PACICC

GUIDE TO COMPENSATION PLAN FOR PROPERTY AND CASUALTY INSURERS

May 2010

The compensation plan for property and casualty insurers (the "Plan") funded by property and casualty insurance companies resulted from extensive negotiations that took place with the provincial and federal Superintendents of Insurance over a period of five years and is designed to come into operation on the insolvency of a property and casualty insurer. The details of the Plan having been agreed upon by the Superintendents, the corporation which administers the compensation arrangements was incorporated as a federal non-profit corporation in 1988. Its name is the Property and Casualty Insurance Compensation Corporation/Societe d'indemnisation en matière d'assurances IARD ("PACICC"). Prior to PACICC entering into agreements with each of the provinces and territories, it was necessary to have each provincial and territorial Superintendent agree with PACICC on "prudential criteria" i.e. solvency standards to be imposed on all P&C insurers in his or her jurisdiction. The Plan has been in effect country-wide since 1989.

The following sections describe the main features of the Plan.

1. The Plan

The Plan is designed to provide a reasonable level of recovery for claims of policyholders under most policies issued by property and casualty insurance companies. The life insurance industry has a similar plan for life insurers which are therefore excluded from the Plan. Also excluded, because of their distinctive characteristics are aircraft, credit, crop, directors' and officers', employer's liability, certain errors and omissions (medical malpractice is not excluded), fidelity, financial guarantee, marine, mortgage, surety and title insurance. Automobile insurance in Manitoba and Saskatchewan is excluded, as are claims for bodily injury arising from automobile accidents occurring in Quebec for which compensation is available from the Société d'assurance automobile du Quebec. However, government-owned insurers otherwise participate in the Plan. Accident and Sickness Insurance is protected by the Plan, if the insurer writes it and also writes one or more classes of general insurance; if the insurer writes A and S insurance only, or A and S and Life insurance, the life insurance industry plan applies. Notwithstanding these exclusions, the Plan covers most claims under most P&C insurance policies.

The Plan, to begin with, assumed no liability for unearned premiums whatsoever but for insolvencies occurring after 1996, it now responds to claims for unearned premiums. This is limited, however, to 70% of a maximum unearned premium of $1,000 so that,effectively, the most PACICC will pay in respect of a claim for unearned premiums is $700. To take an example, if your policy period is January 1 to December 31 and a winding-up order is made in respect of your insurer on May 31, that means, in effect, that the premium for the period January 1 to May 31 has been earned (your insurance has been on risk for that period) and the premium for the period June 1 to December 31 (7 months) is unearned. If your premium was $960, your claim for unearned premium is 7/12's of $960 i.e. $560. PACICC would pay 70% x $560.00=$392.

2. Initiation of the Plan

The Plan is administered by PACICC, a non-profit corporation incorporated under Part II of the Canada Corporations Act. All participating insurance companies are members of PACICC. A participating insurance company is a company licensed in a participating jurisdiction to sell any of the classes of insurance for which PACICC provides protection. Those jurisdictions enacting legislation relating to the Plan have provided for exemptions for e.g. reinsurers, farm mutuals, and reciprocals. Some of the jurisdictions have enacted appropriate legislation that deems all licensed property and casualty insurers to be members of PACICC and to be bound by its By-laws and Memorandum of Operation, including commitments to make their appropriate contributions to assessments. Others have enacted legislation or regulations making it a condition of being licensed that the property and casualty insurer enter into a contract of membership with PACICC that imposes similar obligations on the insurer. All Provinces and Territories have the necessary legislation in place.

While a company is licensed in a participating jurisdiction it may not withdraw from membership in PACICC and PACICC may not terminate its membership. The company's membership is, however, deemed to be terminated six months after cancellation of its licence by a jurisdiction, if that cancellation results in its not being licensed in any participating jurisdiction to sell any of the classes of insurance protected by PACICC.

In addition, as mentioned earlier, agreement had to be reached with the Superintendents of Insurance on prudential criteria and before amending prudential criteria in future, the jurisdiction concerned is required to consult with PACICC.

3. Operation of PACICC

PACICC is administered by a Board of Directors elected by its members i.e. participating insurers. It operates in close liaison with the Federal Superintendent of Financial Institutions and with Superintendents of Insurance or similar insurance regulatory authorities of participating jurisdictions. The Superintendents are not official members of the Board of Directors of PACICC but they may designate representatives to participate in Board discussions on a non-voting basis. Also, the Board has the right to appoint an advisory committee as to any specific insolvency and to delegate responsibilities to that committee; again, the Superintendents are entitled to designate non-voting representatives to any advisory committee.

The obligations of PACICC come into operation only upon a formal winding-up order under the federal Winding-Up and Restructuring Act. Until that occurs, PACICC has no financial responsibility in connection with an insurer.

4. Procedure in an Insolvency

Immediately after the winding-up order is made, representatives of PACICC consult with the court appointed liquidator to arrive at an appropriate working relationship. Indeed, preliminary consultations are held on an informal basis prior to the appointment although, as mentioned earlier, PACICC is not called upon to make any payments until after the winding-up order has been made.

PACICC has discussions with the relevant Superintendent of Insurance as to pre-selecting the liquidator or the agent of a liquidator, when an insolvency is imminent. The major accounting firms tend to be invited to take part in a tender process, although the firm that has been the auditor of the insolvent insurer is excluded from consideration. We have also developed a model wind-up order (in conjunction with the liquidators) and we find the liquidators invariably use it.

PACICC's Memorandum of Operation is sufficiently flexible to allow for a variety of factual situations that may arise and to permit appropriate working arrangements to be made.

Under current arrangements, the procedures established by the liquidator to settle the quantum of policyholder claims against the insolvent insurer are reviewed with PACICC in order that PACICC is prepared to accept and act upon the settlements reached by the liquidator's adjusters. Where consensus is reached as to the procedures, it is possible for PACICC simply to make payment to a policyholder after the quantum of his claim is settled with the liquidator. PACICC is not, however, obligated to do this - it may review the settlement to verify that the amount is appropriate.

PACICC has discretion to make payments to third parties and in such cases the model wind-up order deems the policyholder has transferred her/his rights against the insurer to PACICC. PACICC does not stand in the shoes of the liquidator but it is generally the case that the co-operation between them is such that PACICC requires minimal staff resources.

5. Payment of Claims

The maximum recovery from PACICC is currently $250,000 for all covered policies (with the exception of personal property policies, where the maximum recovery is $300,000) in respect of all claims arising from policies issued to a single named insured by the insolvent insurer and which arise from a single occurrence. The actual amount to which a particular insured (or third party claiming through the insured) is entitled is determined by first calculating what the aggregate of his entitlement is under all applicable provisions of his or her policy or policies (such as deductibles, co-insurance, etc.) and secondly, determining the lesser of that amount and the PACICC limit.

For example, an automobile insurance policyholder with a policy deductible of $250 and a claim of $300,000 can look to PACICC for $250,000; a policyholder with a claim of $175,000 and with a policy deductible of $500 can look to PACICC for $174,500. The purpose of the Plan, therefore, is to provide policyholders with basic compensation. It is not designed to provide full protection in all cases.

Because all claims by a policyholder arising out of a single occurrence are aggregated, it is sometimes necessary for PACICC to establish priorities as to how a particular payment is to be applied. You may, for example, as a result of your negligence in driving your vehicle, be sued by, say, 3 passengers in your vehicle, and by 2 occupants of the other vehicle.

6. Other Arrangements as to Plan Payments

So that the Plan can operate effectively, other limitations are necessary as to the claims that PACICC will pay. Claims asserted by persons who have a special relationship with the insolvent insurer may be excluded by the Board of PACICC. Further, in extreme cases, a major insolvency might trigger the limit (see paragraph 8 following) on the extent to which a participating insurer can be called upon in any year to pay assessments to PACICC; in such case it may be necessary for the Board of PACICC to make decisions that will stretch out the time over which claims will be met by PACICC.

Subject to these limitations, the Plan applies to any claims that arise under insurance policies described in paragraph 1 either prior to the winding-up order or within such time thereafter as the PACICC Board may determine. The extended time period is intended to give ample time to brokers and others to notify policyholders of the need to put in place other insurance arrangements.

7. Recovery by PACICC of Amounts Paid

A key principle of the Plan is that any amounts paid by PACICC are recovered by PACICC before any additional payment is received by the policyholder as to that claim. To the extent that resources to pay a particular claim are available from the insolvent insurer (or through third party claims) payments by PACICC towards that claim would therefore be of an interim nature.

Before a payment is made to or on behalf of a policyholder, the policyholder is required to certify that he or she has exhausted any available claim against any solvent insurer with whom he has a policy that covers the same loss. Further, he or she is required to assign to PACICC all of his or her rights against the insolvent insurer that arise under the particular policy. This is normally dealt with in the wind-up order. The consequence of this assignment for an insured with a claim of $300,000, as to which PACICC pays $250,000, would be that the insured would receive no participation in a distribution of $150,000 made by the liquidator of the insolvent insurer; if the distribution was $275,000, the insured would receive $25,000.

PACICC is also entitled to first priority against amounts received by the insured from third parties with respect to the loss for which PACICC provided payment.

8. Assessment Process

PACICC recovers the amount that it advanced to and on behalf of the policyholders of an insolvent insurer through assessments levied against particular participating insurers licenced in the participating jurisdictions in which the insolvent insurer was writing business. Separate assessments are made in respect of each participating jurisdiction in which the insolvent insurer wrote business. These assessments are limited to the shortfall between amounts advanced by PACICC and amounts recovered by it from the insolvent insurer and third parties.

To ensure that PACICC is in a position to respond to the financial demands that may be made on it, provisions were added to its Memorandum of Operation in 1996 to provide for some pre-insolvency funding. In each of the years 1998, 1999 and 2000 a special levy was made on companies to establish a Compensation Fund of approximately $30 million. Investment income is being accumulated to the Fund. The value of the Fund was approximately $43 million as of June 2009. (The Fund value is publicly disclosed at each calendar year-end in PACICC's Annual Report).

A particular participating insurer is assessed as to each participating jurisdiction in which it is licenced and in which the insolvent insurer was also licenced in accordance with the following formula:

$$A = B \times \frac{C}{D}$$

Where:

"A" is the assessment to be borne by the particular participating insurer in respect of the relevant participating jurisdiction;

"B" is the total amount being assessed against all participating insurers in respect of the relevant participating jurisdiction;

"C" is the total direct written premiums for protected policies of the particular participating insurer in respect of the relevant participating jurisdiction; and

"D" is the total direct written premiums for protected policies of all participating insurers in respect of the relevant participating jurisdiction.

For the purpose of determining the premium income of insurers, PACICC relies on the reports which insurers are required to file with the relevant Superintendents of Insurance. The maximum annual levy that an insurer may be asked to pay in a particular jurisdiction is 1.5% of its direct written premium in that jurisdiction. The Board of Directors of PACICC, in practice, makes a general assessment in respect of each participating jurisdiction early in the course of a particular insolvency, reflecting the maximum exposure that it anticipates under the particular insolvency, subsequently levying draws on that assessment as the need for funds has arisen. The Board may also choose to have PACICC borrow money from its Compensation Fund and delay implementing an assessment until it is better able to estimate PACICC's exposure. The money borrowed from the Fund must be fully repaid with interest, with the relevant insurers being assessed for the appropriate amount.

The Board of Directors is also entitled to levy administrative assessments for the administration expenses of PACICC. In 2009, the fee varied from $1,850 for the smallest companies to $9,200 for the largest companies.

If the making of Compensation Payments is likely to cause financial difficulty to the property and casualty industry or to PACICC, the Corporation is required to have discussions with the regulators with a view to modifying the compensation arrangements and possibly to defer making payments, if this is appropriate, while the discussions are continuing.

9. Conclusion

The Plan protects policyholders who are in need of protection against the more serious results of the insolvency of a property and casualty insurer without exposing the general insurance industry to an unlimited liability for all claims against an insolvent insurer. Prior recovery of amounts advanced by PACICC from any other recoveries of the insured against the same claim is consistent with this approach.

It has been proved that the plan arrangements can operate effectively and efficiently in the context of the established degree of co-operation among Superintendents of Insurance, liquidators and the insurance industry in insolvencies.

Alex Kennedy
December 2003 (and updated as of June 2009)

(Alex Kennedy was Vice-President, Secretary-Treasurer and Counsel to PACICC from its inception in 1988 to 1998. Alex served as PACICC’s President and Chief Executive Officer from 1998 to 2003)