

# Summer 2008 Quarterly



Cove  
Financial Planning Ltd.

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## 2008 Summer Quarterly

Happy summer from our family to you and yours. We are all well and healthy and happy. The sun is shining and the forecast looks bright and the weather reporter says that we have had one of the driest July's on record. Who would have thought only a month ago during that long rainy build up to summer? The kids are happy to be out of school and Christie and I are happy that there are no sports to chauffeur the kids to and from. We have migrated down to Point Roberts for the summer and I have been commuting on my work days to and from Deep Cove. I have set up an office in our home down here to work out of but I must admit it is hard to focus when the pool and beach are so close at hand. This is an experiment in alternative working and so far I like it. I have a separate line for my work and have forwarded my office extension from my office to here on those days that I don't drive into the city. If you call and if I don't answer I promise it's because I am working and not because I am lying by the pool.

### **NEXUS**

Friends often ask me about border lineups for coming to and from the US. I have been part of the NEXUS program since its inception and can recommend that you consider joining even if it is only to travel to the US on an occasional basis.

NEXUS offers a priority line at many of the land border crossing points allowing us to drive right up to the border, flash our NEXUS card in front of the card reader and keep driving. Sometimes they will stop us and ask a few questions but for the most part it is very painless. Another great feature of the NEXUS program are the NEXUS Air benefits. Once you have your NEXUS card you can sign up for NEXUS Air which involves going to the airport NEXUS office and having a picture taken of your retina. Once you have done that you are able to bypass the Immigration and Customs lineups to the US and returning to Canada from anywhere. There is a retina reader in the US Border Services section of the airport that you simply approach and look into. It takes a picture of your retina, asks you two questions and dispenses a card. You take the card to the officer at the customs desk, hand it to him or her and walk through to security. Coming back it works the same way when moving through the Canada Border Services inspection room. Every quarter I travel to Los Angeles for a coaching program and the last time I returned the Immigration lineup completely covered the floor back to the escalators. I was able to walk past the lineups and was out of the airport within 10 minutes of landing on the runway.

The cost is \$80 per person for 5 years and you can now apply online for your NEXUS program. After about two or three weeks you will be contacted to arrange an interview appointment at the downtown NEXUS office which takes about 20 to 30 minutes. You have your picture taken and the NEXUS card is generated while you wait. The link to apply for NEXUS online or to get more information about the NEXUS program is [www.nexus.gc.ca](http://www.nexus.gc.ca).

### **State of the Life Insurance Industry in Canada**

Why should you care? There have been many changes that have taken place behind the scenes in the Life Insurance Industry in Canada. Understanding them will allow you to fully appreciate the planning you have done over the years.

There has been a trend towards consolidation in the Canadian life insurance industry. Over the last 15 years about 35 insurance companies have ceased operations in Canada. The consolidation has created less choice for consumers and agents but has also created system challenges for the remaining insurance companies that have merged because of the challenges of integrating different company systems. When one company acquires multiple companies through mergers and acquisitions Head Offices have a hard time finding staff that can understand the many unfamiliar products that have been brought under one roof.

The trend to consolidate spreads to the reinsurers as well. Reinsurers are companies that share the risk with the retail insurance companies to prevent a retail insurer from being caught with big loss from one or two large claims. There used to be about eight reinsurers with only three remaining. This consolidation has reduced the total number of parties sharing risk and therefore has led to a reduction in total capacity. In other words, because there are fewer reinsurers the supply of risk has reduced. The excess in demand and more limited supply has given the reinsurers more power when it comes to the decision of whether or not to accept non standard risks.

Another trend in the insurance industry was the switch from mutual companies to stock companies. This is called Demutualization. Most companies were once mutual companies which meant that the policy holders were the actual owners of the company and they shared in the profits in the form of dividends that were paid in the policies that they owned with that company. Their ownership was determined by the size of the policy that they owned. The trend to Demutualize started when regulators introduced the Minimum Continuing Capital and Surplus Requirements (MCCSR) rules. It became very expensive from a capital perspective for Mutual Companies to underwrite insurance because their reserving requirements were more onerous than those of public companies. As a result now most major insurers in Canada are public companies putting them under the watchful eye of not only the regulators but analysts and shareholders. Of course this presents another set of challenges because shareholders and analysts create pressure to perform on a short term basis rather than looking at the long strength of the company. Because of this level of scrutiny stock companies are much less flexible with respect to their willingness to make business decisions in fear of repercussions and the negative impact a bad decision can have on a company's reputation. Less flexibility means less innovation and less willingness to think outside the box to provide creative solutions to unique situations. One off decision must be considered as potentially setting precedent.

The accounting scandals of the 90s lead to the downfall of well established companies, including Arthur Anderson, leading to even more scrutiny of financial institutions. The collapse of Enron and Worldcom lead to the Sarbanes–Oxley (SOX) Act of 2002 in the US. This spills over into Canada by way of the fact that any company listing on a US stock exchange must comply with SOX bringing a whole separate level of compliance in addition to Canadian rules. The Office of Superintendants of Financial Institutions (OSFI) in Canada has placed a heavy emphasis on compliance and rigorous processes like those in the banking sector. This has forced insurers to take a hard look at the impact of low interest rates on policy reserves and stress testing reserves and capital.

This change in climate lead to a change in the way insurers do business. Back in the early 90s small insurance companies held onto very small portions of risk of each policy they underwrote and large companies held onto large amounts of risk of each policy they wrote. Business decisions on a particular case were common especially among large carrier because they were holding the majority of the risk without reinsuring. This gave them a competitive advantage over the small insurer who could not afford to take the risk of a business decision going bad. The introduction of the MCCSR rules in the early 90s and the move to Demutualize companies in the late 90s changed all of that. The MCCSR rules created financial incentive for even the large insurers to reinsure larger portions of the risk, putting them on a much more level playing field with small insurers from both a cost of insurance and compliance point of view. Reinsurers gained power because now all insurers had to play by their rules if they wanted to gain access to the now small total insurance capacity in the market place. The amount of risk that an insurer retained dropped from 85% in 1990 to 15% in 2005.

The reinsurer's dilemma is that they have had to face huge rate drops over the years driven by competitive pressures with ongoing pressure to reduce rates further with profit margins very low in

relation to risk. There is very little margin for error and reinsurers have responded by tightening underwriting rules, conducting audits of the retail insurers business and by completely avoiding making business decisions that fall outside of the tightly regulated guidelines.

Participating Whole life insurance that relies on paying dividends to its policy holders has all but disappeared from the insurance market in Canada. Universal Life has become the dominant product in the variable permanent insurance realm. Universal Life is not however immune from the pressures of increased scrutiny by the new era of regulation. The testing of reserves and capital requirements has brought to light the weakness in under pricing Universal Life products as well as Term to 100 products. The lower interest rates and the aggressive position that insurers took with respect to reducing insurance costs have left some companies vulnerable to failing the NCCSR test for reserves resulting in their need to make massive increases to the cost of the insurance products, virtually pricing themselves completely out of the market. Insurers have looked for ways to mitigate their losses and relied on high investment accountant management fees for Universal Life investment accounts. This has been a pet peeve of mine for many years. The only rational way to deal with the under pricing in the insurance market is for insurance companies to take the appropriate step which is to raise rates and in some cases the rate increases will need to be substantial. Who will take the first step is anyone's guess but my guess is that when it happens it will happen quickly and unexpectedly.

The purpose of this discussion about insurance in Canada was to provide you with a background to your decision to buy insurance. The bottom line is that if you have adequate amounts of insurance today you will not regret having purchased it in the past. There will never been a better time than the present to review your insurance requirements.

You may already know that there are only a few companies that I have relied on over the years to provide quality insurance products for my clients. The above discussion gives you an idea of some of the issues that I have considered to be of utmost importance when making an insurance recommendation to you. A paramount issue is the solvency of the company and its pricing practices when pricing their products. They have to be priced so that they keep the company solvent and they have to be competitive. The profitability of the product offering needs to be there so that your company is around when it is needed to pay your survivor's claim. One such profitability factor is the profit that the insurer makes on the investment account of the policy. It has been my practice to recommend RBC's and more recently Industrial Alliance's Investment Credit Facility (ICF) programs. This program has proven to be very successful for RBC Insurance and one of the reasons why it has become very attractive to RBC to maintain and expand is the fact that the interest spread that they take (2%) has proven to be a very powerful support for the viability of their product pricing. They are experiencing less upward pressure than many other carriers that simply offer traditional investment account options. The total credit that RBC has allocated towards this program is approach two billion dollars up from \$50 million when the program was first introduced 6 years ago.

The ICF program is available exclusively through advisors affiliated with PPI Financial Group with which I have had an excellent working relationship for over 20 years. Please call if you have any questions about your insurance or if you would like to know more about trends impacting your insurance program.

### **Living Benefits**

There has been much published in the media about living benefit insurance. This class of insurance includes: Disability Insurance for Income Replacement, Disability Insurance for Business Overhead Expenses, Disability Insurance for Buy Sell agreements, Long Term Care insurance, Critical Illness Insurance and TriAccess US Healthcare Insurance. The most popular products from my own experience have been Income Replacement Insurance, Business Overhead Insurance and TriAccess US Health Care Insurance. Critical Illness insurance and Long Term Care insurance are not as popular as the industry originally thought they might be. Long Term Care insurance holds the greatest appeal to me of these two because of the rapidly rising cost of home care and facility care. Unlike health care in Canada long term care is not tightly regulated and there is a broad spectrum of services available based on ability to pay. Having Long Term Care insurance definitely can limit the cost of care with a high degree of certainty that the insurance will pay a benefit if the appropriate coverage is chosen.

Critical Illness coverage on the other is a very particular and confusing product in the Canadian market place. I am still not convinced it offers great value for the premium dollar. The definitions are not consistent from policy to policy and the opportunities to collect are very specific and typically are available upon the onset of a life threatening illness or condition. The costs are typically quite high and unless they offer access to care as well as cash I think there are other alternatives to consider. Having said that, in the right circumstances, Critical Illness Insurance can offer peace of mind against an abrupt stoppage in income at the onset of a life threatening illness or condition. If you would like more information about living benefits, please call our office.

### **In Closing**

I hope that you enjoy the summer and take some time to reflect on how lucky we are to live in such an incredible country, city and climate. We may have rain, but beyond that, the weather is pretty tame. When the weather is fine it is a great time to reflect on all of the wonderful people and things we have in our life. It is easy to be appreciative when the sun is shining, so my goal will be to keep that appreciation going even when the weather turns in the fall. Summer is a time to practice seeing the good so that we can be happy even when the clouds cover our sky.

All the best, from everyone here at Cove Financial and from the Geiss household.

Sincerely,

**Cove Financial Planning Ltd.**

A handwritten signature in blue ink, appearing to read 'Bernie Geiss', with a horizontal line extending to the right.

Bernie Geiss, CFP, CLU, RHU  
Certified Financial Planner