PACICC

Insolvency protection for home, car and business insurance consumers

2018-20 Plan and 2018 Budget

November 2017

Contents

Message from the President

During the first half of 2017, Canada's P&C insurance industry began to recover from the costliest insured loss ever experienced in this country – the wildfires that devastated Fort McMurray a year earlier. Net income for the industry as a whole increased by $2 billion, and the total loss ratio improved by more than seven percentage points. Underwriting income improved by $1.5 billion, and investment income rose by $0.5 billion.

At PACICC, we continue to caution that periodic large catastrophe losses and accompanying earnings volatility are more the "new normal" for our industry. This underscores the importance of sound risk management for insurers, with the goal of better preparedness for and increased resilience to severe weather loss events.

Mitigating risks to insurer solvency is central to PACICC's mandate as the industry's guarantee fund. Working with the Insurance Bureau of Canada, PACICC's research and analysis played a key role in convincing the Federal Department of Finance to consider "how to limit the system-wide risks an extreme earthquake could pose to federal P&C insurers." [1] While we do not yet know what the Federal government may be prepared to do, it is noteworthy that policymakers are taking seriously a risk that could potentially overwhelm the industry.

PACICC was also successful in completing formal intervention guideline agreements with OSFI and AMF. These agreements will give PACICC earlier notice of financial difficulties facing a member insurer. This could potentially reduce costs for the industry and be less disruptive for insurance consumers. Similar guideline agreements are being discussed between PACICC and insurance regulators in Alberta and B.C. Recent changes made to PACICC's governance ensure that any exchanges of company information under these agreements will remain confidential.

In addition to setting out PACICC's priority issues for the next three years, our strategic plan includes information on our risk profile, and on our initiatives through the Risk Officer's Forum to support member companies in strengthening their risk management practices. As PACICC continues its work on behalf of insurance consumers, our Board of Directors and management welcome your feedback on any aspect of our plan and operations.

Paul Kovacs
President and CEO
PACICC

[1] From the *Review of the Federal Financial Sector Framework* policy paper released on August 11, 2017.

Priorities for the period 2018 to 2020

Priority for 2018
Renewing Federal financial sector legislation

PACICC's priority for 2018 is to pursue two objectives that relate to the Federal government's current review of financial sector legislation. The first objective is to support Finance Canada as it considers how to limit the system-wide risks a catastrophic earthquake could pose to federal P&C insurers. PACICC has had numerous discussions with Finance officials and provided written submissions on this issue during 2017. We expect the file to stay active in the year ahead. A possible outcome is that PACICC could be authorized to borrow funds from the Federal government to provide liquidity to distressed member insurers in the event of an extreme earthquake. If this issue can be successfully addressed, it would help to mitigate a critical risk in PACICC's risk profile (see page 10 of this document; Risk 1-1) – and most important, it would strengthen the soundness and financial stability of Canada's P&C industry.

PACICC's second objective is to advance the case for modernizing the Federal *Winding-Up and Restructuring Act* (WURA) – the legislation governing the liquidation of failed banks and insurance companies. This has been a longstanding issue for PACICC. Our position advocating reform is well-developed and has been communicated to Federal officials.

While modernizing WURA is outside the scope of strictly reviewing the Federal *Bank Act* and *Insurance Companies Act*, a compelling argument can be made to include it in the review because of its role as the resolution mechanism for insolvent banks and insurance companies (and because it is woefully outdated!) Restructuring, or resolution planning, is on the Federal government's policy radar, having stated its intent to introduce a recapitalization "bail-in" regime for banks as part of the review.

As PACICC advances over recommendations on this issue, we will take advantage of opportunities to strengthen and leverage our position by partnering with other industry stakeholders – including IBC and Assuris.

Priorities for the period 2018 to 2020 (continued)

Priority for 2019
Reviewing PACICC`s coverage and benefits

PACICC last reviewed its coverage and benefits in 2006. It is appropriate that a review be conducted approximately once every 10 years. The review would examine the full range of PACICC coverage and benefits. Stakeholder consultations would include member insurers, insurance consumers, regulators and liquidators. The last review in 2006 resulted in one significant change being made – the limit on personal property coverage was increased to a maximum of $300,000 per claim. (All other PACICC claims limits remained at a maximum of $250,000). PACICC has conducted research to help benchmark best practices of insurance guarantee funds in other jurisdictions. The results of this research will inform our planned review of coverage and benefits.

Insurance regulators have requested that PACICC review current limits for personal property claims owing to the significant increase in house prices since the last review and new knowledge about the potential for multiple total loss claims as a result of a wildfire or earthquake.

Priorities for the period 2018 to 2020 (continued)

Recommended priority for 2020
Developing an early-intervention framework for PACICC

Recent developments have made it prudent for PACICC to consider when and how the Corporation would use the early-intervention (pre-insolvency) powers specified in Section XI, paragraph 40 of the Memorandum of Operation. This section of the Memorandum permits the Board of Directors to take "reasonable steps" prior to a member being ordered into wind-up if such steps are consistent with the Corporation's objectives. The Memorandum further clarifies that "reasonable steps" include, "without limitation, assisting in the sale, transfer or reinsurance of a book of business written by a member company," and/or "issuing guarantees or otherwise providing financial support."

In PACICC's 28-year history, these powers have never been utilized – PACICC's involvement has always been triggered by a Court-ordered wind-up of an insolvent member company. However, changing circumstances – including the joint development of intervention guidelines between PACICC, OSFI and key provincial solvency supervisors – have increased the likelihood of PACICC being asked to intervene to protect policyholders prior to a winding-up order. Good risk management suggests that PACICC should clarify, in advance, the criteria the Board of Directors would use to decide whether early, pre-insolvency intervention serves the interests of policyholders and members.

A first step would be to set out the conditions when PACICC may consider intervening to assist insurance consumers beyond the circumstance when a regulator forces a member insurer to wind-up. For example:

- <u>Policyholders are at risk</u> – the safety and soundness of a member company is at risk (this would likely correspond to "Stage 3" as identified in the PACICC-AMF and PACICC-OSFI intervention guidelines)
- <u>Savings can be realized</u> – early intervention must cost less than full liquidation
- <u>Shareholders of the troubled insurer should not benefit</u> – the focus is on consumers
- <u>Advance notice</u> – sufficient time exists for PACICC to take meaningful action
- <u>Reputation may be at risk</u> – a member insolvency may harm confidence in the industry
- <u>Board approval</u> – PACICC will not act without approval from its Board of Directors.

Core principles

- No policyholder will be worse off under an early-intervention scenario compared to full liquidation
- The method of financing an early intervention would need to provide PACICC with repayment prospects similar to the dividends typically received in a liquidation.

PACICC's operations priorities for 2018 to 2020

Because preparedness is a constant requirement, PACICC also identifies its operational priorities separately from the strategic policy priorities approved each year by the Board of Directors.

2018

- Review PACICC's investment management services, guided by the Audit & Risk Committee. The last such review was conducted in 2007-08.
- Consider issuing an RFP for PACICC's external audit services. (The decision will be made by the Audit & Risk Committee).

2019

- Conduct a review of outsourced Information Technology services to ensure PACICC is utilizing up-to-date, productive and cost-effective technology.

2020

- Conduct a review of banking services to ensure PACICC is getting the range of services it needs at a competitive price.

Recent accomplishments

Corporate governance (2004) PACICC took steps to modernize its corporate governance, including: adopting a corporate mission; downsizing the Board and streamlining Board Committees; introducing competitive compensation for public directors; and evaluating the Board's performance.

Financial preparedness (2005) The Corporation's financial preparedness was enhanced by doubling PACICC's potential maximum annual insolvency assessment; modeling future insolvency costs; and simulating the impact of shocks on the financial health of member insurers.

Coverage and benefits (2006) We led a comprehensive review of PACICC's coverage and benefits, ensuring that Canadians remain well protected in the unlikely event that a member insurer fails. PACICC harmonized covered lines to accord with CCIR's classes of insurance, and raised its maximum benefit for personal property claims to $300,000.

Enterprise risk management (2007) PACICC developed an ERM plan and strategy that is now embedded in our corporate governance practices. Initial action plans focused on mitigating six of PACICC's own highest-rated risks.

Insolvency legislation (2008) PACICC championed the call for a comprehensive review of the *Winding-Up and Restructuring Act* (WURA), identifying changes to improve the insolvency management framework for PACICC, our members, liquidators and regulators. Submissions outlining key reforms were made to Finance Canada and to the Senate Banking Committee.

Reducing insolvency contagion risk (2009) PACICC undertook several projects in 2009 aimed at reducing contagion risk, including: participating in the reinsurance market review led by OSFI and AMF; communicating our research findings on how rate regulation impacts insurer solvency; and by proposing a liquidity facility to respond to the winding-up of a large insurer.

Strengthening provincial solvency supervision (2010) PACICC updated its model wind-up order and Insurance Act provisions to address capital adequacy, investments and governance.

Federal financial sector legislative review (2011) PACICC proposed technical amendments to the *WURA* designed to improve the liquidation process; submitted a discussion paper on the resolution of complex failures; and proposed new insolvency wording for use in reinsurance contracts.

Promoting sound risk management (2012) After conducting a benchmark survey on member-company ERM practices, PACICC worked with an advisory committee of Chief Risk Officers to deliver member-focused seminars on ERM standards, risk appetite and risk governance.

Managing earthquake risk (2013) PACICC undertook detailed research and analysis to quantify the maximum catastrophic loss the Corporation could handle without threatening the solvency of otherwise healthy insurers. Findings were shared with key stakeholders.

Promoting actuarial best practices (2014) PACICC worked with the actuarial profession in Canada to identify best practices to reduce insolvency risk, including appointed actuary requirements and mandatory reporting; peer review of estimates; and DCAT requirements.

Developing an Extraordinary Assessment Mechanism (2015) PACICC developed a mechanism to reduce the risk of contagion for PACICC members following the failure of a large insurer, a proposal to be considered when discussions are completed concerning a government backstop.

Reducing systemic risk to solvency (2016) PACICC partnered with IBC to help secure a commitment from the Federal government to consider "how to limit the system-wide risks an extreme earthquake could pose to federal P&C insurers."

Achievements in 2017

Priority for 2017
Developing P&C Intervention Guidelines with Insurance Regulators

PACICC reached agreement in 2017 with the Federal and Quebec insurance regulators – OSFI and Autorité des Marchés Financiers (AMF), respectively – on intervention guidelines that formalize the joint roles of the regulator and the guarantee fund in responding to financially-distressed insurance companies and protecting policyholders.

PACICC's Pre-Insolvency Regulatory Liaison Committee (PIRL) – consisting of the Corporation's public (non-industry) directors – provides the conduit for confidential discussions and exchanges of member company information with regulators when necessary.

Discussions are under way with regulators in British Columbia and Alberta with the goal of reaching agreement on intervention guidelines with PACICC similar to those in place with OSFI and AMF.

Approximately 95 percent of PACICC member insurance companies are accountable to one of these four solvency regulators – OSFI, AMF, BC FICOM, or Alberta Treasury.

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. 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 by the Audit & Risk 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 by the Audit & Risk Committee.

PACICC's risk profile

PACICC's Risk Profile remains stable – no significant change for any of the individual risks.

Impact Rating

Very High	**Financial Risk** 1-1 Insolvency costs exceed risk limit-risk appetite			
High		**Regulatory Risks** 1-5 New laws 1-6 Benefits enhanced		
Medium		**Operational Risks** 1-7 Resource demands 1-8 Unexpected insolvency costs	**Regulatory Risks** 1-3 Rate regulation **Operational Risks** 1-9 Lack of liquidator expertise	
Low				**Regulatory Risks** 1-2 Solvency supervision 1-4 Outdated winding-up legislation
	Very Low	**Low**	**Medium**	**High**

PACICC's priority risks (risk profile)

1-1 An earthquake or other hazard causes a very large insurer to fail, or leads to multiple, smaller insolvencies; resulting insolvency costs exceed PACICC's risk limit-risk appetite (2 times our annual general assessment capacity)

1-2 Supervisory practices below minimum IAIS standards

1-3 Rate regulation causes insolvency

1-4 Outdated winding-up legislation

1-5 Adverse changes in insurance legislation

1-6 PACICC could be forced to increase coverage and benefits

1-7 Risk 1-1 puts extraordinary demands on human resources

1-8 Lack of member financial data results in unexpected insolvency costs

1-9 Much of Canada's accumulated P&C liquidation expertise has "retired"

Risk Officer’s Forum

PACICC launched a P&C insurance Risk Officer’s Forum in December 2013 in response to needs expressed by member companies for better information sharing on effective ERM practices. This initiative also reinforces PACICC’s goal of promoting better enterprise risk management in Canada’s P&C insurance industry. Over the past year, the Risk Officer’s Forum liaised with principal contacts in all 200 member companies regarding a full schedule of Forum activities and events. There are more than 400 risk professionals in PACICC’s Forum member database, including: Presidents and Chief Executive Officers, Chief Risk Officers, senior Finance department staff from larger member companies and Chief Agents.

Two in-person Forum meetings have already been held in 2017, with another scheduled for mid-November to coincide with OSFI`s annual Risk Management Seminar. Forum meetings feature a topical guest speaker and are supported by a rotating panel of industry experts who guide group discussion. Recent agenda items have included: operational risk management, reputation risk, economic capital modelling and Own Risk and Solvency Assessment.

Two Emerging Risks Webinars have been held so far this year (“*On-Demand Insurance*” and “*The Smart Factory: New Technologies Affecting P&C Insurance*”), led by subject-matter experts. A third is scheduled for late October (“*Demographic and Generational Change: Implications for P&C Insurance*”).

The Forum is overseen by an Advisory Committee of member-company CROs, chaired by Susan Meltzer of Aviva Canada. The Risk Officer’s Forum seeks to enhance risk management within the P&C insurance industry by:

- Discussing and sharing risk management best practices within industry;
- Reviewing and communicating topical risk management information;
- Serving as a risk management resource for PACICC and for insurance regulators;
- Discussing major existing risks and significant emerging risks within the industry; and
- Providing resources, references and information to facilitate research of risk management and related governance topics.

The Risk Officer’s Forum is planning a full program for 2018:

Forum Meetings

- **April 5, 2018** — OSFI P&C Insurance Group presentation
- **September 6, 2018** — Cyber Security
- **November 2018*** — Results of PACICC 2018 Benchmark Survey on ERM Practices

* *PACICC schedules its final Forum meeting of the year to coincide with OSFI’s annual Risk Management Seminar. This allows PACICC to reach more out-of-town members attending the OSFI information session.*

Emerging Risks Webinars

- **February 21, 2018** — Climate Change
- **May 16, 2018** — Artificial Intelligence
- **October 24, 2018** — Changing Consumer Preferences

PACICC Fund balances

PACICC Liquidation Funds

	Balances on August 31, 2017
Beothic General	$274,605
Canadian Universal	$833,200
Ontario General	$614,500
Hiland	$2,381,150
Gisco	$2,746,580
Canadian Millers'	$1,078,930
Markham General	$12,825,975
Total	**$20,754,940**

PACICC Compensation Fund Balance

	on August 31, 2017
Total market value	**$53,551,625**

PACICC Operating Fund Balance

	Projected to December 31, 2017
Total	**$1,695,000**

Projected 2017 revenue and spending, and proposed 2018 budget

	Budget 2017	Projected 2017	Proposed 2018
REVENUE:			
Administrative assessment	$1,467,000	$1,467,000	$1,504,000
Investment income	$15,000	$15,000	$15,000
Funding from liquidation funds	$75,000	$75,000	$75,000
Funding from ICLR	$100,000	$100,000	$100,000
Total Revenue	**$1,657,000**	**$1,657,000**	**$1,694,000**
EXPENSES:			
Salaries	$716,000	$725,000	$770,000
Benefits	$81,000	$81,000	$83,000
Sub-total: Salaries and Benefits	**$797,000**	**$806,000**	**$853,000**
Research and other consulting	$186,000	$177,000	$154,000
Legal fees	$41,000	$35,000	$35,000
Premises	$145,000	$155,000	$155,000
Corp. secretary, finance & admin.	$46,000	$46,000	$46,000
Travel	$51,000	$70,000	$70,000
Directors' fees and expenses	$90,000	$90,000	$92,000
Furniture and equipment	$23,000	$27,000	$27,000
Telephone and postage	$31,000	$31,000	$31,000
Insurance	$17,000	$16,000	$17,000
Annual report and other printing	$23,000	$24,000	$26,000
Investment mgt and banking fees	$86,000	$86,000	$88,000
Audit and other expenses	$101,000	$94,000	$98,000
Expense contingencies	$20,000	0	0
Sub-total: Non-Salary Expenses	**$860,000**	**$851,000**	**$839,000**
Total Expenses	**$1,657,000**	**$1,657,000**	**$1,694,000**
VARIANCE (Revenue – Expenses)	**0**	**0**	**0**

NOTES:

Projected 2017

- The higher Salaries figure includes the cost of a new Administrative Assistant for PACICC (three months).

Projected 2018

- Administrative assessments for 2018 are projected to increase on average by 2.5 percent.
- Salaries and Benefits are projected to increase by 5.8 percent over the Projected 2017 Budget. This includes the full-year cost of PACICC's new Administrative Assistant and the budgeted 2.5% increase for Salaries and Benefits.
- Non-Salary Expenses are expected to decrease by 1.4 percent.
- Total Revenue and Total Spending are each projected to increase by 2.2 percent in 2018.