year but you can choose the frequency of the withdrawals, whether you'd like to receive the money monthly, quarterly, annually, etc. You can also withdraw more than the minimum if you wish.

TFSA

Another type of investment is a Tax-Free Savings Account (TFSA). This program was introduced by the Canadian government in 2009. It allows people who are 18 years old or older and who meet the eligibility requirements to save money in a registered plan without having to pay taxes on the growth earned by their investment. There is a set limit to the amount of money you can contribute to a TFSA

each year and it is the same for everyone who qualifies regardless of income. The cool thing about the limit is that, whether you open a TFSA right away or not, your contribution room begins in 2009 or the year you turn 18 years old and will continue to grow each year. Any unused contribution room is carried forward. So, for example, if you turned 18 in 2020 the contribution limit for that year was \$6,000. It was also \$6,000 in 2021 and 2022. So, if you opened a TFSA in 2022, your contribution room would retroactively include all the years since you turned 18 and you would be able to contribute up to \$18,000. And, as with an RRSP, you will need to be careful not to over-contribute because if you exceed the contribution limit, you will have to pay a tax on the highest excess TFSA amount during the month for each month until you withdraw the excess amount.

TFSAs are a great way to save money, even for retirement. Unlike an RRSP, you do have to pay taxes on the money you invest in your TFSA but you do not ever have to pay taxes on the growth your money earns in your TFSA. So, when you withdraw money from your TFSA, you do not have to pay taxes on your withdrawal. Many people find it helpful to save for retirement using both a TFSA and an RRSP as they both provide different benefits.

TFSAs are convenient and useful for a wide variety of savings goals. They are not limited to saving for retirement and can be used to save for any short or long term goal. Depending on the terms and conditions of the investment vehicle you choose for your TFSA, you can withdraw the money at any time and for any reason. When you withdraw the money, the following year the amount you withdrew is added back to your contribution limit and any unused contribution room will carry forward to use in future years.

TFSAs also provide a great tax benefit. You can choose all sorts of vehicles to invest in a TFSA, from basic savings accounts, to term deposits and even mutual funds and stocks and bonds. While you do have to pay taxes on the money you invest in your TFSA, you don't ever have to pay taxes on any growth your investment earns. So, the higher the rate of return on your investment, the greater the tax benefit from your TFSA.

While some investments may interfere with your ability to receive income-based benefits from the Government (such as Guaranteed Income Supplement, Old Age Security, Employment Insurance, Child Tax Benefits, etc) a TFSA does not interfere with these benefits.

TFSAs and RRSPs have some different but complimentary features. While an RRSP is intended for retirement savings, a TFSA can be used to save for any purpose. RRSPs are tax-deductible when you invest but you must pay the taxes when you withdraw the money. TFSAs are not tax deductible when you invest but you do not have to pay any taxes when you withdraw the money which makes any growth your investment earned tax free. RRSPs only allow you to contribute until you are 71 (or your spouse is 71 in the case of a Spousal RRSP) whereas there is no age cap for contributions to a TFSA. If you would like help deciding whether a TFSA or RRSP or both will best suit your personal situation, contact your financial institution or a qualified financial planner and they will be happy to help.

Conclusion

In this lesson we've discussed the basics of a variety of standard investments offered by most financial institutions. As you consider how to save and invest your money, it's always a great idea to contact a qualified financial planner or someone at your financial institution. When you seek advice, it's important

that any financial or tax planning is done by a qualified individual. They can give you more in-depth information about all of your options and will be able to help you come up with a savings and investment plan that will work hard to help you accomplish your short and long term savings goals.