



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

2019-21 Plan and 2019 Budget

November 2018

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Message from the President

PACICC has no outstanding or unresolved claims. All eligible claims made since PACICC was established 30 years ago have been paid. All member companies that were put into wind-up by their regulator have been resolved, many over the past couple of years. For more than 15 years there has been no adverse media coverage concerning the protection provided to consumers with insurance companies that fail. There are no outstanding public complaints from any of the hundreds of thousands of customers affected by insolvency.

Member insurers were assessed \$68 million to support the payment of the claims over past 30 years. \$57 million was eventually recovered from the estates of failed insurers and returned to the industry. The overall cost of providing protection has been modest. PACICC is prepared to protect consumers when the next insurer fails. For example, \$30 million was assessed to create a liquidity fund to support the immediate cash requirements for future industry failures. Presently this fund is valued at \$55 million. The number of Canadian insurance consumers that report that they are confident or very confident in their insurers' ability to pay claims increased by 15 percentage points over the past 15 years.

In brief, PACICC has been successful protecting consumers, minimizing the cost to member insurance companies, and supporting confidence in the insurance industry. We have addressed past industry insolvencies and are looking ahead to ensure preparedness for future risks.

PACICC is now established as Canada's P&C insurance resolution authority. Staff oversee the resolution of insolvent insurers, prepare for future failures, assess the risk of failure, and promote solvency risk reduction by member insurers and insurance regulators. PACICC supports regulatory authorities, when requested, if a member insurer experiences extreme distress. If it becomes clear to the regulator that a company must be wound up, we are prepared to take the lead to protect consumers and support the resolution. We work with other organizations responsible for insolvency risk consumer protection programs as a founding member of the Canadian Financial Services Insolvency Protection Forum and the International Forum of Insurance Financial Guarantee Schemes.

A foundation for success has been a commitment to understand and actively confront solvency risk. This includes one of the world's leading programs for the analysis of solvency risk in the P&C insurance industry, including our popular series of reports – *Why Insurers Fail*. PACICC also partnered with the Insurance Bureau of Canada to champion a government backstop to address systemic risk in the insurance industry from a catastrophic earthquake. Moreover, PACICC's Risk Officers Forum has been successful in narrowing the gap between the risk reduction and management practices of large and smaller insurers in Canada.

It has been an honour and privilege to lead PACICC for more than 15 years. PACICC is well positioned to protect consumers. In retirement, I look forward as others work to further enhance the protection provided to consumers and build confidence in the industry.

Paul Kovacs
President and CEO
PACICC

Priorities for the period 2019 to 2021

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 will examine the full range of PACICC coverage and benefits. Stakeholder consultations will include member insurers, insurance consumers, regulators and liquidators. The planned review of coverage and benefits will seek to address three questions:

1. What are the appropriate levels for PACICC claim limits?

The limits are the first thing that reporters, regulators and policyholders ask about PACICC operations. In 1989, PACICC member insurers offered a voluntary compensation payment for loss claims up to a \$250,000 maximum per claim. In 2006, the loss limits for homeowners were increased to \$300,000. 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. The loss limits for auto and commercial have remained unchanged since 1989. Product innovations, claims frequency and severity and inflation have all contributed to a loss claim environment that is substantially different than that of 30 years ago.

2. Should PACICC change or exclude types of insurance coverage?

- Accident and Sickness Insurance
- Automobile Insurance
- Boiler and Machinery Insurance
- Credit Protection Insurance
- Legal Expenses Insurance
- Liability Insurance
- Property Insurance

Each of these lines of coverage is defined in Part B of PACICC's Memorandum of Operation. Specific exclusions for each of the lines of insurance are detailed in Part C of the same document. PACICC will consult with member companies, insurance brokers and regulators to ascertain if changes are required to our defined coverages.

3. Should PACICC make changes for large commercial consumers?

PACICC protects all commercial insurance policyholders up to our claims limits. Some international guarantee funds have sought to focus their benefits on small business owners. PACICC coverage of large commercial risks disproportionately directs resources toward large commercial policyholders. PACICC will establish a working group from members that write primarily commercial coverage to seek input about whether PACICC should introduce limits for large commercial insureds.

Priorities for the period 2019 to 2021 (continued)

Priority for 2020

Liquidation and other resolution options

Since the global financial crisis of 2008, policymakers in Canada and elsewhere have given priority to better resolution planning as a means of mitigating market disruptions caused by failed financial institutions. While much of the discussion has focused on banks, insurance companies have also come in for scrutiny – particularly larger firms considered by policymakers to be “systemically-important.” The completion of intervention guideline agreements with Canada’s principal insurance solvency regulators has increased the likelihood of PACICC being called on to protect policyholders of a troubled member insurer prior to actual insolvency – thus in the absence of a Court-ordered liquidation.

As the policy discussion on resolution planning continues to advance, PACICC has made changes to its corporate governance and to its working relationships with insurance regulators. These changes include establishing a new Board-level Committee (the “Pre-Insolvency Regulatory Liaison Committee”, consisting only of PACICC’s public, non-affiliated directors) and developing intervention guidelines in partnership with Canada’s major insurance regulators (notably OSFI and AMF). As a result, PACICC is better positioned as a guarantee fund to play a broader, constructive role in enhanced resolution planning for Canada’s P&C insurance industry.

In the new world of enhanced resolution planning, the likelihood has increased that PACICC will be called on to protect policyholders of a troubled member insurer at an earlier stage, and in the absence of a Court-ordered liquidation.

PACICC will seek to address any gaps that exist between actual vs. recommended powers for P&C insurance resolution authority, or authorities, in Canada. This will be based largely on recommendations made by policymakers (e.g. Financial Stability Board and the International Association of Insurance Supervisors) compared to actual powers in place for P&C insurance resolution authorities in Canada.

Priorities for the period 2019 to 2021 (continued)

Priority options for the Board to consider for 2021

1. Earthquake preparedness -- Phase II (EAM Implementation)

- Earlier research showed that PACICC's funding model could fail to protect consumers if the Corporation was faced with an extreme event, such as a catastrophic earthquake
- PACICC could be confronted with serious liquidity problems and be unable to pay eligible policyholder claims in a timely manner
- Once Finance decides upon a course of action, PACICC will be ready to act – obtaining regulatory and member approval for this Extraordinary Assessment Mechanism to protect consumers

2. *Winding-Up and Restructuring Act (WURA)* Modernization

- Advance the case for modernizing the Federal *Winding-Up and Restructuring Act (WURA)* legislation governing the liquidation of failed banks and insurance companies
- PACICC's position is well-developed and has been communicated previously to Federal officials
- There may be opportunities to partner with other industry stakeholders (e.g. IBC, Assuris, CLHIA, KPMG, Deloitte) and to leverage our position in the process

3. Benchmarking Canadian insurance regulators to IAIS core Principles

- Canada has 13 different authorities that regulate the solvency of P&C insurers
- The majority of failures over the past 30 years have been provincially supervised insurers
- International best practices are well defined by IAIS core principles
- PACICC should assist regulators in achieving best practices
- Regulatory authorities unable to meet IAIS best-practice standards should be encouraged to exit the solvency supervisory field

PACICC's operations priorities for 2019 to 2021

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.

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.

2021

- Review and update PACICC's documented insolvency management procedures as part of maintaining adequate preparedness.

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."

Developing P&C Intervention Guidelines with Insurance Regulators (2017) PACICC reached agreement with OSFI and Autorité des Marchés Financiers (AMF) on intervention guidelines that formalize the joint roles of the regulator and PACICC in responding to financially-distressed insurance companies and protecting policyholders.

Renewing Federal financial sector legislation (2018) PACICC supported Finance Canada’s examination of limits to system-wide risks from earthquake and advanced the case for modernizing the Federal *Winding-Up and Restructuring Act*.

Achievements in 2018

Priority for 2018

Renewing Federal financial sector legislation

PACICC worked closely with IBC to support Finance Canada as it considers how to limit the system-wide risks a catastrophic earthquake could pose to federal P&C insurers. This is an active file. 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 strengthen the soundness and financial stability of Canada’s P&C industry.

PACICC continued 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. PACICC’s 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.

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** A catastrophic earthquake or other factor causes a very large insurer to fail, or leads to multiple, smaller insolvencies; resulting insolvency costs exceed PACICC's risk limit-risk appetite (twice 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 195 member companies regarding a full schedule of Forum activities and events. There are more than 450 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.

Three in-person Forum meetings were held in 2018 (April 5, September 5 and October 31). The latter coincided 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: Risk Culture; Top 10 ERM Best Practices; IFRS 17 (Insurance Contracts); Market Conduct Regulation; PACICC 2018 Benchmark ERM Survey Results; and A.M. Best's Updated Capital Adequacy Model and the Role of ERM within Best's Credit Rating Methodology. Three Emerging Risks Webinars were also held this year, led by subject-matter experts – "*Climate Change*" featuring Paul Kovacs (February 21); "*Marijuana Legalization*" featuring Dr. Brenda Wells (May 16); and "*Artificial Intelligence and Machine Learning*" featuring Dr. Charles Dugas (October 24).

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 2019:

Forum Meetings

- **April 3, 2019** OSFI P&C Insurance Group presentation
- **September 4, 2019** Cyber Security
- **November 2019*** Results of PACICC 2019 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 20, 2018** Cyber Security
- **May 15, 2018** Technological Change
- **October 16, 2018** Government Regulation

PACICC Fund balances

PACICC Liquidation Funds

	<u>Balances on August 31, 2018</u>
Advocate	\$ 15,591
Beothic General	\$ 280,457
Canadian Millers'	\$ 1,107,703
Canadian Universal	\$ 849,347
Gisco	\$ 2,803,575
Hiland	\$ 2,452,415
Maplex	\$ 54
Markham General	\$ 13,041,026
Ontario General	<u>\$ 627,218</u>
Total	\$ 21,177,386

PACICC Compensation Fund Balance

	<u>on September 30, 2018</u>
Total market value	\$54,105,658

PACICC Operating Fund Balance

	<u>Projected to December 31, 2018</u>
Total	\$1,650,000

Projected 2018 revenue and spending, and proposed 2019 budget

	Budget 2018	Projected 2018	Proposed 2019
REVENUE:			
Administrative assessment	\$1,504,000	\$1,442,000 ¹	\$1,477,000 ²
Investment income	\$15,000	\$32,000	\$30,000
Funding from liquidation funds	\$75,000	\$103,000	0
Funding from ICLR	\$100,000	\$100,000	\$25,000
Total Revenue	\$1,694,000	\$1,677,000	\$1,532,000
EXPENSES:			
Sub-total: Salaries and Benefits	\$853,000	\$845,000	\$766,000^{3 4}
Research and other consulting	\$154,000	\$179,000	\$130,000
CEO Search	-	\$48,000	-
Legal fees	\$35,000	\$35,000	\$35,000
Premises	\$155,000	\$170,000	\$170,000
Corp. secretary, finance & admin.	\$46,000	\$46,000	\$46,000
Travel	\$70,000	\$64,000	\$55,000
Directors' fees and expenses	\$92,000	\$70,000	\$70,000
Furniture and equipment	\$27,000	\$38,000	\$20,000
Telephone and postage	\$31,000	\$20,000	\$20,000
Insurance	\$17,000	\$15,000	\$15,000
Annual report and other printing	\$26,000	\$29,000	\$25,000
Investment mgt and banking fees	\$88,000	\$88,000	\$78,000
Audit and other expenses	\$98,000	\$64,000	\$77,000
Contingency	0	0	\$25,000
Sub-total: Non-Salary Expenses	\$839,000	\$866,000	\$766,000
Total Expenses	\$1,694,000	\$1,711,000	\$1,532,000
VARIANCE (Revenue – Expenses)	0	\$(34,000)	0

NOTES:

¹ Assessment revenue decreased due to the loss of nine members (firm closures, industry consolidation).

² The 2019 Budget includes a 3.5% increase in administrative assessments.

³ The 2019 Budget includes provision of 2.0% for salary increases for continuing staff.

⁴ Staff changes include the retirement of Paul Kovacs, Jim Harries and Tracy Waddington and hiring of a new CEO, Denika Hall and Jim Harries's ongoing work as a part-time advisor.