Benefits and drawbacks

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Although self-administered plans have the potential to offer a higher return than virtually any other type of RRSP investment (especially now while the stock market is so buoyant), some investors end up losing precious retirement dollars. How, then, do you decide if the self-directed vehicle is right for you?

Philip Scheiding, vice-president of trust services at First City Trust, believes that the three most important factors in determining the success of a self-directed RRSP are capital adequacy, knowledge and time. It is worth looking at these factors individually.

Most financial advisors suggest that unless you have a minimum of $10,000 in your plan, the annual fee represents too high an expense in relation to the level of assets in the account. (For example, First City's self-administered plan fee is one of the lowest in the market at $95 per year with no additional transaction charges, yet this still represents an expense ratio of almost two per cent if you have only $5,000 in your self-directed plan.) They advise that you are almost certain to achieve a better return with a guaranteed investment-type RRSP. Of course, it is better to transfer in (tax-free) the proceeds of an RRSP you already own rather than start from scratch.

Because your self-directed RRSP can only be as good as the investment decisions you make for it, the second important factor — knowledge — is critical. This includes knowledge both of the product and of the market. Not everyone realizes that under the terms of the trust agreement, the planholder is solely responsible for ensuring that all his investments conform to Revenue Canada legislation governing the eligibility of investments.

A partial list of eligible investments includes common stocks and preferred shares of companies listed on a prescribed Canadian stock exchange, options, deposits of money in a Canadian bank, trust company, or credit union, government bonds, trust company guaranteed investment certificates, certain units of a mutual fund trust and certain mortgages secured by real property located in Canada.

Unqualified assets include gold or other precious metals, art and antiques, shares of almost all private corporations, commodity futures, and real estate. Adding an unqualified asset to your RRSP exposes your plan to a significant tax penalty. This is to be avoided for obvious reasons.

"The 10-per-cent foreign ownership limit within an RRSP can also cause problems for unwary investors," Scheiding pointed out. "This 10 per cent is based on 'book value' (original cost), not market value, so special care must be taken in this area also. A one per cent per month tax penalty is levied on the excess and this can be very costly."

Yet another area in which the prospective investor must acquire some expert knowledge is the proposed new legislation on capital gains. These proposals are both too complex and too unsettled to treat satisfactorily here but they can be expected to have a significant impact on the way investors choose to structure their self-directed plans. This will be especially true if they plan to "sell" or contribute in specie any personally owned assets to their self-directed vehicle.