Limitations of GICs

Guaranteed Investment Certificates (GICs) have been a valuable tool for investors seeking exposure to fixed income. They provide safety of principal through deposit insurance and offer predictable returns with fixed interest payments and a set maturity date.

However, GICs come with a significant drawback: a lack of liquidity. Almost all GICs require investors to hold them until maturity, posing challenges especially in the event of unexpected expenses. GIC issuers may allow redemption under extreme circumstances such as death of the holder or financial hardship, however redemption requests are strictly at the issuer's discretion and could be denied.

In addition, GICs present an opportunity cost risk, as investors may miss out on higher-return investment opportunities throughout the holding period. For example, above we highlight the last year of a five-year GIC, purchased in January 2021. With only a year left, this holder will receive 1.85% until the end of the year. However, in January 2024, prevailing interest rates were much higher, meaning an investor who had a shorter maturity or had a more liquid holding may have been able to switch to a higher-yielding investment.

Should liquidity be a concern, there are other fixed income options to consider. While cashable GICs are an option with more liquidity, they offer lower interest rates and have shorter final maturities than traditional GICs.

High quality bonds, from well-rated corporations or governments, help alleviate liquidity concerns associated with GICs. They offer liquidity through a secondary market in most market conditions, allowing investors to sell their bonds at market value should they need access to funds. Canadian banks issue investment-grade corporate bonds that provide similar yields as well as predictable payments. The Federal and Provincial governments also issue bonds that may appeal to investors looking for safety of capital.

Another advantage of bonds is their potential to reduce tax liability in unregistered accounts. Unlike GICs, which only pay interest income subject to full taxation at the purchaser's marginal tax rate, bonds offer capital gain opportunities. Bonds trading below par value derive a portion of their total yield from the bond's predicted move to par, which is taxed as a capital gain.

A GIC's lack of liquidity and potential opportunity cost risks can be a significant restriction for many investors. In the worst case, they identify this limitation once the GIC is already purchased and they need or want their funds immediately. On the other hand, bonds provide a viable alternative by addressing these concerns, and may offer tax benefits that are not possible with GICs. Though they may not always be the highest-yielding product, purchasing bonds can allow investors to sell their position when they need to most.