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## JUNE 2016

## SPECIAL BULLETIN

- Canadian Bank Sector
- Impact of Bank Layoffs on Your Financial Well-being
- Comparing Independent Financial Advisor to Institutional Financial Consultant
- Mortgage Insurance as a Bank Product

# SPECIAL BULLETIN – CANADIAN BANK SECTOR

This newsletter will focus on Canadian banks. This is not by chance, but because there are many interesting changes taking place in the Canadian banking world. Given that most of us have dealings with banks, some of these transformations in business practices will undoubtedly affect you and most others in the community.

The business of banking is competitive. Consequently, Canadian banks must increasingly compete in a world market. In 2014 PWC Canada, an organization vested in the Canadian banking industry, reported that Canadian banks were doing well in 2013, but noted "risks and challenges loom under the surface with downward pressure on return on equity and an ever changing regulatory environment."

Some of these risks have now come to fruition for a multitude of reasons. The average debt load of individual Canadians is at record highs and continues to grow. This is the other side of those wonderfully seductive low interest rates that have been available over the last few years for mortgages and consumer goods. Extending credit to clients already overextended financially is simply not good banking or a prudent business practice. A rise in interest rates would have a traumatic impact on the recovery of those loans.

This scenario has been exacerbated by the dramatic fall of oil prices. Loans based on the economic security of a $100 a barrel oil price look much different when the price is below $50. In areas of Alberta and other oil-fueled economies, housing prices and employment have fallen significantly exposing many marginal mortgages and loans.

Regulatory issues within Canada and abroad have also affected Canadian banks. According to the Canadian Bankers Association, "The most significant changes to global banking rules are in the areas of capital and liquidity. Both the quantity and quality of capital – which helps banks absorb losses – has been increased."
Since the crash of the US banking sector in 2008, financial markets have become more globally integrated. In Canada, there are now more stringent mortgage qualifications and much more disclosure of investment costs to clients. All of these changes make banking more difficult.

As we can see from the banks readjustments to both clients and shareholders, there are changes required to maintain traditional banking profits. Those changes will be felt by most Canadians.

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## THE IMPACT OF BANK LAYOFFS ON YOUR INVESTMENT WELL-BEING

Thomas Flynn, the chief financial officer of the Bank of Montreal stated, “Customers are increasingly doing things in a digital way – either mobile or online.”

That’s certainly true. Banks are complicit in shifting their clients to digital banking. When you next visit your bank, you will likely meet a cheerful individual just inside the door who will be happy to assist you in learning the convenience of banking through the ATM, or help you discover the magic of banking anywhere in the world with your mobile unit.

Those of us who feel technically savvy will breeze on by, but we’ll give a nod of approval to this person. Others who would like a little assistance with the technological aspects of hands-on banking will appreciate the thrill of independence and personal power such mastery brings. All this wonderful technology provides us with expedited services that saves us time and money.

But at what cost? MIT academic Erik Brynjolfsson foresees dismal prospects for many types of jobs as powerful new technologies are increasingly adopted not only in manufacturing, clerical, and retail work, but also in professions such as financial services.

The shift towards automation means less service people are required. That’s having a big impact on job security for bank employees. BMO is anticipating laying off over 1850 staff members over the next year on top of the over 650 last year. Scotia Bank has terminated the employment of over 1500 staff and CIBC has started the process with 500.

The realignment of services and costs taking place throughout the Canadian banking industry towards service automation and the resulting layoffs will theoretically help banks address their bottom lines. That makes bank shareholders happy and justifies the high personal earnings of CEOs who are dedicated to bringing their respective banks up to speed. In the bank management culture, a positive impact on the bottom line is deemed crucially important.

And while we might feel a momentary pinch of guilt when we realize our lessened need for that congenial teller manning the counter will cost someone their job, our guilt may well be dissipated when we smugly realize our increased personal proficiency with banking technology will allow us to avoid those tedious line ups for the counter.

However, there are greater issues at stake that are necessary to understand for the protection our financial well-being. The problem is not simply technology and the savings generated through offloading banking administration to “do-it-yourself” clients, it is also a reflection of the health of our Canadian banks and how robust their service can be.

Jim Shanahan, senior analyst for Edward Jones, states “The banks are responding to a very difficult loan growth and revenue growth environment by getting a lot more aggressive with expenses." He goes on to discuss how Canadian banks are currently over-exposed to oil patch loans and residential mortgages. Investors are increasingly betting against Canada's financial institutions as growing evidence suggests our country's biggest banks – recently considered among the safest in the world - are now struggling to grow their earnings.

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## THE IMPACT OF BANK LAYOFFS ON YOUR INVESTMENT WELL-BEING - Continued

Lack of bank earnings are compounded by record high Canadian indebtedness across the country which has substantially slowed the growth in new loans, despite historically low interest rates.

So the issue becomes, “How does all this affect **the well-being of the bank’s investment clients?”**

Layoffs in the banks are across the board. That means front end staff, senior executives and consultants. Within this group of consultants are a large number of financial advisors - the individuals who are responsible for providing sound financial advice to clients.

Scotia Bank just released 7% of their financial advisors because they were not bringing in the revenue that once would have qualified them for bonuses.  Within the banking system, all advisors are subject to personal performance assessments which are based on the development of new clients and selling bank products. These assessments do not consider client satisfaction, but are based on quota sales of bank products.

Most clients rely on a trusted professional with a comprehensive understanding of the changing complexities of our financial needs. Perhaps we’re going to need more than a 1-800 number and a faceless website to ensure our future financial welfare?

If you have any questions or comments in this regard or require clarification, please feel free to call.

## HOW DOES AN INDEPENDENT FINANCIAL ADVISOR COMPARE TO AN INSTITUTIONAL FINANCIAL CONSULTANT?

Given the ongoing changes in the philosophy of Canadian banks towards investors, particularly small investors, this is more than a good question.

So let us list and examine some of the major differences:

1. Independent financial advisors are business owners. Their success depends on how well they run their businesses and how well they service their client base. The costs of their offices, equipment and staff are theirs alone. Many will align with major financial firms, such as Raymond James, to take advantage of more sophisticated investment research and the economies of larger processing and compliance systems. But in every case, the responsibility to their clients is based on their specific investment and business philosophies. Most established advisors grow their businesses through referrals which generally assures that a very competent level of service has to be offered. Responsiveness to clients through effective client servicing is the life blood of their businesses.

   In the institutional sector, specifically banks and credit unions, advisors are essentially employees, and as such are subject to performance assessments. Although there can certainly be referrals, the majority of new clients are provided by front line staff who are trained to direct clients with financial needs to the appropriate staff. This scenario characteristically leads to very large client bases for each representative.

   There are also some firms where the representatives function under a company umbrella. In this case the advisors cover most of their own expenses except office, processing and marketing materials. However unlike independent advisors, the client bases are considered the property of the umbrella firm.

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## HOW DOES AN INDEPENDENT FINANCIAL ADVISOR COMPARE TO AN INSTITUTIONAL FINANCIAL CONSULTANT? - continued

2. Independent financial advisors are not subjected to "personal assessments." Like the banks, their bottom line will indicate how efficiently they are running their businesses.

   This contrasts to institutional advisors who may direct investments to a wide spectrum of opportunities, however their corporate personal assessments and income will be primarily based on their promotion of bank products.

3. Independent financial advisors tend to development at a much higher level of personal expertise and financial knowledge. Under the institutional systems, advisors are encouraged to quickly delegate more sophisticated investment scenarios, advanced financial structuring and tax considerations to higher levels in the banking system. Consequently, clients must trust that the bank advisor is fully knowledgeable and perceptive in the recognition or potential problems or opportunities. Because independent financial advisors characteristically take complete responsibility for the implementation of the total financial process, they generally build very good professional relationships with appropriate accountants, lawyers and advisory firms. Most also have the capability to recognize where insurance solutions will be advantageous to the client.

4. Perhaps the most significant factor, in terms of client servicing and developing a more integrated relationship with your financial advisor, is the aspect of accessibility. Most independent financial advisors pride themselves on their availability to clients and their timely response to client requests. Small business owners know their clients well. As independent advisors have considerably smaller client bases, there is much less tendency to divide clients into a type of hierarchical service formula based on the client's level of investment.

Having made these differentiations between independent and institutional financial advisors, there will always be independent advisors and institutional advisors who do not perform to the level you should expect. Ultimately you are responsible for your own wealth development and financial security. Consequently, you should always make your expectations clear to your advisor regardless of their independence or lack of independence.

Feel free to call if any clarification is required.

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## MORTGAGE INSURANCE AS A BANK PRODUCT

**This article is based on the recent CBC program Market Place that reviewed the approach of Canadian banks to mortgage insurance.**

Mortgage insurance: It seems like a responsible way to ensure your family will be cared for should anything happen to you and it fits easily into any budget. All you have to do is read the form, answer "yes" or "no" to a questionnaire about your health, then the bank employee shakes your hand and congratulates you on your wise choice. You don't even have to go through any medical exams. Good decision. Or is it?

Most people assume that once you fill out the health questionnaire and the bank starts to collect payments, you've qualified for the insurance. That's the way it's supposed to work, right?

It turns out that isn't the way this insurance product works. When you complete the form, all you are really approved for is to pay the premium. You are not approved for coverage the way you are with traditional life insurance. Your application and your health is not actually reviewed until you file a claim, meaning, you don't find out if you're covered until something bad happens and you ask for the money. This practice is called "post-claim underwriting".

"What the insurance industry is doing on these mortgage policies is foregoing all that expense, and only investigating the few that die," says Jim Bullock, an insurance broker and expert witness in lawsuits. "It costs them money for blood tests, urine tests or chest x-rays."

That's good for the insurance companies, but not so good for you. The questionnaires they provide are not consumer friendly. They are full of generalities that few people are knowledgeable enough to answer correctly. Bullock says mistakes are inevitable when filling out complex questionnaires. People forget about health issues that result in a doctor's visit, but turn out to be false alarms.

Consider the question, "Have you ever been *tested* for high blood pressure?" If you don't have high blood pressure, you would very likely answer "no", however, did you know a test for high blood pressure is simply the pressure cuff the doctor, as a matter of course, puts on your arm to test your blood pressure? Therefore, you have been tested and you may very well be disqualified – a definite reality check.

"These (questionnaires) are terrible," says Bullock. "If they really wanted to develop the information correctly, they would break all these generalities in about thirty specific yes or no questions."

Since the majority of the bank's mortgage advisors are not licensed to sell insurance, they are unable to clarify or answer any questions you may have. Indeed, they are not objective advisors. They are paid to sell you the policy. Past bank mortgage advisors have come forward and admitted they were even coached by management to use a little psychology. For instance, if you refuse the insurance, they may, in a last ditch effort to get you to comply, say something along the lines of, "If you sign this waiver of refusal, you and your family will not be protected if something should happen to you."

It seems bank management doesn't find it unconscionable to induce a little anxiety while you are in a vulnerable state making a huge life decision.

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## MORTGAGE INSURANCE AS A BANK PRODUCT - Continued

And the banks? They are laughing all the way to… well, themselves. The major banks are making billions of dollars pushing mortgage insurance every year. The big three insurers, who provide mortgage insurance to Canada's big five banks keep the disqualification rates a closely guarded secret. There is no way to even know the statistics on whether or not you will be successfully insured. Currently there is very little consumer protection legislation with the exception of Alberta, which made it mandatory for anyone selling insurance to be licensed. The insurance companies fought that decision all the way to the Supreme Court.

Three more things you should know about mortgage insurance. It is more expensive compared with the same coverage using traditional life insurance, and the products are less flexible. Most policies are tied to both the property and the bank, so if you move or switch to a different lender, your policy cancels.

If you pass away and you end up being disqualified for coverage by your mortgage insurance, at least the bank will give the premiums you paid back to your loved ones. It's the absolute least they could do. A small consolation for your family who will have to deal with the unexpected burden of debt.

A qualified insurance professional would also disclose that you are purchasing a declining value product. Every mortgage payment you make, pays off some of the original principal.  For example after 10 years, a policy for $250,000 at a 3.5% mortgage rate only has to pay out $174,888 – if you actually qualify! Yet, your payment does not change to reflect this drop in value. Ironically, your very last mortgage insurance payment will be worth more than the payout.

Your professional financial adviser is aware of alternatives that will protect your family's future responsibly.