



*Insolvency protection for home, car and business
insurance consumers*

**Proposed
2010-12 Plan
and 2010 Budget**

November 2009

Contents

	Page
Message from the President	1
Recent accomplishments	2
Key deliverables for the year ahead	3
Mission and principles	4
PACICC's planning process	5
Enterprise Risk Management report	6
Priorities for the period 2010 to 2012:	
Strengthening provincial solvency supervision (2010).....	8
Promoting risk management (2011).....	9
Federal financial sector legislative review (2012).....	10
PACICC's operations priorities for 2010 to 2012	11
Update on PACICC Fund balances.....	12
Projected 2009 revenue and spending, and proposed 2010 budget	13

Message from the President

This is a difficult time for Canadians. Unemployment is rising. Financial markets remain troubled. Government deficits have ballooned. Nevertheless, the property and casualty insurance industry has provided an element of stability for consumers. Indeed, most insurance companies are well-capitalized and there was relatively little impact on the industry from the global financial crisis.

However, this year and next will be a period of rising costs, poor earnings and increased insolvency risk for insurance companies. The cost of vehicle collisions has risen. There has been a marked increase in storm damage. And insurers have seen a reduction in the value of their investments. The introduction of the harmonized sales tax further adds to the cost of providing insurance in Ontario and British Columbia.

As the insurance industry approaches the weakest point in the insurance cycle, the risk of insolvency is on the rise. Indeed, over the past 30 years, four or five insurance companies, on average, fail each cycle, and most of these have failed within the first year or two of recovery. Presently, while the insurance industry as a whole continues to report healthy capitalization, some companies are experiencing a marked deterioration in their financial health.

PACICC is well-prepared to respond to the next insolvency. We remain focused on protecting policyholders from undue financial loss by minimizing the risk and costs of insurer insolvencies.

Paul Kovacs
President and CEO
PACICC

Recent accomplishments

Corporate governance (2004)

PACICC's corporate governance was modernized by: adopting a corporate mission; reducing the size of the Board to enhance efficiency; introducing more competitive compensation for public directors; implementing regularly-scheduled Board meetings; streamlining the Board's Committee structure; introducing an annual self-evaluation of Board performance; and enhancing disclosure by issuing an Annual Report.

Financial preparedness (2005)

The Corporation's financial preparedness was enhanced by: member insurers agreeing to double the potential maximum annual insolvency assessment; increasing current capacity from \$250 million to \$500 million; building a model to anticipate the ultimate cost of future insolvencies; and construction of the Financial Impact and Risk Evaluation model to simulate the impact of shocks on the financial health of member insurers.

Coverage and benefits (2006)

We led a comprehensive review of the coverage and benefits paid to policyholders, ensuring that Canadians remain well protected in the unlikely event that a member insurer fails. PACICC harmonized the lines of insurance covered to accord with the new classes of insurance recommended by the Canadian Council of Insurance Regulators, and increasing the maximum benefit for personal property claims from \$250,000 to \$300,000.

Enterprise risk management (2007)

PACICC developed an ERM plan and strategy that is now a permanent feature of our corporate governance practices. Initial action plans focus on mitigating our six highest-rated risks. Leading by example, PACICC is actively encouraging all member insurers to embed ERM plans in their governance practices.

Insolvency legislation (2008)

PACICC championed the call for a comprehensive review of the *Winding-Up and Restructuring Act* (WURA), identifying changes that would improve the insolvency management framework for PACICC, our members, liquidators and regulators. Submissions outlining key reforms to the WURA were made to the Standing Senate Committee on Banking, Trade and Commerce and to the Federal Department of Finance.

Reducing insolvency contagion risk (2009)

PACICC undertook several projects during 2009 aimed at reducing the potential for an insurance company failure to impose financial hardship on other insurers. These include: participating in the review of the reinsurance market in Canada led by OSFI and AMF (our input highlighted the need for adequate insolvency clauses in reinsurance contracts); communicating our research findings regarding the adverse effects of rate regulation on insurer solvency, as part of PACICC's series of *Why insurers fail* studies; and setting out options to enhance our capacity to respond to the winding-up of a large insurer.

Key deliverables for the year ahead

PACICC's main focus in 2010 will be on launching a discussion about options to strengthen the solvency supervisory standards and practices that apply to provincially-incorporated P&C insurance companies. To do this, PACICC will review the solvency supervisory systems for provincially-licensed insurers in Canada in relation to the international best regulatory practices set out by the International Association of Insurance Supervisors (IAIS) in their report *Common Structure for the Assessment of Insurer Solvency*. As part of the process, we will develop a toolkit for enhancing solvency supervision that could be made available to provincial supervisors and legislators. Findings and recommendations regarding necessary reforms will be communicated in a position paper for Ministers, policy staff and provincial regulators.

Beyond the activities described above, PACICC is proposing several enhanced activities to support stronger provincial solvency supervisory frameworks if resources are available. The goal would be to actively champion the need for legislative reforms in target jurisdictions. This work would include information seminars involving issue experts to more effectively communicate PACICC's recommendations for strengthening provincial solvency supervision, and development of specific legislative and regulatory reform proposals.

We also plan to complete case study research on the failure of Advocate General Insurance Company, the largest PACICC member insolvency. This will be the fourth paper in PACICC's *Why insurers fail* series of research studies.

With respect to PACICC's corporate governance and operations in 2010, we plan to:

- implement the recommendations from PACICC's five-year corporate governance review, including the adoption of a written Board mandate and a *Code of Ethics and Business Conduct* that applies to all Directors and employees of PACICC
- evaluate the effectiveness of joint communications efforts undertaken with the Insurance Brokers Association of Canada to help ensure that brokers are able to partner actively with PACICC in the event of a member-company failure
- explore with insurance regulators and liquidators the concept of an industry liquidity facility to enhance PACICC's ability to respond to extraordinary insolvency events; and consult with PACICC member insurers about a possible counter-cyclical funding mechanism.

Mission and principles

Mission Statement

The mission of the Property and Casualty Insurance Compensation Corporation is to protect eligible policyholders from undue financial loss in the event that a member insurer becomes insolvent. We work to minimize the costs of insurer insolvencies and seek to maintain a high level of consumer and business confidence in Canada's property and casualty insurance industry through the financial protection we provide to policyholders.

Principles

- *In the unlikely event that an insurance company becomes insolvent, policyholders should be protected from undue financial loss through prompt payment of covered claims.*
- *Financial preparedness is fundamental to PACICC's successful management support of insurance company liquidations, requiring both adequate financial capacity and prudently managed compensation funds.*
- *Good corporate governance, well-informed stakeholders and cost-effective delivery of member services are foundations for success.*
- *Frequent and open consultations with members, regulators, liquidators and other stakeholders will strengthen PACICC's performance.*
- *In-depth P&C insurance industry knowledge – based on applied research and analysis – is essential for effective monitoring of insolvency risk.*

PACICC's planning process

PACICC's Board of Directors has established a formal planning cycle focused on two regular meetings during the calendar year:

- **Spring** – PACICC staff present their evaluation to the Board summarizing the business environment for the Corporation, industry capitalization and measures of solvency risk. Staff analysis of individual company results remains confidential, so discussion with the Board focuses on trends in the number of insurers with weak regulatory capital scores, rapid premium growth, significant adjustments in loss reserves, and identification of member insurers unwilling to share financial results or other signs of vulnerability. Enterprise risk management (ERM) priority risks, ratings and action plans are reviewed and updated by the Audit Committee and by the Board.
- **Fall** – The Board considers PACICC's strategic plan, identifying the priority issues that the Corporation plans to address over the next three years, as well as the budget for the coming year. The main focus of the Plan is on the strategic priorities that PACICC will address and deliver on in the year ahead. ERM priority risks, ratings and action plans are reviewed and updated by the Audit Committee and by the Board.

Enterprise Risk Management report

In 2008, PACICC introduced a Board-approved ERM plan and strategy that has become a permanent part of the Corporation’s governance and management practices. Given that PACICC can incur substantial policyholder liabilities on behalf of its member companies when insolvencies occur, it is important that the Corporation mitigate potential exposures where possible. This “enterprise-wide” view of risks faced by the Corporation is consistent with best practices of member companies and other leading organizations in the financial services industry.

PACICC’s ERM plan identifies more than 30 potential risks that the Corporation could face. We group our risks in four main categories: regulatory, financial, operational, and reputation risks.

PACICC has developed a risk management protocol that calls for the Corporation’s Audit Committee and Board of Directors to review, at least annually, the full risk register and action plans to address higher-rated risks. Regular ERM reporting to stakeholders occurs in both the annual plan and in PACICC’s annual report.

From PACICC’s total risk register, six higher-rated priority risks have been identified by the Audit Committee and the Board of Directors as warranting additional mitigation. The table below summarizes highlights of PACICC’s action plans and progress to date in addressing the Corporation’s highest-rated risks.

Summary of PACICC priority risks and action plan status

Risk description and risk category	Plans for additional risk mitigation	Current Status
<p>Regulatory risks Provincial insurance supervisory frameworks may not meet the standards recommended by the International Association of Insurance Supervisors (IAIS)</p>	<ul style="list-style-type: none"> • Conduct research to identify divergence from IAIS standards in each jurisdiction • Develop awareness and education plan to utilize research findings • Consider the quality of insurer solvency supervision when determining risk-based assessments that may be levied by PACICC 	<ul style="list-style-type: none"> ➤ Research commissioned by PACICC has confirmed the deficiency in provincial solvency supervision ➤ The proposed PACICC Plan for 2010-12 identifies this as the Corporation’s priority issue for 2010
<p>Regulation of insurance rates may contribute to insurer solvency problems</p>	<ul style="list-style-type: none"> • Conduct research on the relationship between solvency and rate regulation; build into PACICC internal modeling • Consider rate regulation as a factor in any future risk-based assessments that may be levied by PACICC • Develop plan to utilize rate regulation research findings 	<ul style="list-style-type: none"> ➤ Research findings were published in 2009 as the third paper in PACICC’s <i>Why insurers fail</i> series (“Inadequately pricing the promise of insurance”) and circulated to PACICC members, insurance regulators and other stakeholders

Summary of PACICC priority risks and action plan status (continued)

Risk description and risk category	Plans for additional risk mitigation	Current Status
<p>Regulatory risks (cont'd) Insurance company winding-up and restructuring practices are outdated in Canada</p>	<ul style="list-style-type: none"> • Work plan approved by the Board in November 2007 has guided PACICC's work to address this risk 	<ul style="list-style-type: none"> ➤ Presentations/submissions made to Senate Banking, Trade & Commerce Committee and to Finance Canada ➤ Model legislation has been drafted in partnership with Assuris (PACICC's counterpart in the life insurance industry)
<p>Financial risks Insolvency costs could exceed PACICC's available financial resources</p>	<ul style="list-style-type: none"> • Explore options that could enhance PACICC's capacity to respond to extraordinary insolvency events, including an industry liquidity facility and a possible counter-cyclical funding mechanism • Premium tax offsets could also mitigate this risk • PACICC needs to reinforce with liquidators the importance of using loan agreements to fund covered claims payments where appropriate 	<ul style="list-style-type: none"> ➤ Options to address this risk were presented to the PACICC Board in November 2009 ➤ Board decisions on the options presented will guide PACICC's contingency planning
<p>Operational risks PACICC's preparedness for the failure of a larger, or multiple smaller member companies may need to be strengthened</p>	<ul style="list-style-type: none"> • Develop a contingency plan that addresses: claims management staffing; work space; funding; and communications and media response 	<ul style="list-style-type: none"> ➤ Contingency planning efforts are well advanced and should be ready to present to PACICC's Board of Directors in April 2010
<p>Reputation risks Processes to protect confidential information held by PACICC may require strengthening</p>	<ul style="list-style-type: none"> • Conduct a security review of PACICC's premises • Develop a data/document classification and retention policy for PACICC • Include accidental disclosure of confidential information in a media response plan for PACICC Board members and staff 	<ul style="list-style-type: none"> ➤ Completed security review in cooperation with PACICC's landlord and building security personnel; security measures were found to be adequate ➤ We have attempted to learn from the practices of others in the industry, including IBC ➤ Goal is to complete mitigation work on this risk during 2010

Priorities for the period 2010 to 2012

Priority for 2010

Strengthening provincial solvency supervision

Core activities:

- Review the solvency supervisory systems for provincially-licensed insurers in Canada in relation to the international best regulatory practices set out by the International Association of Insurance Supervisors (IAIS) in their report *Common Structure for the Assessment of Insurer Solvency*
- Develop a toolkit for supervisors and legislators to use in strengthening provincial solvency supervisory frameworks, including a checklist and model statutory provisions
- Communicate findings regarding necessary reforms in a position paper for Ministers, policy staff and provincial regulators
- Complete case study research on the failure of Advocate General Insurance Company. (This will be the fourth paper in PACICC's *Why insurers fail* series of research studies).

Enhanced activities (optional, at the Board's discretion):

- Actively champion the need for legislative reforms in target jurisdictions, likely focusing on two or three provinces
- Identify specific legislative reforms and resources needed to bring provincial solvency supervisory practices up to the standards of the IAIS and those of the Office of the Superintendent of Financial Institutions, building on research findings commissioned by PACICC and published last year by Dr. Norma Nielson at the University of Calgary's Haskayne School of Business
- Hold regional information seminars to more effectively communicate PACICC's findings and recommendations for strengthening provincial solvency supervision (these seminars could involve issue experts like Dr. Norma Nielson, who conducted the research commissioned by PACICC on this concern).

Priorities for the period 2010 to 2012 (continued)

Priority for 2011

Promoting risk management

- Facilitate dialogue among PACICC member insurers regarding the benefits of adopting comprehensive risk management practices and approaches – base key messages on findings from planned benchmarking ERM survey of PACICC members.
- Encourage member companies to implement a comprehensive risk management approach which is appropriate to their risk profile, identifying all reasonably foreseeable and relevant material risks (for example, underwriting risk, market risk, credit risk, operational risk and liquidity risk).
- Advocate the need for appropriate risk monitoring and risk management practices with particular emphasis on the role of sound corporate governance and the relationship between liquidity, leverage and capital adequacy (counterparty risk management).
- With a special focus on smaller insurance companies, encourage PACICC members to incorporate ERM in their corporate planning activities as an effective approach to manage risk, consistent with rating agencies' and regulators' growing expectation of the employment of comprehensive risk management practices by insurers.
- Work with OSFI to reinforce among PACICC member companies the risk management practices expected by the Federal regulator, perhaps through a joint seminar.

Priorities for the period 2010 to 2012 (continued)

Priority for 2012

Federal financial sector legislative review

- Participate in the scheduled five-year review of the Federal *Insurance Companies' Act*, *Bank Act* and other financial-sector legislation, with emphasis on enhancing the safety and soundness of Canada's P&C insurance companies.
- Liaise with member insurers, liquidators, insurance regulators and insurance consumers to identify solvency issues that may relate to the legislative review.
- Continue to participate on the OSFI MCT Advisory Committee reviewing capital standards, including the provision of PACICC-supported research regarding the use of terminal provisions and time horizons.
- In particular, PACICC will continue to champion reforms to the *Winding-Up and Restructuring Act* (WURA) to improve the operating environment for PACICC, our members and liquidators and regulators with respect to managing insurance company insolvencies.
- Advocate for industry and regulatory actions to promote the inclusion of adequate insolvency clauses in reinsurance contracts – to improve the likelihood of collecting reinsurance recoverables when insurance companies are liquidated.
- Participate in the continuing dialogue regarding macro-prudential supervision by contributing information about systemic risk in the P&C insurance industry.
- Examine opportunities to dampen swings in the insurance cycle through mechanisms like a counter-cyclical PACICC assessment.

PACICC's operations priorities for 2010 to 2012

Because preparedness is a constant requirement, PACICC has begun the practice of identifying its operational priorities separately from the unique strategic policy priorities approved each year by the Board of Directors.

2010

- Liaise with the Insurance Brokers Association of Canada to ensure that brokers are able to partner actively with PACICC in the event of a member-company failure. An information package titled *What brokers need to know in the event of an insolvency* has recently been posted on both PACICC and IBAC websites. Evaluate how the information is working and whether further actions are needed.
- Explore with insurance regulators and liquidators the concept of a liquidity facility to enhance PACICC's ability to respond to extraordinary insolvency events; and consult with member insurers about a possible counter-cyclical funding mechanism.
- Implement recommendations from PACICC's recent review of corporate governance practices.
- Consistent with PACICC's Board-approved investment policy, examine options to generate higher returns on the Corporation's Operating Fund assets.

2011

- Conduct a simulated insurance company failure to test PACICC's preparedness, ideally in partnership with solvency regulators and liquidators.
- Review and update PACICC's documented insolvency management procedures as part of maintaining adequate preparedness.
- Develop operating procedures for resolving disputes about unpaid assessments, termination of membership, and other recurring issues with members.
- Review best practices of other leading P&C insurance guarantee funds as part of the operational preparedness review.
- Work with PACICC's Audit Committee to review the performance of the Corporation's appointed auditor.
- Review PACICC's current banking service arrangements.
- Review PACICC's information-technology service arrangements (current contract with Insite Computer Group was put in place in 2006).

2012

- Review PACICC's premises requirements in advance of the expiry of the current lease (December 31, 2012).
- Review PACICC's coverage and benefits to ensure they provide adequate protection for insurance policyholders (the last such review was done in 2006).
- Review PACICC's investment management services, guided by the Audit Committee (the last such review was done in 2007-08).

Update on PACICC Fund balances

PACICC Liquidation Funds

	<u>Balance on September 30, 2009</u>	<u>Projected to December 31, 2009</u>
Advocate General	\$1,658,470	\$1,659,500
Beothic General	\$151,090	\$151,180
Canadian Universal	\$782,620	\$783,110
Ontario General	\$221,990	\$222,130
Maplex General	\$3,298,720	\$3,300,795
Hiland	\$476,270	\$476,570
Gisco	\$1,982,700	\$1,983,945
Canadian Millers'	\$672,300	\$672,720
Markham General	\$6,652,000	\$6,150,000
Total	\$15,896,160	\$15,399,950

Notes

- PACICC has received final dividends for the estates of Advocate General and Maplex. We expect to refund to members all remaining dividends for these two liquidations during 2010.
- The Liquidator for Reliance Canada declared a 100% dividend in December 2008. As a result, PACICC has no further financial obligations to the Reliance Canada estate, and the Corporation's former loan agreement with the Liquidator for Reliance (which provided funding in lieu of a general assessment) has been cancelled.
- The Liquidator for Markham General declared a further 25% dividend in 2009, bringing the total interim dividend to 35%. PACICC now has more than adequate funds available to complete the Markham General liquidation. The projected fund balance for Markham General is lower at year-end 2009 than at September 30, 2009 because this remains an active liquidation fund, with claims still being paid.

PACICC Compensation Fund Balance

	<u>on September 30, 2009</u>	<u>Projected to December 31, 2009</u>
Total market value	\$43,785,000	\$44,025,000

PACICC Operating Fund Balance

	<u>on September 30, 2009</u>	<u>Projected to December 31, 2009</u>
Total	\$2,006,190	\$1,663,000

Projected 2009 revenue and spending, and proposed 2010 budget

	Budget 2009	Projected 2009	Proposed 2010
Revenues			
Administrative assessment	\$1,150,000	\$1,175,000	\$1,234,000
Investment income	\$70,000	\$8,000	\$55,000
Funding from liquidation funds	\$100,000	\$100,000	\$100,000
Funding from ICLR	\$100,000	\$100,000	\$100,000
[Proposed one-time transfer from Operating Fund]			\$100,000
Total Revenue	\$1,420,000	\$1,383,000	\$1,589,000
Spending			
Salaries	\$542,000	\$557,000	\$571,000
Benefits	\$127,000	\$132,000	\$135,000
Research and other consulting	\$200,000	\$180,000	\$200,000
[Enhanced activities – 2010 priority]			\$100,000
Legal fees	\$55,000	\$60,000	\$55,000
Premises	\$124,000	\$124,000	\$124,000
Corp. secretary, finance & admin.	\$45,000	\$42,000	\$45,000
Travel	\$50,000	\$53,000	\$45,000
Directors' fees and expenses	\$55,000	\$55,000	\$64,000
Furniture and equipment	\$25,000	\$26,000	\$25,000
Telephone and postage	\$29,000	\$29,000	\$29,000
Insurance	\$16,000	\$16,000	\$16,000
Annual report and other printing	\$25,000	\$30,000	\$26,000
Investment mgt and banking fees	\$65,000	\$65,000	\$70,000
Audit and other expenses	\$62,000	\$67,000	\$65,000
Total Spending	\$1,420,000	\$1,436,000	\$1,570,000
Change in PACICC Operating Fund	0	- \$53,000	\$19,000

Notes

- The operating shortfall projected for 2009 is attributable to low interest rates, which led to a sharp drop in the income realized by PACICC from its invested Operating Fund assets. Options to generate a higher return on these assets are being carefully considered, consistent with PACICC's Board-approved investment policy.
- Administrative assessments for 2010 will increase on average by 5%. Two percentage points will cover expected increases in PACICC's annual operating costs, while the balance (3 percentage points) is needed to complete the transition to full funding of investment management expenses for PACICC's Compensation Fund from the Corporation's annual operating budget, as authorized by the Board of Directors in 2008.
- Budgeting for 2010 assumes that salary and benefits costs will increase by 2.5% on average.
- The projected surplus of \$19,000 for 2010 will be used for HST and other contingencies.