Information

Canada's Financial Services Sector

September 2002

Canada's Life and Health Insurers

Overview

- Canada's life and health insurance industry comprises 120 firms, down from 163 companies in 1990, and includes companies incorporated both domestically and abroad.
- With the increased consolidation in the industry, the five largest companies account for approximately 59 per cent of domestic general assets, up from about 43 per cent in 1994. The life and health insurance industry employs approximately 113,000 Canadians, of which half are employed full time by the insurers while the remainder work as independent agents.
- Canada's life and health insurance companies had total domestic assets of $267 billion in 2000, ranking them third among the country's financial industries, behind banks ($1,080 billion) and the mutual fund industry ($419 billion).
- Total revenue for the life and health insurance industry in 2000 was roughly $73 billion. Approximately two-thirds of this amount was from premium income and one-third from earnings on investments.
- The domestic market share of Canadian companies has increased over the past decade from 68 per cent to 71 per cent of total premium income collected.
- International operations have become increasingly important to Canadian insurers. Foreign premium income now accounts for over half of the industry's total premium income.
- Retirement products such as annuities, registered retirement savings plans and registered retirement income funds represent one of the fastest-growing areas of the life and health insurance business.
- Regulation of Canada's life and health insurance industry is shared between the federal and provincial governments. With respect to prudential regulation, the federal government, through the Office of the Superintendent of Financial Institutions, supervises the federally incorporated firms (including foreign firms), which account for over 90 per cent of the industry's premium income.
- In June 2001 the Government of Canada passed legislation reforming the regulatory framework governing the financial services sector, including the life and health insurance industry. The legislation came into force in October 2001.

Introduction

The life and health insurance industry plays an important role in the lives of Canadians by providing insurance against unexpected events and helping individuals plan their financial future. Traditional insurance, such as life and health, spreads risk across many persons to insure against loss of life, serious disability affecting employment, or the need for additional medical attention.

In 2000 about 24 million Canadians and their dependants were covered by some form of life and health insurance, with domestic firms accounting for 71 per cent of that business. Further, the total value of life insurance owned by Canadians was over $2 trillion, almost double the amount owned only 10 years earlier. While the industry has traditionally been focused on life and health insurance products, there is now an increasing focus on wealth management and retirement products.

Structure of the Industry

In 2000 Canada's life and health insurance industry comprised 120 firms, down from 163 companies in 1990 (see Table 1). This decline is largely the result of foreign insurers selling their operations to Canadian insurance companies, although there has been significant merger and acquisition activity among Canadian companies as well.

In 2000 the five largest companies accounted for approximately 59 per cent of the domestic general assets of the Canadian life and health insurance market, up from about 43 per cent in 1994. These insurers are all Canadian-controlled firms that continue to gain market share over foreign insurers.

Approximately 113,000 Canadians are employed in the life and health insurance industry, making it a significant contributor to Canada's economy. About 56,000 people are employed full time by the insurers while the remainder work as independent agents. The life and health insurance industry employs more people than the forestry, chemicals, or pulp and paper sector.

Table 1

Category		Number of firms (2000)	Percentage of premium income (%)
By incorporation	Canada	71	91
	U.S.	39	4
	Europe	10	5
	Total	**120**	**100**
By registration	Federal	94	92
	Provincial	26	8
	Total	**120**	**100**

Source: Canadian Life and Health Insurance Association Inc.

Life and health insurers' products

Canada's life and health insurance companies figure prominently in the market for life insurance, private sector health insurance (which complements public insurance plans) and annuities, which include private pensions. Life insurance now makes up a smaller proportion of premium income, while savings products such as annuities have assumed a greater prominence. For example, in 1970 annuities, including group and individual retirement products, accounted for only 19 per cent of premium income; by 2000 they represented 53 per cent. The aging of Canada's population and increased demand for retirement income are seen as the main reasons for the increase.

Life insurance (25 per cent of total premium income)

Sales of life insurance have grown rapidly in recent years, with individual insurance showing faster growth than group insurance. Individual life insurance can be classified into two basic types: term insurance and permanent insurance. Term insurance offers benefits on death only and does not build up cash value. The premiums are lower in the initial years and increase over time to reflect higher mortality rates at older ages. Policies usually terminate at a specific age – e.g. 65, 70 or 75. Alternatively, permanent insurance offers more than death protection. These policies build cash value to help meet financial emergencies, pay for specific goals or provide retirement income. The policyholder who redeems the policy is entitled to its cash value. About 17 million Canadians own some form of life insurance.

Health insurance (22 per cent of total premium income)

While Canada has a publicly funded system of medical and physician services, life and health insurers play an important role throughout the country in funding health services not covered under government programs. These services include extended health care benefits, dental insurance, travel insurance, disability income insurance and accidental death and dismemberment benefits. Canada's life and health insurance companies provide over 90 per cent of Canada's private health insurance, with the remainder provided by some property and casualty insurance companies. In 2000, 24 million Canadians had extended health care insurance, 16 million had dental insurance and 8 million were covered by disability income insurance. Much of this insurance is provided through benefit plans provided by employers for their workers.

Annuities (53 per cent of total premium income)

Annuities include group retirement plans and individual retirement products administered by insurers. Group retirement plans include private pension plans sponsored by employers and known in Canada as registered pension plans. They play an important role in Canada, with about 41 per cent of eligible Canadian workers belonging to such plans. Individual retirement products include annuities that are in the process of being paid out, such as life annuities and registered retirement income funds, as well as annuities still in the accumulation phase, such as registered retirement savings plans. Total premiums received from annuities rose by 17 per cent in 2000 over the previous year as demand for segregated – or market-based – investment remained strong (see the box "What Are Segregated Funds?").

Distribution Network

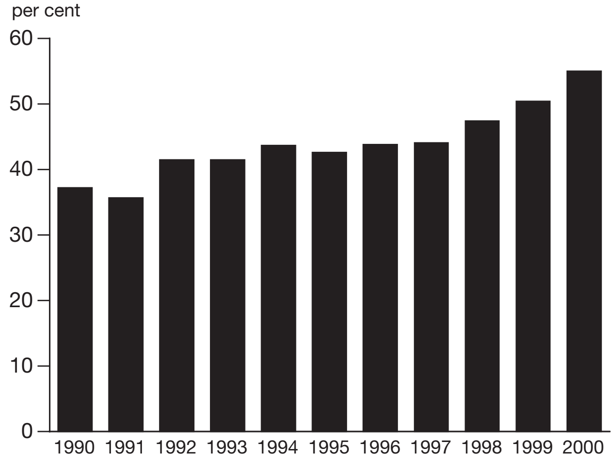
Individual life insurance products are distributed by full-time career agents, who tend to represent a single company, or by independent agents, who sell the products of any insurer. Both career and independent agents are paid sales commissions to cover their expenses, although career agents usually receive additional payments such as pension benefits and access to employer-paid training. While the majority of individual insurance products are sold through career or independent agents, other distribution channels include telephone and mail solicitation as well as sales over the Internet.

Group life and health insurance is usually distributed through employer-sponsored benefit plans and sold through a competitive bidding process, which helps minimize the cost of product distribution.

International Operations

Life insurance services are sometimes characterized as Canada's most important financial services export. Over a dozen Canadian life and health insurance companies operate branches and subsidiaries in more than 20 countries. Foreign premium income for the industry has been growing steadily in recent years, increasing from 37 per cent in 1990 to 55 per cent in 2000 (see Chart 1). Although the United States provides the bulk of foreign premium income, life and health insurance companies are active in other markets, particularly the United Kingdom and Asia.

Chart 1
Percentage of premium income derived from foreign sources



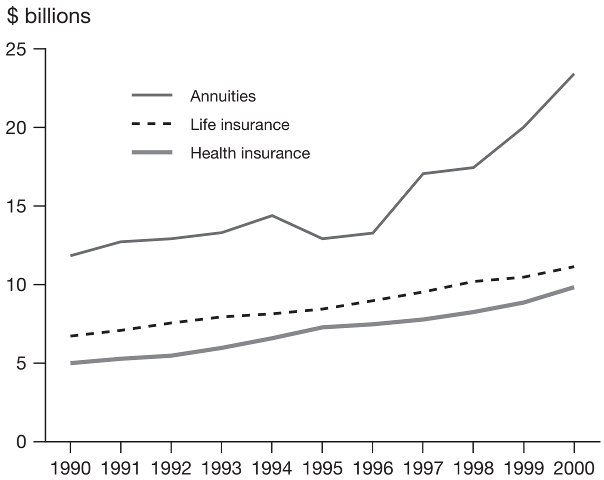
Source: Canadian Life and Health Insurance Association Inc.

Canadian companies collect more premium income abroad than foreign-owned companies collect in Canada. Indeed, the share of total premium income collected in Canada by Canadian companies has increased over the past decade from 68 per cent to 71 per cent. This trend is expected to continue as the domestic industry further consolidates.

Income

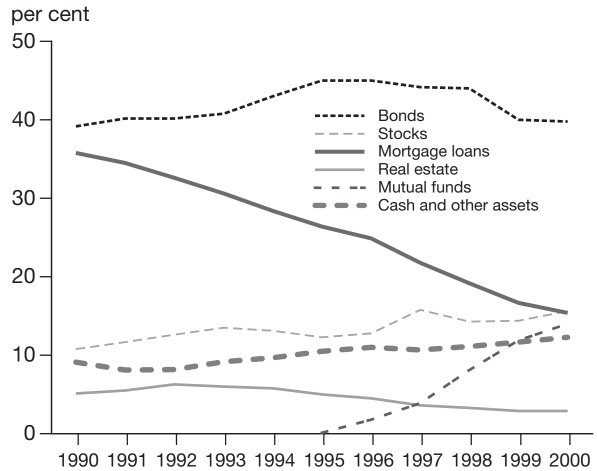
Life and health insurance companies receive revenue from premium income (i.e. premiums paid by policyholders) as well as from earnings on investments. Premium income accounts for about two-thirds of industry revenues, with earnings on investments accounting for the rest. Total premium income in 2000 was $44.4 billion, of which 53 per cent was from annuities, 25 per cent from life insurance policies and 22 per cent from health insurance (see Chart 2). Total premium income grew by over 12 per cent in 2000, above the average annual rate of 6.5 per cent during the 1990s.

Chart 2
Premium income by product type (individual and group)



Source: Canadian Life and Health Insurance Association Inc.

Chart 3
Life and health insurers' asset allocation



Source: Canadian Life and Health Insurance Association Inc.

Assets and Liabilities

At the end of 2000 Canada's life and health insurance companies reported domestic assets of $267 billion. Chart 3 shows the asset allocation of the Canadian life and health insurance industry. At the end of 2000 total domestic assets were allocated as follows: 40 per cent bonds, 16 per cent stocks, 15 per cent mortgage loans, 14 per cent mutual funds, 3 per cent real estate, and 12 per cent in cash, policy loans and other assets. Over the past decade the percentage of assets in mortgage loans has declined steadily owing to the sharp decline in commercial real estate values in the early 1990s, while the percentage in stocks and mutual funds has increased.

Assets can also be broken down into general assets and segregated fund assets, with general assets making up 70 per cent of total assets and segregated assets the remaining 30 per cent. The assets in a segregated fund are held and managed separately from the other assets of the firm and are used for investing funds from individual and group retirement plans and annuities. General assets include all other assets of life and health insurance companies. In 2000, 42 per cent of the life and health insurance industry's segregated assets were held in mutual funds, 31 per cent in stocks and over 14 per cent in bonds.

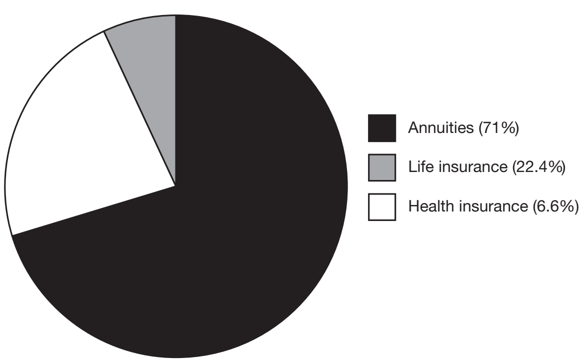
At the end of 2000 domestic actuarial liabilities (i.e. funds needed to honour future benefits and expenses plus an allowance for adverse experience) equalled $212 billion, or 79 per cent of total domestic assets of Canada's life and health insurers. Chart 4 shows the industry's liability distribution. The majority of the liabilities are for annuities, which made up 71 per cent of total liabilities in 2000. Life insurance accounted for about 22 per cent of total liabilities and health insurance for the remainder. The liability distribution has been relatively stable over the past decade.

What Are Segregated Funds?

Segregated funds, available only from life and health insurance companies, are similar to mutual fund products offered by other financial institutions in that they offer shares of investment funds in a variety of securities (e.g. equities, bonds, balanced funds). However, they differ from mutual fund products in that a minimum percentage of the investment – usually 75 per cent or more – must be returned to the investor when the fund matures. The term "segregated" is used because the funds must be kept separate, or segregated, from the other assets of the insurance company. Segregated funds are used for the investment of contributions to group pension plans as well as the investment of funds from individual annuities.

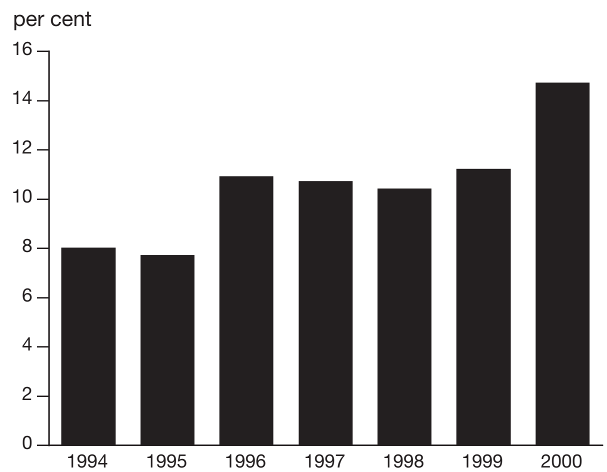
With almost $90 billion of assets, segregated funds are making up an increasingly greater proportion of the industry's total assets, representing 30 per cent of the domestic life and health insurers' total assets in 2000. This represents an 18 per cent increase over the 1999 figure of $76 billion and almost five times the 1990 level. Although segregated funds have tended to be invested largely in common stocks and bonds, mutual funds are now the largest investment vehicle.

Chart 4
Life and health insurers' domestic liabilities, 2000 year-end



Source: Canadian Life and Health Insurance Association Inc.

Chart 5
Life and health insurers' return on equity



Source: Conference Board of Canada.

Return on Equity

The life and health insurance industry reported a return on equity (ROE) of over 14 per cent for 2000, well above the ROEs posted at the beginning of the 1990s and above the average of 10 per cent for the 1994-99 period (see Chart 5). The increase in profitability is primarily attributable to the increasing popularity of insurers' products, particularly wealth management and retirement products.

A New Legislative Framework – Demutualization and a New Ownership Structure

In June 2001 the Government of Canada passed legislation reforming the regulatory framework governing the financial services sector, and the legislation came into force in October 2001. This legislation includes measures affecting the life and health insurance industry. Demutualized insurers[1] with under $5 billion in equity are automatically eligible to be closely held, while those with over $5 billion in equity will, as a matter of government policy, continue to be widely held (i.e. an individual or firm is limited to 20 per cent of voting shares). Also, as a matter of policy, large banks are not permitted to acquire or merge with large demutualized insurance companies and vice versa. This restriction also applies to large bank or demutualized life and health insurance holding companies. The threshold above which all financial institutions, including life and health insurance firms, must have a 35 per cent public float was raised from $750 million to $1 billion.

The legislation also includes provisions that allow life and health insurance companies access to the Canadian Payments System, which is the clearing and settlement system for processing cheques and other types of payment items between financial institutions. This change allows life and health insurance companies to offer a broader range of services, including payment services to customers similar to those found in deposit accounts offered by banks.

Financial service providers, including demutualized insurance companies, also have the option of restructuring under a holding company structure, which provides them with the potential for greater operational efficiency and lighter regulation.

There are also measures in the legislation to empower and protect consumers of financial services. The Financial Consumer Agency of Canada, established in October 2001, is responsible for enforcing the consumer-oriented provisions of the federal financial institutions statutes, monitoring the industry's self-regulatory initiatives designed to protect the interests of consumers and small business, promoting consumer awareness and responding to general consumer inquiries.

Regulation and Supervision

The federal and provincial governments share jurisdiction over life and health insurance companies. In practice, the industry is largely regulated for financial soundness by the federal government as federally incorporated companies account for over 90 per cent of total premium income of life and health insurers. While provinces reserve the power to ensure that federally incorporated companies conducting business in their respective jurisdictions are financially sound, all provinces, with the exception of Quebec, accept federal regulation in this regard.

[1] Insurers that are owned by shareholders, as opposed to mutually owned insurers, which are owned by policyholders.

In addition, the majority of provinces have agreements with the federal regulator to carry out prudential supervision of provincially incorporated companies on their behalf.

Federal oversight is administered by the Office of the Superintendent of Financial Institutions (OSFI), which is responsible for supervising financial institutions, including life and health insurers, to ensure that they are in sound financial condition and in compliance with the law that governs federally regulated financial institutions. If they are found lacking in this regard, OSFI can advise management and require remedial action to be taken. In undertaking this work, OSFI measures life and health insurance companies' capital adequacy by applying the Minimum Continuing Capital and Surplus Requirements (MCCSR) guideline.

The MCCSR measures the minimum capital and surplus required by a company, adjusted for risk factors of the business and its investments, to ensure assets are sufficient to cover its liabilities. It has two main components. First, a risk-based formula is applied to determine how much capital is required by the firm. Then the amount of capital or "margin" which is needed to meet this risk-based requirement is assessed. If the capital of the firm falls below 120 per cent of the minimum required, the company must provide OSFI with detailed plans for raising capital. At the end of 2001 Canadian firms were well above 120 per cent of the minimum required, with over 200 per cent of available capital. Companies are also required to submit annual reports to OSFI detailing financial data, including their assets, liabilities, receipts and disbursements.

All insurers are subject to market conduct regulation by the province in which they operate. This includes the licensing and marketing of insurance company products, standards of competence and behaviour of insurance agents, and consumer protection. The provincial acts governing insurance contracts and beneficiary rights are modelled on the Uniform Life Insurance Act, which is a model law adopted by the Canadian Council of Insurance Regulators to regulate life insurance policies. While Quebec has not adopted this act, its regulations in this area are very similar. All provinces, including Quebec, continue to pursue further harmonization.

Policyholder Protection

Since 1990 life insurance policies, accident and sickness policies and annuity contracts in Canada have been guaranteed up to certain limits by the Canadian Life and Health Insurance Compensation Corporation (CompCorp), a private, non-profit corporation created and financed by the life and health insurance companies. This plan provides policyholder protection in the event of loss of policy benefits due to the insolvency of their life and/or health insurance company. Coverage is $200,000 for death benefits under life insurance policies, $60,000 for cash accumulation plans and health benefits, and $2,000 per month for disability and regular annuity income benefits. With few exceptions, CompCorp's membership includes all insurance companies licensed in Canada to sell life and health insurance to the public. (For further information, see CompCorp's Web site at: http://www.compcorp.ca/.)

Future Challenges

Like other players in the financial services sector, the life and health insurance industry is undergoing rapid change. Technology is having an impact on all aspects of the industry, from distribution to online trading of company shares. Consumers have greater access to insurance products, whether they are domestic or foreign, and can purchase those policies which best meet their needs. Competition is also increasing from other financial institutions including banks and mutual fund dealers, which offer a wide range of investment products. Growth in information technologies is also globalizing financial markets and has led to a significant increase in cross-border financial transactions.

The industry also faces challenges from the changing demographics of the North American population. The strong popularity of annuities is partly due to the desire by the baby boom generation for retirement income. As this segment of the population ages, annuities are expected to make up a larger portion of the market. The proportion of annuities being paid out will also likely increase. In addition, the aging of the population will likely affect claims paid out for the more traditional life insurance products.

In the face of these pressures, the life and health insurance industry continues to consolidate. Industry analysts expect this trend to continue, as demutualization provides the share capital needed for acquisitions. Some smaller life and health insurance firms may meet these challenges by focusing on niche markets.

The legislation to reform the regulatory framework governing the financial services sector is intended to support the life and health insurance industry in meeting these challenges by providing a flexible environment in which to operate, while maintaining strong prudential regulation. The new framework maintains the long-standing practice of ensuring regular reviews of the regulatory framework by including an automatic five-year sunset clause in the legislation. The Government is also prepared to revisit the legislation prior to the five-year review, if necessary, to ensure the framework keeps pace with the rapidly changing marketplace.

Annex 1

Concentration in the Canadian life and health insurance industry: domestic general assets, 2000

	Domestic general assets	Market share
	($ billions)	(%)
The Great-West Life Assurance Company	27.7	15.2
Clarica Life Insurance Company[1]	25.8	14.2
Manulife Financial Corporation	22.0	12.0
Sun Life Financial Services of Canada Inc.	17.7	9.7
Canada Life Financial Corporation	14.6	8.0
Total (top 5)	107.8	59.0
Industry Total	182.6	100.0

Note: Numbers may not add up due to rounding.

[1] In May 2002 the Government of Canada approved the acquisition of Clarica Life Insurance Company by Sun Life Financial Services of Canada Inc.

Sources: Moody's Investors Service, Canadian Life and Health Insurance Association Inc.

Annex 2

Top 10 firms by total assets (general and segregated), consolidated basis, 2000

Company	Total assets ($ millions)
Manulife Financial Corporation	114,944
Sun Life Financial Services of Canada Inc.[1]	106,238
Canada Life Financial Corporation	55,082
The Great-West Life Assurance Company	51,990
Clarica Life Insurance Company	39,315
Industrial Alliance	14,011
The Maritime Life Assurance Company	11,510
Transamerica Life Insurance Company of Canada	9,048
The Imperial Life Assurance Company of Canada	4,857
The Empire Life Insurance Company	4,286
The National Life Assurance Company of Canada	4,183

Note: Includes assets from operations in Canada and in other countries.

[1] In May 2002 the Government of Canada approved the acquisition of Clarica Life Insurance Company by Sun Life Financial Services of Canada Inc.

Source: Moody's Investors Service.

Further information on legislation to reform the financial services sector can be obtained from the Department of Finance at http://www.fin.gc.ca/. Additional information on the Canadian life and health insurance industry is available from the Office of the Superintendent of Financial Institutions at http://www.osfi-bsif.gc.ca/ and from the Canadian Life and Health Insurance Association Inc. at http://www.clhia.ca/.

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