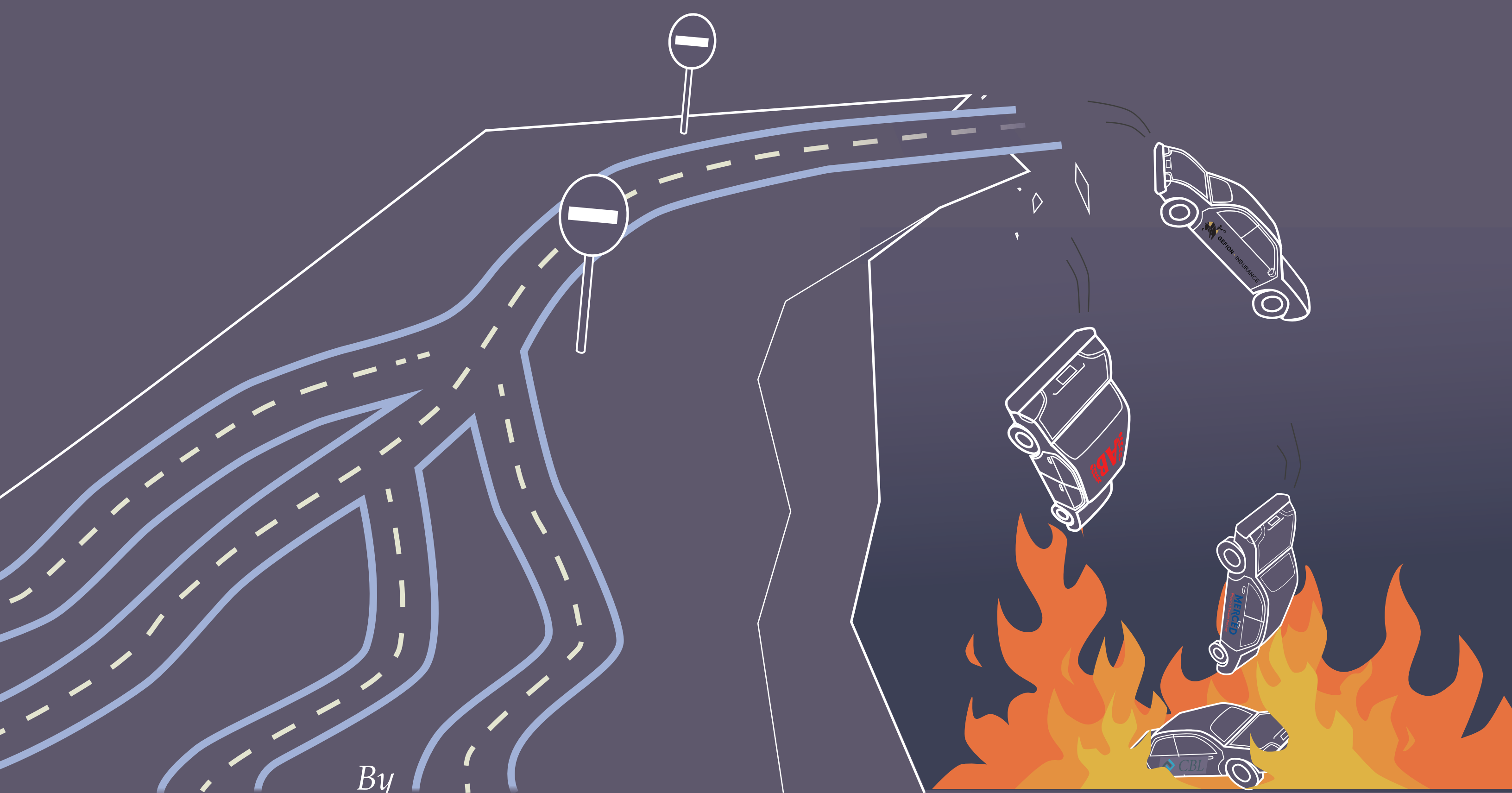
PACICC

Property and Casualty Insurance Compensation Corporation
Société d'indemnisation en matière d'assurances IARD

Why insurers still fail

Mapping the road to ruin: Lessons learned from four recent insurer failures



By

Zhe (Judy) Peng, Ian Campbell and Grant Kelly

The latest instalment in the PACICC *Why insurers fail* series.

2022

Why insurers fail

Mapping the road to ruin: Lessons learned from four recent insurer failures

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PACICC's Vision, Mission and Principles

Vision

To be, and to be recognized as, the authority in Canada supporting the resolution of severely distressed home, auto and commercial insurance companies.

Mission Statement

The mission of the Property and Casualty Insurance Compensation Corporation (PACICC) 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 (P&C) 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

Table of contents

Executive summary 1

Introduction 4

Insolvency case studies 7

1. Internal operations

The case of Gefion Insurance A/S (Denmark, 2021) 7

Causes of the Gefion failure 10

Lessons learned from the Gefion failure 12

References 12

2. Organizational structure

The case of CBL Insurance Limited (New Zealand, 2018) 13

Causes of the CBLI failure 18

Lessons learned from the CBLI failure 20

References 20

3. Adequacy of regulatory oversight

The case of Anbang Insurance Group Co., Ltd. (China, 2020) 22

Causes of the Anbang failure 29

Lessons learned from the Anbang failure 30

References 31

4. Natural disasters

The case of Merced Property and Casualty Company (U.S., 2018) 33

Causes of the Merced failure 36

Lessons learned from the Merced failure 38

References 38

Conclusion 41

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Facts, observations and conclusions in this report are drawn from publicly available information. Some identifying information in the case studies has been altered to preserve confidentiality. The authors are solely responsible for all points made in this study, as well as any errors and/or omissions.

Executive summary

Over the past 15 years, PACICC's *Why Insurers Fail* research series has used both industry analysis and case study examinations to identify key reasons for P&C insurance company failures. The research has focused on failures both within and outside of Canada, including: Advocate General Insurance Company (1989); Maplex General Insurance Company (1995); Canadian Millers' Mutual Insurance Company (2001); HIH Insurance Limited (2001); Reliance Insurance Company (2001); and Markham General Insurance Company (2002). The case studies have helped PACICC to identify common causes of the company failures (primary and contributing) and lessons learned from the failures for both insurance companies and industry regulators. Common causes for P&C insurance company failures identified through this research work include:

1. **Internal operations –** These are problematic approaches to business that include: poor underwriting (improper risk selection); insufficient loss reserving; rapid growth (entry into new markets); inappropriate diversification (new lines of business); risky acquisitions and joint ventures; corporate governance deficiencies (management oversight and internal controls); bad investments; poor capital management; and reinsurance misuse/mismanagement.
2. **Organizational structure –** Holding company arrangements and other complex corporate structures with multiple entities/subsidiaries can lead to issues with corporate governance, transparency, financial reporting, capital management and cost control, and can hamper effective regulatory oversight.
3. **Adequacy of regulatory oversight –** Gaps in regulatory oversight (e.g. inadequate or under-qualified supervisory staffing, lax insurance supervision) can be a significant factor in P&C insurer failures.

Given that two decades have passed since the most recent failure of a Canadian insurer examined in PACICC's *Why Insurers Fail* research series, it is perhaps appropriate to question whether the above causes remain the most common "roads to ruin." Indeed, if one were to focus on Canada exclusively – where the last failure was back in 2004 – it might be tempting to conclude that insurer failures are a thing of the past. After all, there have been many significant improvements, both in the operation and governance of, as well as the supervision of P&C insurers over the past 20 years. Some of these include: risk-based regulation with risk-based capital requirements; risk management best practices; enhanced statutory financial reporting; more sophisticated actuarial and accounting standards; as well as technological advancements which enable more sophisticated pricing and risk selection, and provide both management and regulators with better transparency regarding risks, aggregate exposures and claims development trends.

However, our scan of international markets confirms that, despite the continued evolution of best practice in enterprise risk management and the ever-increasing rigor of prudential oversight across the developed world, property and casualty (P&C) insurance companies can and do still fail – even in highly developed, modern economies. We have selected four very recent P&C failures for deeper case study examination. These are: Gefion Insurance A/S in Denmark (2021); CBL Insurance Limited in New Zealand (2018); Anbang Insurance Group Co., Ltd. in China (2020); and Merced Property & Casualty Company in California, U.S. (2018).

Table 1 (see page 4) summarizes the previous case studies conducted by PACICC and the identified causes (primary and contributing) of the insurer failures. The facts presented in these more recent cases are interesting on their own, but our findings are clear and provide important confirmation that the "traditional" causes of failure still apply today. Internal operations, organizational structure and adequacy of regulatory oversight figure prominently in these recent failures. Perhaps even more important though, is the realization that climate change, fueling increases in natural disasters, has become a new and significant source of potential insurance failures.

This paper thus concludes that we need to add a fourth common cause of insurer failure to the traditional list:

4. **Natural disasters** – Failure to properly understand exposure aggregation, and the inadequate stress-testing of capital and reinsurance requirements in the context of such aggregations, can lead directly to sudden insurer failure. Naturally occurring perils that can lead to catastrophic loss include: earthquakes, floods, hurricanes, tornadoes, wildfires, landslides, severe storms and storm surges. Many of these perils appear to be accelerating in line with scientists' warnings regarding the consequences of climate change.

The three most common causes of P&C insurer failure, identified through our past research, have not changed over time. Despite numerous improvements in P&C insurers' operations, governance and supervision, it is still possible for insurers to fail – and they continue to do so. The role of climate change in magnifying the damage caused by naturally occurring perils adds a new dynamic to the equation. This is now a fourth potential cause of P&C insurer failure.

The factors that lead to P&C insurer failures are not unique to any one country, or to any single business strategy. Our case examples show that they have universal application. Possible “roads to ruin” exist all over the world. It is for this reason that PACICC and all engaged industry participants must remain ever-vigilant about the financial health of P&C insurers in Canada.

Introduction

PACICC's *Why Insurers Fail* research series has used industry analysis and case study review to identify the root causes of several property and casualty (P&C) insurance company failures. The case studies have examined P&C company failures within and outside of Canada. Company failures in Canada have included: Advocate General Insurance Company (1989); Maplex General Insurance Company (1995); Canadian Millers' Mutual Insurance Company (2001); and Markham General Insurance Company (2002). Failures outside of Canada have included HIH Insurance Limited (2001) and Reliance Insurance Company (2001). Interestingly, the latter was a U.S. company failure that led to the demise of its branch office in Canada.

Table 1 – Causes of insurer failures

Cause of Failure	Advocate General Insurance Company (1989)	Maplex General Insurance Company (1995)	Canadian Millers' Mutual Insurance Company (2001)	HIH Insurance Limited (2002)	Reliance Insurance Company (2001)	Markham General Insurance Company (2002)
1. Internal operations						
Poor underwriting	P	P	P	P		P
Inefficient reserving	P	P		P	P	S
Rapid growth (New markets)	P	P	P	S	P	
Inappropriate diversification (New lines of business)			S	S	P	
Risky acquisitions/joint ventures				S		
Cost control			P			P
Corporate governance deficiencies	S	P	S	S	P	P
Bad investments					P	
Poor capital management		P	P		P	P
Reinsurance misuse/mismanagement			S	S		P
Fraud		S				
2. Organizational structure				P		
3. Adequacy of regulatory oversight	S	P		S	S	
4. Natural disaster						

P Primary S Secondary

Source: PACICC *Why Insurers Fail* Studies (2008, 2010, 2012, 2014, 2018, 2020 and 2022)

Over the past 15 years, PACICC's *Why Insurers Fail* studies have helped to identify a number of primary and contributing causes of insurer failure, and lessons to be learned for both insurance companies and industry regulators. These findings are summarized in Table 1 on the previous page, where the year of the failure appears in brackets.[1]

Given that two decades have passed since the most recent failure of an insurer examined in PACICC's *Why Insurers Fail* research series, it is perhaps appropriate to question whether the above causes remain the most common "roads to ruin." There have been a number of general improvements in the global business environment over the past 20 years that should materially reduce the risk of insurer insolvency. These improvements include: risk-based regulation with risk-based capital requirements; risk management best practices; enhanced statutory financial reporting; more sophisticated actuarial and accounting standards; as well as technological advancements which enable more sophisticated pricing and risk selection, and provide both management and regulators with better transparency regarding risks, aggregate exposures and claims development trends.

Yet, some P&C insurers continue to fail. Our current study examines four such P&C failures over the past five years. We looked abroad for these recent examples, as the last insurer insolvency in Canada was 19 years ago (Home Insurance Company). These more recent failures are: Gefion Insurance A/S in Denmark (2021); CBL Insurance Limited in New Zealand (2018); Anbang Insurance Group Co., Ltd. in China (2020); and Merced Property & Casualty Company in California, U.S. (2018). Past *Why Insurers Fail* reports have categorized common causes for P&C insurance company failures into three general areas: internal operations, organizational structure and adequacy of industry oversight.

The first category, **internal operations**, is particularly relevant in relation to the failure of Gefion Insurance A/S in Denmark in 2021. Past *Why Insurers Fail* reports have cited a host of problems with business approaches which have led directly to insurer failure.

The second category, **organizational structure**, is particularly relevant in relation to the failure of CBL Insurance Limited in New Zealand in 2018. Our past studies have shown that complicated organizational structures, where holding companies have layers of companies that are active in numerous jurisdictions and across several lines of business, can prove

[1] Dibra, Suela and Jim Harries, "Why Insurers Fail: Lessons learned from the failure of Maplex General Insurance Company," PACICC, 2008; Harries, Jim, "Why Insurers Fail: Lessons learned from the failure of Advocate General Insurance Company," PACICC, 2010; Harries, Jim, "Why Insurers Fail: Lessons learned from the failure of Markham General Insurance Company," PACICC, 2012; Harries, Jim, "Why Insurers Fail: Lessons learned from the failure of Canadian Millers' Mutual Insurance Company," PACICC, 2014; Campbell, Ian, "Why Insurers Fail: Lessons learned from the failure of HIH Insurance Limited," PACICC, 2018; Campbell, Ian, "Why Insurers Fail: Lessons learned from the failure of Reliance Insurance Company," PACICC, 2020.

challenging for regulators. The complexity of company operations can lead to issues with corporate governance, transparency, financial reporting, capital management. cost control and regulatory oversight.[2]

The third category, **adequacy of regulatory oversight**, is particularly relevant in relation to the failure of Anbang Insurance Group Co., Ltd. in China in 2020. Good regulation is good for business. Risk-based government oversight, with effective controls that provide early warning of problem situations, helps to guide companies toward successful outcomes. These controls include: comprehensive financial reporting requirements, rigid accounting standards and skeptical insurance supervision. Where such oversight is not effectively exercised, the risk of insurer failure is amplified.

Our report introduces a fourth new category, **natural disasters**, with an examination of the sudden failure of Merced Property & Casualty Company in California in 2018. This case demonstrates that climate change, fueling increases in naturally occurring perils (e.g. floods, hurricanes, tornadoes, wildfires, landslides, severe storms and storm surges), adds a new and significant source of potential insurance failure. Failure to properly understand exposure aggregation coupled with inadequate stress-testing of capital and reinsurance requirements in the context of such aggregations, can lead directly to sudden insurer failure. High-impact, low-probability perils, while not cited as a primary cause of failure in any of the *Why Insurers Fail* research studies to date, have more recently led to numerous P&C insurers failures abroad.

The facts in these new cases are revealing, and the findings clear. Issues with internal operations, organizational structure, adequacy of regulatory oversight and natural disasters figure prominently in these failures. Fatal flaws in the actions and approaches of the four companies put each of them on the “road to ruin.” We mean no disrespect to Robert Frost when we caution that this is a road that is best left untraveled.

[2] Campbell, Ian, “Why Insurers Fail: Lessons Learned from the failure of HIH Insurance Limited,” PACICC, 2018.

1. Internal operations

The case of Gefion Insurance A/S (Denmark, 2021)

Gefion Insurance A/S (Gefion) was established in Copenhagen, Denmark in 2014. It offered automobile insurance to customers within the European Union through agents and brokers. Gefion wrote business in Denmark, France, Germany, Ireland, Italy, Poland and the U.K. under "freedom of services."[3] The U.K. was its largest market. Gefion's business focused on individuals and small and medium-sized companies, and specialty lines in different countries.[4] The company became insolvent in the space of six short years – a victim of rapid expansion. Table 2 presents seven key ratios drawn from Gefion's Annual Reports for the years 2015–2019.

Table 2 – Key financial ratios – Gefion Insurance A/S (2015–2019)

Key ratio	2015 %	2016 %	2017 %	2018 Original %	2018 Restated %	2019 %
Gross expense ratio	295.7	52.1	31.1	25.6	25.6	19.8
Gross claims ratio	59.7	38.9	66.8	90.5	90.5	93.1
Reinsurance ratio	9.2	10.0	0.8	–14.3	–12.4	–9.8
Combined ratio	364.7	100.9	98.7	101.8	103.6	103.1
Return on equity (After tax)	–49.0	–7.3	18.1	–88.2	–161.2	–429.4
Solvency ratio (Unaudited)	150	102	123	Not Available	Not Available	Not Available
Solvency ratio (Restated)	150	95	119	Not Available	72	Not Available

Source: Gefion Insurance A/S Annual Reports (2016–2019)

Gefion's gross expense ratio (measuring the percentage of premium used to pay all costs of acquiring, writing, and servicing insurance and reinsurance) fell consistently through the period, from 295.7 percent in 2015 down to 19.8 percent in 2019. Between 2016 and 2019, its gross claims ratio (measuring the percentage of claims costs incurred in relation to premiums earned) rose steadily, from 38.9 percent to 93.1 percent. The firm's reinsurance ratio (measuring reinsurance premiums ceded to premiums written) was negative in 2018 and 2019. Gefion's combined ratio (measuring losses and expenses divided by earned premium) shows that it was profitable in only one year over this period (2017). This is also reflected in the return on equity, which was positive only in that year.

[3] EIOPA, Bankruptcy of Gefion Finans A/S under frivillig likvidation.

[4] DFSA, Supervision Orders, Gefion Insurance A/S.

Gefion experienced 53 percent annual growth in its gross premium income in 2018. However, its solvency ratio fell to 72 percent, which was well below the statutory level of 100 percent. The company's rapid expansion was a serious cause of concern for its regulator, the Danish Financial Supervisory Authority (DFSA, or Finanstilsynet). The DFSA initiated an in-depth investigation into Gefion's business operations in November of 2018. On-site inspections of several of the company's agents and claims handlers were carried out in collaboration with local supervisory authorities. Essential areas were subject to a risk-based assessment. The inspection included: the company's business model, outsourcing, technical provisions, investment area, solvency, capital, capital plan, board of directors and management system.[5]

The DFSA review found numerous deficiencies with Gefion's operations, including:

- **Management controls –** The review focused on Gefion's management system, especially in relation to the control of outsourced activities. It found that Gefion did not have necessary control of external agents and claims managers, and that it lacked a sufficiently effective compliance, risk management and internal audit function. The DFSA assessment revealed that Gefion lacked effective corporate governance.[6] Given that the company's management system deviated so significantly from the legal requirements, the DFSA made Gefion subject to a capital add-on of DKK 39.2 million to its solvency capital requirement.[7]
- **Solvency ratio –** On May 31, 2019, Gefion's solvency ratio was 105 percent. However, the imposed capital add-on decreased Gefion's solvency ratio to 86 percent. Gefion lacked sufficient funds to restore its solvency capital requirement to required levels. Due to the company's tenuous solvency situation, the DFSA ordered Gefion not to further expand its business volume.
- **Loss ratio –** Gefion used loss ratios for the underwriting year 2018 to calculate premium provisions.[8] It had not documented that this was the best estimate to reflect risks for the run-off risk periods. Gefion was ordered to calculate its best estimate for premium provisions using all relevant data.
- **Reinsurance recoverables –** The DFSA found that Gefion did not adjust the amounts recoverable from reinsurance arrangements with expected losses from the default of a counterparty. The company was ordered to do so. The DFSA noted that Gefion used a

[5] Ibid.

[6] Ibid.

[7] Ibid.

[8] According to *Solvency II Technical Provisions for General Insurers* (2013, pg. 6), premium provision is defined as "the discounted best estimate of all future cash flows…relating to future exposure arising from policies that the (re) insurer is obligated to at the valuation date."

simplified method for calculating the risk-mitigating effect of its reinsurance contracts. The DFSA said that this simplified method was not proportional to the nature, extent and complexity of risks associated with its reinsurance contracts, as Gefion relied heavily on various forms of reinsurance from several reinsurers. Gefion was ordered to make a thorough calculation of the risk-mitigating effects of all of its reinsurance contracts.[9]

- **Accounting receivables –** The DFSA ordered Gefion to recognize impairment losses on receivables from three of the company's agents, due to the agents' financial situations. For one of the receivables, Gefion was permitted to omit recognition of impairment losses if it could document to the DFSA that the agent did not have significant financial difficulties. The DFSA also ordered Gefion to ensure that it had a proper accounting practice in place and was able to document its activities.[10]
- **Own Risk and Solvency Assessment (ORSA) –** The DFSA noted that Gefion's assessment of its ORSA did not include an assessment of its ability to comply with the solvency capital requirement and the minimum capital requirement, both within 12 months and for a period at least equal to the company's strategic planning period. Gefion was ordered to make this assessment.
- **Premium provisions –** The DFSA found that Gefion was not calculating its premium provisions in homogeneous risk groups, with calculations based on grouped data. It was ordered to correct this.

In April of 2019, the DFSA determined that Gefion had overstated its income by including deferred taxes. It ordered Gefion to take necessary measures to have liquid assets of at least EUR 5 million by the end of December of 2019. This caused the company to revise its 2018 ratios, highlighted in Table 2. The DFSA informed the host national supervisory authorities via the European Insurance and Occupational Pensions Authority (EIOPA) Cross-Border Platform of Collaboration about the order issued to Gefion.[11]

On November 28, 2019, the DFSA ordered Gefion to prepare a recovery plan, as the company was no longer fulfilling its solvency capital requirement. The recovery plan was to lead to the solvency capital requirement being fulfilled within six months. The DFSA refused to approve Gefion's recovery plan once it was submitted, because the company did not provide sufficient evidence that it could fulfill its solvency capital requirement within six months, and hence be able to adequately protect the interests of current and future policyholders.

[9] Op. Cit.

[10] Ibid.

[11] Ibid.

On March 24, 2020, the DFSA ordered Gefion to stop writing business (including renewals of existing insurance policies), until such time that the DFSA could approve a recovery plan or the company complied with its solvency capital requirement. On June 24, 2020, the DFSA revoked Gefion's insurer's licence to conduct insurance business due to its inability to meet its Solvency Capital Target. As of June 29, 2020, Gefion could no longer write new business or renew existing insurance policies. On July 13, 2020, Gefion entered into solvent liquidation.[12] It continued to settle claims, with existing policies remaining in force. It appeared that the company had sufficient assets to cover its liabilities. Gefion's assets were being liquidated, with proceeds being distributed to creditors. However, Gefion's failure to fend off a EUR 30 million legal claim from a German car rental company, soon pushed the company into formal bankruptcy. Gefion's request for bankruptcy was granted by Denmark's Maritime and Commercial High Court on June 7, 2021.

The failure of Gefion affected some 600,000 policyholders across Europe. The Danish Guarantee Fund only covered risks (within the scope of coverage) in the country's jurisdiction – for insurance policies written in Denmark. European policyholders outside of Denmark were required to consult with their country's national insurance guarantee scheme (not all EU member states have a guarantee scheme in place) to determine whether their losses were protected.[13] Given that this insolvency occurred within the past year, with costs spread across several European jurisdictions, the total cost of the failure remains unclear at this point.

Causes of the Gefion failure

Gefion failed for a number of reasons related to internal operations, including:

- **Corporate governance deficiencies –** Gefion had insufficient control of outsourced activities and ineffective compliance, risk management and internal audit functions. This was also a primary cause of failure for Maplex General Insurance Company, Markham General Insurance Company and Reliance Insurance Company, and a contributing cause of failure for Advocate General Insurance Company, Canadian Millers' Mutual Insurance Company and HIH Insurance Limited.
- **Rapid growth –** The company undertook rapid growth in new markets across Europe in the space of just six years. This was also a primary cause of failure for Maplex General Insurance Company, Advocate General Insurance Company, Canadian Millers' Mutual Insurance Company and Reliance Insurance Company, and a contributing cause of failure for HIH Insurance Limited.

[12] In solvent liquidation, the insurer has the ability to pay its debts that are due in the next twelve months. However, this short-term viability does not imply that the insurer is solvent in the long run.

[13] Ibid.

- **Poor capital management –** Gefion maintained insufficient capital to cover its solvency capital requirement. This was also a primary cause of failure for Maplex General Insurance Company, Advocate General Insurance Company, Markham General Insurance Company, Canadian Millers' Mutual Insurance Company and HIH Insurance Limited.
- **Reinsurance mismanagement –** Gefion employed a simplified method for calculating the risk-mitigating effect of its reinsurance contracts. This was also a primary cause of failure for Markham General Insurance Company and a contributing cause of failure for Canadian Millers' Mutual Insurance Company and HIH Insurance Limited.

These causes are summarized in Table 3, which also includes the causes of insurer failures profiled in six past *Why Insurers Fail* studies.

Table 3 – Causes of insurer failures

Cause of Failure	Gefion Insurance A/S (2001)	Advocate General Insurance Company (1989)	Maplex General Insurance Company (1995)	Canadian Millers' Mutual Insurance Company (2001)	HIH Insurance Limited (2002)	Reliance Insurance Company (2001)	Markham General Insurance Company (2002)
1. Internal operations							
Poor underwriting		P	P	P	P		P
Inefficient reserving		P	P		P	P	S
Rapid growth (New markets)	P	P	P	P	S	P	
Inappropriate diversification (New lines of business)				S	S	P	
Risky acquisitions/joint ventures					S		
Cost control				P			P
Corporate governance deficiencies	P	S	P	S	S	P	P
Bad investments						P	
Poor capital management	P		P	P		P	P
Reinsurance misuse/mismanagement	P			S	S		P
Fraud			S				
2. Organizational structure					P		
3. Adequacy of regulatory oversight		S	P		S	S	
4. Natural disaster							

P Primary S Secondary

Source: PACICC *Why Insurers Fail* Studies (2008, 2010, 2012, 2014, 2018, 2020 and 2022)

Lessons learned from the Gefion failure

Gefion failed for a number of reasons related to internal operations, including:

1. **Internal controls –** Effective internal controls are essential to ensure accountability and encourage the proper use of a company's assets and resources.
2. **Entry into new markets and new lines of business –** Companies must exercise caution and carefully manage uncertainties when expanding into unfamiliar markets and new lines of business in which they have no past experience.
3. **Capital management –** Maintaining capital strength is critically important for the success of any insurer.
4. **Reinsurance arrangements –** When used properly, reinsurance is a legitimate and effective means for an insurer to augment its capital base, but it is not a solution for insurers with chronic underwriting losses.

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Danish Financial Services Authority (DFSA), *Supervision Orders: Gefion Insurance A/S.* Available at https://www. dfsa.dk/Supervision/Orders/Gefion 121219. Accessed on March 5, 2022.

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Insurance Times, "Gefion liquidators revealed after unrated insurer's licence revoked," July 16, 2020. Available at https://www.insurancetimes.co.uk/news/gefion-liquidators-revealed-after-unrated-insurers-licence-revoked/1433749.article. Accessed on March 6, 2022.

2. Organizational structure

The case of CBL Insurance Limited (New Zealand, 2018)

CBL Insurance Limited (CBLI) was established in New Zealand in 1973, specializing in construction and real estate insurance. Its building and construction-related classes of insurance were "long-tail," with claims reporting periods of ten years or more. The company began to operate overseas in the 1990s. While CBLI's primary area of expertise was in contractor and construction bonds, over the years, offerings expanded to include builders' warranty products, property deposit and rental guarantee bonds, travel and cargo agents and reinsurance support. CBLI also gained experience in event financing, passenger protection, student fee insurance and pet insurance.[14]

New Zealand's *Insurance (Prudential Supervision) Act*, passed in September of 2010, required all insurers to be licensed to carry on business in New Zealand. As per the Act, the Reserve Bank of New Zealand (RBNZ) became the prudential regulator of the insurance sector. Since CBLI provided insurance cover and was incorporated in New Zealand, RBNZ issued a full insurance licence to CBLI on September 4, 2013 and became the company's "home country" regulator and prudential supervisor.

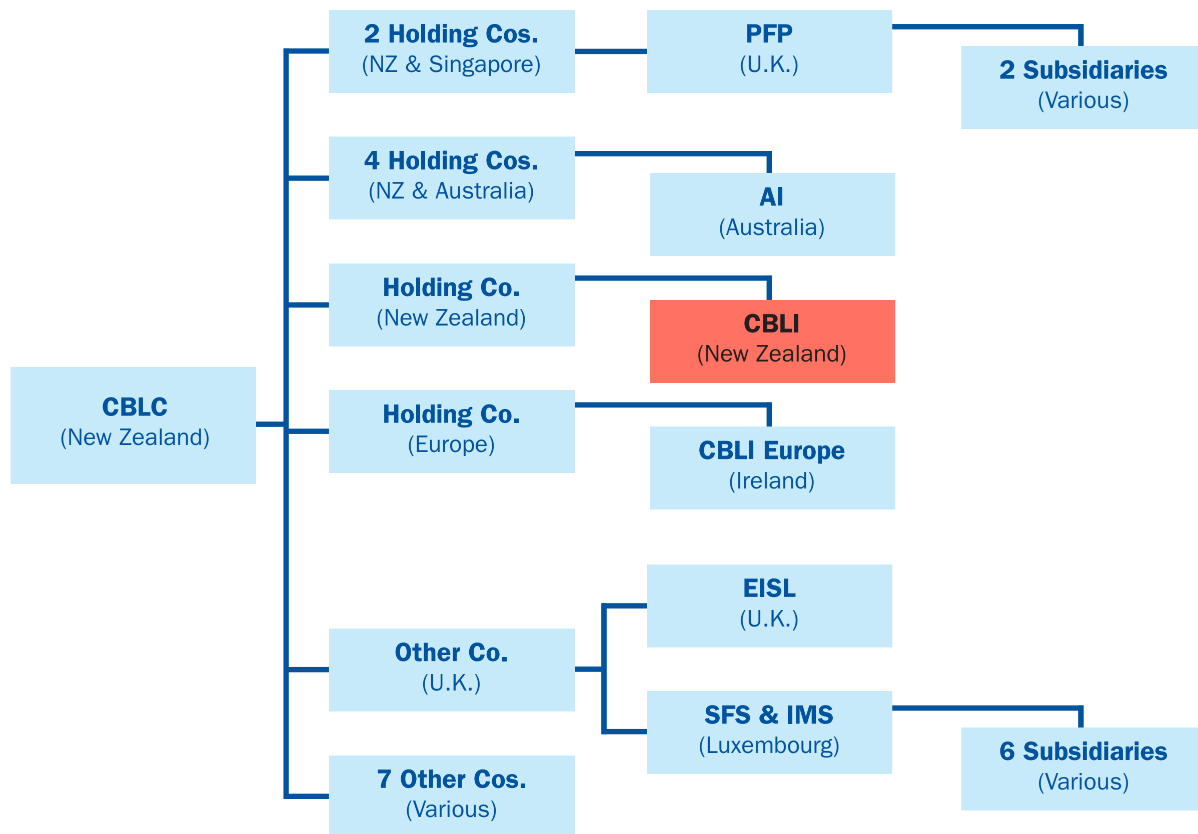
CBLI was a wholly-owned subsidiary of parent company CBL Corporation (CBLC), which was listed on the New Zealand (NZX) and Australian (ASX) stock exchanges on October 13, 2015.[15] CBLC had business operations around the world, including France, the U.K., Australia and Ireland. Given that almost all of CBLI's business was offshore, RBNZ's actions in supervising CBLI affected only a very small number of policyholders in New Zealand.

CBLI's place in parent company CBLC's elaborate corporate structure is highlighted in Exhibit 1. It is common for non-operating holding companies to own one or more insurance companies, as well as other subsidiaries. This was also the case with HIH Insurance Limited, which was the subject of PACICC's *Why Insurers Fail* study in 2018.

[14] Business Insurance Magazine, "CBL Insurance: Everything You Need to Know."

[15] Reserve Bank of New Zealand, "CBL Insurance Limited – (in liquidation)."

Exhibit 1 – CBLC simplified corporate structure



Source: Reserve Bank of New Zealand

CBLI expanded rapidly between 2012 and 2018. By 2013, it was writing the vast majority of its business as offshore inward reinsurance from Europe, mainly in France. In 2013, gross written premiums totaled NZD 165 million – but less than NZD 2 million of this was actual New Zealand business.[16] Premiums continued to climb and were NZD 247 million in 2016 and NZD 313 million by 2017. Expansion was achieved by acquiring a range of managing general agents across Europe. In 2016, CBLI's parent company, CBLC, acquired Securities and Financial Solutions (SFS), the largest insurer offering builders' warranty in France. This acquisition resulted in substantial, additional reinsurance exposure for CBLC.

From 2013 on, CBLI's balance sheet steadily deteriorated in relation to its statutory minimum capital requirement. The insurer had shortfalls of: NZD 86.6 million in 2013; NZD 102 million in 2014; NZD 104 million in 2015; NZD 98.6 million in 2016; and NZD 136.5 million in 2017. In December of 2017, CBLI's solvency ratio fell to 25 percent,

[16] Trowbridge, John and Mary Scholtens, "An Independent Review for the RBNZ of the Supervision of CBL Insurance Ltd," Reserve Bank of New Zealand, pg. 4.

Table 4 – Key financial ratios – CBLI Ltd (2011–2016)

Key ratio	2011 %	2012 %	2013 %	2014 %	2015 %	2016 %
Expense ratio	46.79	48.63	48.11	42.89	43.01	42.12
Loss ratio	33.91	30.54	37.87	41.31	35.82	33.14
Combined ratio	80.70	79.17	85.98	84.20	78.84	75.26
Operating ratio	75.21	74.26	82.02	83.00	74.26	74.05
Retention ratio (NPW/GPW)	62.44	67.06	73.13	90.54	90.79	91.10
Return on equity	17.80	26.56	33.10	31.57	30.95	30.19
Solvency ratio			120.60	138.80	115.20	186.60

Source: Calculated from CBLI Annual Reports, 2011–2016 (CBLI Annual Reports are only available up to 2016)

suggesting severe under-reserving. Although the company's key loss ratio indicators suggested good performance (see Table 4), these numbers were later found to be substantially exaggerated.

Soon after RBNZ commenced supervision of CBLI, the regulator began to have doubts about the company's claims reserves and solvency. It was also concerned about CBLI's risk management practices (long-tail business, rapid growth and offshore focus). A formal inquiry after the company's liquidation established that RBNZ had failed to resolve these concerns for a number of reasons, including: a legal opinion warning against challenges to the company's assertions of financial strength, limited supervisory resources, staff inexperience and competing regulatory priorities.

Although RBNZ had suspected that CBLI was under-reserved, the company consistently maintained that it was fully reserved for all outstanding claims. Only years later would it be shown that CBLI had failed to accurately estimate claims liabilities and establish adequate claims reserves. Claims cost estimation error for short-tail classes of insurance (e.g. home and automobile) is relatively lower than those for long-tail classes, so the prospect of having inadequate reserves can be less problematic. However, accurate claims cost estimation matters greatly for long-tail business – like the policies written by CBLI. The longer the tail, the greater is an insurer's reliance on estimates of future claim payments, rather than past payments.[17] Interestingly, the estimation of long-tail workers' compensation claims costs was also a significant issue in the HIH Insurance Limited insolvency.

[17] Ibid., pg. 7.

CBLI encountered several well-publicized adverse developments relating to its business in Europe. At that time, there were five European regulators with a strong interest in CBLI operations:

- **U.K. –** Gibraltar Financial Services Commission (GFSC), supervising Elite Insurance (Elite)
- **Denmark –** Danish Financial Services Authority (DFSA), supervising Alpha Insurance (Alpha)
- **Ireland –** Central Bank of Ireland, supervising CBL Insurance Europe (CBLI Europe)
- **France –** Autorité de contrôle prudentiel et de résolution (ACPR), supervising the French market
- **European Union –** European Insurance and Occupational Pensions Authority (EIOPA), as part of the European System of Financial Supervisors, working in conjunction with the country supervisors.[18]

In 2017, European insurers that were heavily reliant on reinsurance from CBLI started to encounter difficulties with their European insurance regulators, for not maintaining large enough claims reserves. CBLI's fortunes would soon begin to unravel from there. The company's single largest source of inward reinsurance business was Elite, in Gibraltar. In mid-2017, UK regulator GFSC sounded alarms about Elite's solvency position, pointing to a PwC (UK) report that it had commissioned which raised concern about material under-reserving by CBLI for its reinsurance of Elite.[19]

On June 14, 2017, RBNZ sought information from CBLI about its French business, and a description of any other CBLI insurance or reinsurance business for which Elite (UK) or Alpha (Denmark) was either cedant or reinsurer. Elite, Alpha and CBLI Europe wrote French Directors & Officers and Directors Liability insurance and reinsured most of it with CBLI. On June 23, 2017, the Irish regulator – Central Bank of Ireland – issued an information order to CBLI Europe. In France, CBLI responded to French regulator ACPR's request for information regarding the reserves of the company's French business. In July, Danish regulator DFSA required Alpha to substantially increase its claims reserves. The Irish regulator directed CBLI Europe to withhold payment of CBLI reinsurance premiums. On July 5, 2017, Elite was put into solvent run-off in the UK.

[18] Trowbridge, John and Mary Scholtens, "An Independent Review for the RBNZ of the Supervision of CBL Insurance Ltd," Reserve Bank of New Zealand, pg. 67–68.

[19] Reserve Bank of New Zealand, "CBL Insurance Limited – (in liquidation)."

RBNZ directed CBLI to maintain a solvency ratio of 170 percent and ordered the company not to enter into any transaction or series of transactions (without its permission) that provided new or increased levels of financial support to any insurer or reinsurer that was not currently owned by its parent company CBLC. In August of 2017, RBNZ appointed a specialist advisory and restructuring firm (McGrathNicol) and actuarial experts (Milliman and Finity) to examine CBLI's claims reserves and solvency. CBLI's new appointed actuary and the investigating actuaries all saw the need for substantially increased claims reserves at that time (late 2017 and early 2018), demonstrating that CBLI was not meeting RBNZ's solvency requirements.[20]

On September 17, 2017, CBLI requested permission to increase its reinsurance of Elite (UK) from 80 percent to 100 percent for all past business. RBNZ declined the request. On September 29, 2017, CBLI's semi-annual solvency return showed a solvency ratio of 132 percent, as of June 30, 2017. CBLI advised RBNZ that it was reviewing restructuring options. On November 15, 2017, CBLI and its appointed actuary informed RBNZ that the company was unlikely to achieve a solvency margin of 170 percent on December 31, 2017. On November 22, 2017, RBNZ ordered insurer CBLI and parent company CBLC not to enter into any transaction or series of related transactions involving payments or transfers of assets in excess of NZD 5 million, without RBNZ's prior consent.

On January 3, 2018, SFS – CBLC's French subsidiary – was fined EUR 5,000 by its Luxembourg regulator, after it determined that SFS was operating outside of its authority as an insurance agent. On February 2, 2018, the New Zealand and Australian stock exchanges halted trading of parent company CBLC's shares. Four days later, CBLC forecast an after-tax loss of up to NZD 85 million. This stemmed from an NZD 100 million increase in reserves for its French business, and an NZD 44 million write-off of SFS receivables. On February 7, 2018, the Irish regulator started a supervisory engagement of CBLI Europe.

At this point, the RBNZ appointed independent investigators and ordered CBLI not to make a proposed EUR 25 million payment to Alpha (Denmark), or to enter into any other transaction or series of related transactions worth NZD 1 million or more, without its written permission. Less than two weeks later, CBLI made payments totaling approximately NZD 55 million to Alpha (Denmark) and United Specialty Insurance Company (U.S.), without consulting RBNZ and in violation of the order. On February 17, 2018, CBLI was found to have a shortfall of NZD 294 million in relation to its New Zealand solvency standards. Two days later, the Central Bank of Ireland – the Irish regulator – directed CBLI Europe to cease underwriting new business.

[20] Op. Cit., pg. 5.

On February 23, 2018, the High Court of New Zealand appointed interim liquidators for CBLI, noting that the company had failed to maintain its solvency margin and breached the RBNZ directive regarding corporate transactions. On November 12, 2018, the New Zealand High Court ordered the liquidation of CBLI. Trading in parent company CBLC's shares was suspended. CBLC was placed into full liquidation on May 13, 2019. [21]

The failure of CBLI had several ripple effects. The two European insurers that relied on CBLI for reinsurance were forced into run-off – Elite (U.K.) in July of 2017 and Alpha (Denmark) in March of 2018. As well, the failure of CBLI brought significant losses to the second and tenth largest retirement savings providers in New Zealand (ASB and AMP). It also affected the performance of two Chinese banks – Bank of China (New Zealand) and Industrial and Commercial Bank of China (New Zealand) which had loaned a total of NZD 55 million to CBLI before its collapse. The failure also resulted in the spin-off of a former subsidiary, Deposit Power, an Australian deposit bond provider.

The cessation of business by CBLI, its placement into liquidation and the events leading to its liquidation caused RBNZ to review its prudential regulatory and supervisory arrangements for insurance companies that it licensed.[22] An inquiry revealed that while RBNZ had suspected that CBLI was under-reserving as early as 2013, given that CBLI's business was almost entirely offshore and its impact on the New Zealand economy viewed as low, RBNZ had allocated its supervisory resources elsewhere in New Zealand to deal with other priorities.[23]

CBLI liquidators brought proceedings against the company's six directors, seeking to recover losses of NZD 316 million. They also sought to recover NZD 278 million from CBLI's appointed actuaries (PwC), alleging that the actuaries had failed in their duties to CBLI in various ways, contributing to CBLI's collapse. The CBLI liquidation prompted two competing class actions (institutional investors and individual investors) and three regulatory actions (civil proceedings against company directors and officers) in New Zealand's court system by the end of 2019.[24] Litigation is ongoing.

Causes of the CBLI failure

There were a number of leading causes of the CBLI failure, including:

- **Organizational structure –** CBLC's (holding company) corporate structure enabled CBLI to operate as a reinsurer in Europe and write most of its business outside of New Zealand, without appropriate local supervisory scrutiny.

[21] Chamberlain, Nikki, "CBL Collapse Ignites Firestorm of Litigation."

[22] Trowbridge, John and Mary Scholtens, "An Independent Review for the RBNZ of the Supervision of CBL Insurance Ltd," Reserve Bank of New Zealand, pg. 4.

[23] Ibid., pg. 7.

[24] Ibid.

- **Reserving** – CBLI failed to properly estimate reserves required to cover its long-tailed claims.
- **Regulatory intervention** – RBNZ took a cautious approach to investigating CBLI more closely, even though it suspected that the company had been under-reserving its long-tailed claims for many years. RBNZ was less inclined to devote material resources to supervising portfolios that had little connection with New Zealand policyholders.
- **Outsourcing** – CBLI outsourced not only its back-office functions, but also fundamental insurance operations (e.g. underwriting, pricing and claims management).

Table 5 – Causes of insurer failures

Cause of Failure	CBL Insurance Limited (2018)	Gefion Insurance A/S (2001)	Advocate General Insurance Company (1989)	Maplex General Insurance Company (1995)	Canadian Millers' Mutual Insurance Company (2001)	HIH Insurance Limited (2002)	Reliance Insurance Company (2001)	Markham General Insurance Company (2002)
1. Internal operations								
Poor underwriting	P		P	P	P	P		P
Inefficient reserving			P	P		P	P	S
Rapid growth (New markets)		P	P	P	P	S	P	
Inappropriate diversification (New lines of business)					S	S	P	
Risky acquisitions/joint ventures						S		
Cost control	P				P			P
Corporate governance deficiencies	P	P	S	P	S	S	P	P
Bad investments							P	
Poor capital management		P		P	P		P	P
Reinsurance misuse/mismanagement		P			S	S		P
Fraud				S				
2. Organizational structure	P					P		
3. Adequacy of regulatory oversight	P		S	P		S	S	
4. Natural disaster								

P Primary S Secondary

Source: PACICC *Why Insurers Fail* Studies (2008, 2010, 2012, 2014, 2018, 2020 and 2022)

Lessons learned from the CBLI failure

- **Holding company supervision** – A "whole company" approach is needed when supervising insurance groups that own non-operating holding companies and insurance subsidiaries (as in the CBLI and HIH cases). This approach ensures capital integrity and enforces protection against contagion risk within the group. In the absence of group supervision, parent companies can borrow funds (which are not capital) and use them to "capitalize" insurance subsidiaries. Group regulation helps to identify and eliminate this double use of funds.
- **Reserving** – Adequate provisions for outstanding claims are critical to the financial health of any insurance company.
- **Regulatory oversight** – When in doubt about a company's financial soundness, regulators must be prepared to act quickly, forcefully and skeptically and make full use of powers available.
- **Regulatory capacity** – Regulatory capacity – Jurisdictions that are host to insurance groups, and which are expected to be accountable for oversight of international subsidiaries, need to have the resources and capabilities to perform the crucial supervisory functions.

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Reserve Bank of New Zealand, “CBL Insurance Limited – (in liquidation).” Available at https://www.rbnz.govt. nz/ regulation-and-supervision/insurers/regulation/cbl-insurance-limited-in-liquidation. Accessed on March 28, 2022.

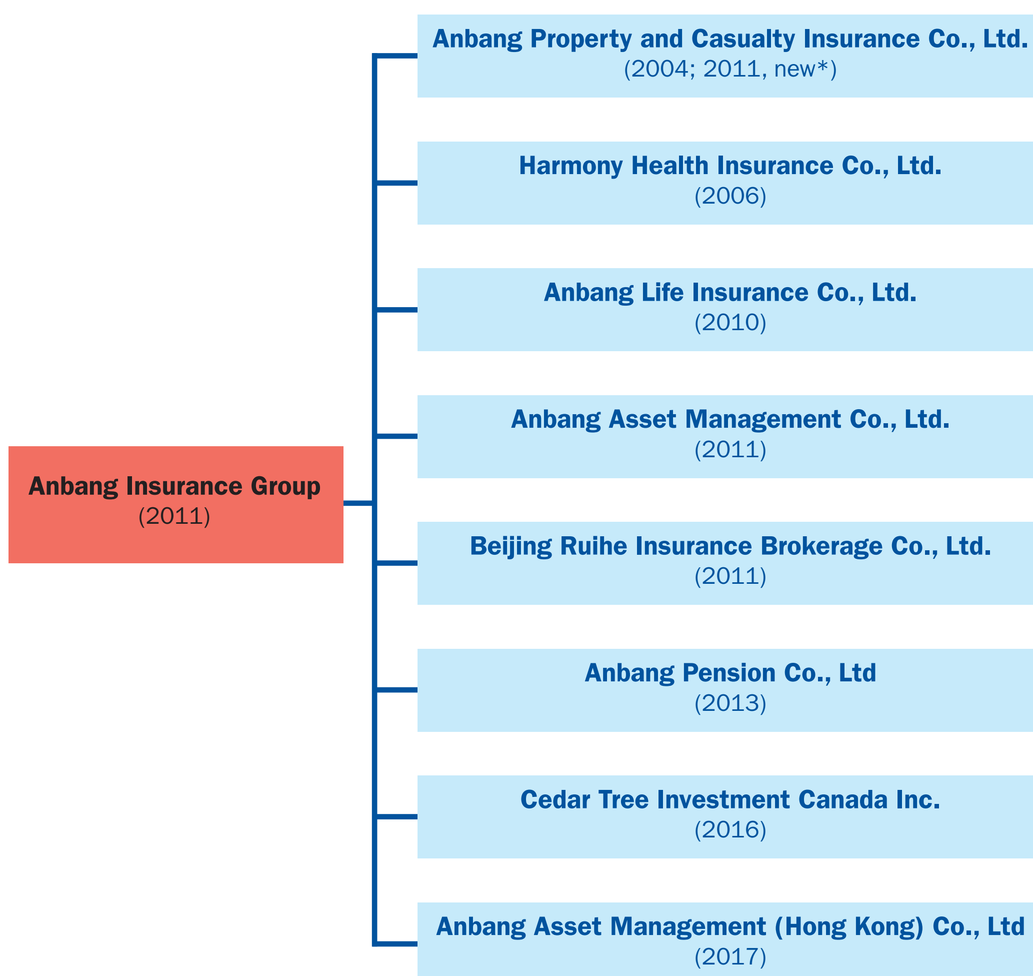
Trowbridge, John and Mary Scholtens, “An Independent Review for the RBNZ of the Supervision of CBL Insurance Ltd,” Reserve Bank of New Zealand, May 6, 2019.

3. Adequacy of regulatory oversight

The case of Anbang Insurance Group Co., Ltd. (China, 2020)

Anbang Property and Casualty Insurance Co., Ltd (Anbang P&C) was established in October 2004 as a pure P&C insurer. With a registered capital of RMB 500 million, Anbang P&C was by no means a major player in the Chinese insurance market in the beginning. In 2005, the company's gross written premium (GWP) was RMB 1.001 billion, which was equal to a mere 1.52% of the GWP of People's Insurance Company of China (PICC), the top P&C insurer in Mainland China.

Exhibit 2: Anbang Insurance Group's (Anbang) organizational structure



Notes: The number in the brackets indicate a firm's year of establishment.
*Anbang Insurance Group (Anbang) began as Anbang Property and Casualty Insurance Co., Ltd (Anbang P&C) in 2004. In November 2011, Anbang P&C became the Anbang Insurance Group (Anbang), and its P&C line of business was spun off to the new Anbang Property and Casualty Insurance Co., Ltd.

Source: caixin.com, qcc.com

Under the leadership of Xiaohui Wu, a businessman with strong political ties, Anbang P&C experienced rapid expansion. Between 2006 and 2011, it made daring forays into other lines of business, setting up Harmony Health Insurance Co., Ltd in 2006, Anbang Life Insurance Co., Ltd in 2010, and Anbang Pension Co., Ltd in 2013. In November 2011, Anbang P&C (by then also a holder of assets in both life and health lines) became the Anbang Insurance Group (Anbang). Its P&C business was packaged into a new P&C company bearing the original name (Anbang Property and Casualty Insurance Co., Ltd). Exhibit 2 on the previous page shows the organization of Anbang following this change in the corporate structure.

From 2011 to 2017, Anbang initiated a series of acquisitions and ended up holding assets in banking, hotels, retirement homes and securities, both inside China and abroad. Table 6 summarizes Anbang's acquisition history in chronological order and shows that the company gradually evolved into a substantial financial conglomerate. Among these transactions, Anbang's purchase of 35 percent ownership in Chengdu Rural Commercial Bank, in 2011, put the previously low-key insurer in the limelight for the first time. Through private placement, Anbang paid RMB 5.6 billion and became the dominant shareholder of the bank. Before the purchase in November, Anbang's 2010 year-end assets were valued at RMB 25.67 billion. This number was well below that of the bank, whose assets were worth RMB 106.3 billion. As a result, the acquisition was dubbed a case where "a snake swallows an elephant."[25]

Despite its small size relative to that of the bank, Anbang's registered capital reached RMB 12.0 billion after a capital increase in June 2011. This pushed Anbang to rank second among all Chinese P&C insurers, where the top insurer, PICC, had registered capital of RMB 17.0 billion. By mid-June 2017, Anbang was among the top-10 shareholders of at least 25 Chinese-listed companies. The market capitalization of its shareholdings was RMB 218.6 billion.[26]

Another high-profile Anbang acquisition also occurred overseas. In October 2014, the company announced its purchase of Waldorf Astoria New York, a luxury hotel and landmark at Manhattan.[27] Hilton, the owner of Waldorf Astoria at the time, revealed that the bid amounted to USD 1.95 billion. In Canada, Anbang set up a subsidiary called

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[25] "The Truth about Anbang," *Southern Weekly* (in Chinese), January 29, 2015. Under pressure from Anbang, Southern Weekly (also known as Nanfang Zhoumo) issued an apology on February 1, 2015, noting that the report contained some unsubstantiated content – but the collapse of Anbang at the end of 2017 proved the opposite.

[26] Shao, Hao, "Anbang holds 25 A-shares with a total market value of 218.6 billion," *Shanghai Securities News* (in Chinese), June 14, 2017.

[27] Nicolaou, Anna, "Waldorf Astoria NY hotel sold to China's Anbang for $1.95bn," *Financial Times*, October 6, 2014.

Table 6 – Anbang's acquisition history

Date announced	Date completed	Target	Industry	Country	Anbang ownership percentage	Bid Value	Ownership change after Anbang's liquidation in 2018
March 2011	November 2011	Chengdu Rural Commercial Bank	Banking	China	35	RMB 5.6 billion	Taken over by two state-owned asset management firms (April 2020)
October 2014	February 2015	Waldorf Astoria New York	Hotels	U.S.	100	USD 1.95 billion (RMB 1.2 billion)	
October 2014	October 2015	Fidea NV	Insurance (P&C)	Belgium	100	EUR 220 million (RMB 1.8 billion)	Acquired by Baloise Group (July 2019)
December 2014	July 2015	Delta Lloyd Bank NV (new name: Bank Nagelmackers)	Banking	Belgium	100	EUR 206 million (RMB 1.68 billion)	
February 2015	July 2015	REAAL NV (new name: VIVAT Insurance)	Insurance (P&C)	Netherlands	100	EUR 1.35 billion (RMB 9.45 billion)*	Acquired by Athora Holding Ltd and renamed as Athora Netherlands (April 2020)
February 2015	June 2015	Tong Yang Life Insurance Co., Ltd	Insurance (Life)	Korea	63.01**	KRW 1,131.9 billion (RMB 6.17 billion)	
April 2016	December 2016	Allianz Life Korea	Insurance (Life)	Korea	100	KRW 3.5 billion (RMB 19.43 million)	
March 2016	October 2016	Strategic Hotels & Resorts Inc (incl. 15 hotels in final portfolio)	Hotels	U.S.	100	USD 6.5 billion (RMB 43 billion)	MAPS Hotel and Resorts One LLC (affiliated with Mirae Asset Capital Co) agreed to purchase for USD 5.8 billion but the deal was terminated due to legal issues
November 2016	February 2017	Retirement Concepts	Healthcare	Canada	100	CAD 1 billion (RMB 5.1 billion)	

Notes: The "Date completed" column indicates the year and month that Anbang obtained approval from the insurance authorities and completed the acquisition.
*The bid was a nominal EUR 1, but Anbang injected EUR 1.35 billion into VIVAT (Chatterjee, Wu and Sterling, 2018).
**57.5% of the shares was purchased from Vogo Investment Group. 1 RMB ≈ 0.2 CAD; 1,000 KRW (Korean Won) ≈ 1 CAD.

Source: caixin.com and the target companies' websites

Cedar Tree Investment Canada Inc. in 2016. Not long after its incorporation in July, Cedar Tree announced an acquisition. The target was Retirement Concepts, the largest retirement home chain in British Columbia. The purchase gained regulatory approval in February 2017.[28]

But where did Anbang get the money to fund its aggressive acquisitions? It was later learned that the company issued a large quantity of wealth management products (WMPs) beginning in 2014, which were short-term savings-type instruments offering guaranteed yields.[29] WMPs issued by Anbang Life Insurance Co., Ltd. were issued as "universal life insurance." According to Court documents released in 2018, from 2015 to 2017, Anbang sold short- and medium-term WMPs that were worth RMB 1.5 trillion, with most WMPs having a maturity of less than three years. Moreover, the aggregate size of the issuance exceeded the quota approved by the Chinese insurance authority (Hu and Wu, 2020). According to Court records, as of January 5, 2017, Anbang had sold WMPs to more than 10 million individuals, raising RMB 723.867 billion in excess of the approved amount.

However, before Anbang's fraud was exposed, there was no information available publicly on the magnitude of these WMPs. That is because, at that time, China did not require P&C insurers to disclose their issuance of WMPs and thus, Anbang's issuance of these instruments was not under regulatory surveillance (Southern Weekly, 2015). Life insurers were able to categorize revenues from WMPs under "gross premium written" (GPW) or a separate item called "new payments of policyholders' investment," which itself had no clear definition (Southern Weekly, 2015; Guo, 2017).

To give the impression that it had sound financial performance, Anbang inflated its income using cosmetic accounting techniques. For example, its revenue in 2013 totaled RMB 15.43 billion, of which RMB 8.43 billion came from "investment in real estate." Interestingly, the same accounting notation did not exist in the previous year (Southern Weekly, 2015). Such techniques also allowed it to report astonishingly solid underwriting performance (see Table 7).

Meanwhile, Anbang adopted a complex equity structure to help exaggerate its assets. From 2004 to 2014, it increased its capital seven times from RMB 500 million to RMB 61.90 billion, which is summarized in Table 8. After its capital increase in September 2014, Anbang had 39 shareholders, of which 37 were non-state-owned enterprises. These 37 enterprises

[28] "Chase, Steven, "Ottawa approves sale of B.C. retirement-home chain to Chinese group with murky ownership," *The Globe and Mail*, February 21, 2017.

[29] S&P Global, "Anbang Life pivots back to sales of investment-type policies," *Market Intelligence*, December 4, 2017.

were further linked to 64 shareholders. The 101 enterprises (37 plus 64) were, or had been historically linked to, the Chairman of Anbang, Xiaohui Wu (Guo, 2017). Most of these enterprises cross-held shares in each other. Such cross-holding of shares enabled Anbang to inflate its assets, pushing it to rank 139th on the Fortune 500 list in 2017.[30]

Table 7 – Indicators of Anbang's financial performance

Panel A: Assets (in million RMB)

	2011	2012	2013	2014	2015	2016
P&C	5,193.40	89,716.35	15,048.77	208,887.60	268,661.73	795,452.02
Life	3,992.69	8,142.62	16,972.21	119,529.01	256,198.20	573,808.77
Health	11,082.54	21,290.27	31,922.08	88,830.11	248,805.25	285,255.41
Pension	–	–	–	6,24	5,469.27	1,542.25
Wealth	300.36	485.49	352.59	452.3	851.60	915.70

Panel B: Gross written premium (GWP)

	2011	2012	2013	2014	2015	2016
P&C	–	4,421.71	4,885.06	5,313.52	5,261.69	112,439.75
Life	104.23	1,245.51	1,368.17	52,887.56	54,527.22	114,197.32
Health	1.69	24.3	131.92	159.14	30,805.52	107,031.33
Pension	–	–	–	–	0.23	0.26

Panel C: Combined ratio (%)

	2011	2012	2013	2014	2015	2016
P&C	–	31.97	23.64	15.38	22.93	5.41
Life	85.20	16.40	11.07	3.11	3.76	3.50
Health	139.70	63.77	23.60	4.30	2.11	2.77

Notes:

- **P&C** = Anbang Property and Casualty Insurance Co., Ltd
- **Life** = Anbang Life Insurance Co., Ltd
- **Health** = Harmony Health Insurance Co., Ltd
- **Pension** = Anbang Pension Co., Ltd
- **Wealth** = Anbang Asset Management Co., Ltd
- **Combined ratio** = (claim-related losses + expenses) / earned premium (calculated by the authors).

Source: China Banking and Insurance Regulatory Commission

[30] Miller, Matthew and Engen Tham, "China seizes control of Anbang Insurance as chairman prosecuted," Reuters, February 22, 2018.

Table 8 – Indicators of Anbang's financial performance

Date	Registered capital (in billion RMB)	Number of shareholders	Notes
October 14, 2004	0.50	7	
June 18, 2005	1.69	8	
May 15, 2006	3.79	8	
May 25, 2007	4.60	8	
June 5, 2007	5.10	8	
June 30, 2011	12.00	8	
January 27, 2014	30.00	25	17 new shareholders
September 17, 2014	61.90	39	14 new shareholders
June 11, 2019	41.50	2	Taken over by the Chinese insurance guarantee fund

Source: Guo (2017) and qcc.com

Anbang's aggressive expansion and deviation away from its insurance business led to its eventual demise. The investigation of Wu and his Anbang empire started in early 2017. On June 14, 2017, Anbang announced that Wu could not "perform his duties due to personal reasons," which essentially acknowledged the investigation. On February 23, 2018, China Insurance Regulatory Commission (now China Banking and Insurance Regulatory Commission, CBIRC) – the prudential regulator – declared that it would take over Anbang's business operations, citing company violations of Article 144 of China's *Insurance Law* concerning solvency requirements.

In April of 2018, China Insurance Security Fund Co. (CISF) – China's insurance guarantee fund, which was fully backed by the Ministry of Finance – injected RMB 60.804 billion into Anbang. At the same time, the prudential regulator mandated Anbang to undergo an overhaul of its organizational structure: selling off its overseas assets; offloading its equity holdings in domestic, non-insurance firms; removing companies connected with Wu from the shareholders; and rearranging the term structure of its wealth management products (WMPs). Through this change, Anbang's shareholders were reduced to just three: CISF (98.2294%), Shanghai Automotive Industry Corporation (SAIC) Motor Corp., Ltd (1.2246%), and China Petroleum and Chemical Corporation (Sinopec, 0.545%).[31]

[31] The numbers in the brackets are the percentages of shareholdings, which were obtained from qcc.com.

On May 10, 2018, Wu was found to have misappropriated and embezzled RMB 10 billion of Anbang's funds and was sentenced to 18 years in prison. In June of 2018, it was revealed that Anbang's net assets were actually RMB –82.8 billion (Hu and Wu, 2020). This colossal negative number stands in stark contrast to the 2016 Annual Report which had claimed RMB 71.14 billion worth of net assets. On July 11, 2019, the three shareholders of Anbang established Dajia Insurance Group (Dajia), a bridge entity that assumed Anbang's insurance obligations and other business operations. The new entity had registered capital of RMB 20.36 billion. On September 14, 2020, Anbang announced on its website that it was dissolving and would start the liquidation process in due course. Due to the sophisticated nature of Anbang's reorganization, CBIRC allowed Dajia to delay the release of its 2019 and 2020 Annual Reports. Consequently, we are not currently able to track financial indicators of Anbang or Dajia after 2018.

As the last column of Table 6 shows, Anbang's offloading of assets is still in progress at the time of this writing. In Mainland China, the company's shares in the Chengdu Rural Commercial Bank were transferred to two state-owned asset management enterprises – Chengdu Wuhou Capital Investment Management Group Co., Ltd and Chengdu Gaoxin Innovation Investment Co., Ltd. Anbang's shares in two European insurers (Fidea NV and VIVAT Insurance) were sold to Baloise Group and Athora Holding Ltd in 2019 and 2020, respectively. In the U.S., MAPS Hotel and Resorts One LLC (affiliated with the Korea-based Mirae Asset Capital Co.) agreed to purchase Anbang's equity in Strategic Hotels & Resorts Inc., but the deal was subsequently cancelled due to legal issues.[32]

[32] Frankel, Alison, "Buyer can dodge USD 5.8 billion hotel deal after seller's 'drastic' COVID response: Dela. Supreme Court," *Reuters*, December 9, 2021. The deal was called off because Anbang had shut down some hotels and laid off workers without notifying MAPS, the buyer, violating the Material Adverse Effect (MAE) clause.

Causes of the Anbang failure

- **Adequacy of regulatory oversight –** China does not have a consistent financial reporting system for insurers. Based on our review of the *Chinese Insurance Yearbooks* (a book series that collects the financial information from insurers operating in China), there is a lack of consistency in the reported items across different years and insurers. There is also a lack of definition of certain items – for example, in the case of wealth management products, the item called "new payments of policyholders' investment." In addition, key ratios such as the expense ratio, solvency ratio, and combined ratio are not disclosed in the financial statements, and we are unable to calculate these important indicators accurately from public sources.
- **Corporate governance deficiencies –** Anbang had insufficient internal control on its financing activities and risk management. The lack of internal control resulted in a mismatch of term structures for its assets and liabilities, and the embezzlement of funds by top executives. Corporate governance was also the primary cause of insolvency in Xinhua Life Insurance, another failure in China that occurred in 2005. In the case of Xinhua, the Chairman Guoliang Guan misappropriated RMB 260 million and embezzled RMB 3 million.
- **Rapid growth –** Anbang experienced rapid growth in its P&C and Life lines from 2011 to 2017. It embarked on expensive acquisitions overseas, despite the fact that it had no experience in running hotels and had little knowledge of the insurance market in Europe and Korea. Entering untested markets abroad was also a primary cause of failure for Maplex General Insurance Company, Advocate General Insurance Company, Canadian Millers' Mutual Insurance Company and Reliance Insurance Company, and a contributing cause of failure for HIH Insurance Limited.
- **Fraud –** Anbang adopted a complex and opaque equity structure. By letting its shareholders cross-hold stocks in each other, it was able to inflate its assets and revenue and create an impression of good financial performance.

Table 9 – Causes of insurer failures

Cause of Failure	Anbang Insurance Group Co., Ltd. (2020)	CBL Insurance Limited (2018)	Gefion Insurance A/S (2001)	Advocate General Insurance Company (1989)	Maplex General Insurance Company (1995)	Canadian Millers' Mutual Insurance Company (2001)	HIH Insurance Limited (2002)	Reliance Insurance Company (2001)	Markham General Insurance Company (2002)
1. Internal operations									
Poor underwriting		P		P	P	P	P		P
Inefficient reserving				P	P		P	P	S
Rapid growth (New markets)	P		P	P	P	P	S	P	
Inappropriate diversification (New lines of business)						S	S	P	
Risky acquisitions/joint ventures							S		
Cost control		P				P			P
Corporate governance deficiencies	P	P	P	S	P	S	S	P	P
Bad investments								P	
Poor capital management			P		P	P		P	P
Reinsurance misuse/mismanagement			P			S	S		P
Fraud	P				S				
2. Organizational structure		P					P		
3. Adequacy of regulatory oversight	P	P		S	P		S	S	
4. Natural disaster									

P Primary S Secondary

Source: PACICC *Why Insurers Fail* Studies (2008, 2010, 2012, 2014, 2018, 2020 and 2022)

Lessons learned from the Anbang failure

- **Regulatory oversight** – The prudential regulator should harmonize financial reporting criteria for all insurers, give a clear definition to each accounting item and review insurers' performance regularly. A sudden change in an income-related item should be subject to immediate scrutiny, as it may be a sign of aggressive financing activities. In retrospect, the prudential regulator should have identified Anbang's troubles much earlier than 2017.

As Table 7 shows, Anbang's P&C assets had grown disproportionately with its gross written premium (GWP). Between 2015 and 2016, its assets tripled, but its GWP increased more than twenty-fold.

- **Internal controls** – Internal controls help to ensure accountability and encourage the proper use of a company's assets and resources.
- **Entry into new markets and new lines of business** – Companies must exercise caution and carefully manage uncertainties when expanding into unfamiliar markets and new lines of business where they have no past experience.
- **Risk management** – Maintaining sound risk management is important for the sustainability of any insurer.

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4. Natural disasters

The case of Merced Property and Casualty Company (U.S., 2018)

Climate change has driven up the intensity of natural perils over the past number of decades. Global warming has been cited as a significant factor underlying the growing scale of various natural disaster events (e.g. earthquakes, floods, hurricanes, tornadoes, wildfires, landslides, severe storms and storm surges).[33] Insured losses due to climate change are expected to continue to rise significantly in the coming years. Socio-economic factors, such as the growth of cities in coastal areas and wilderness, are only compounding the problem. Smaller regional insurance companies – whose insured risks are geographically concentrated – are likely to be the most exposed to impacts of climate change. A single large-scale natural disaster can cause the failure of an otherwise solvent insurer. This was certainly the case with Merced Property and Casualty Company (Merced), a small and historically stable P&C insurance company headquartered in Atwater, California.

Established in March 1906 as Merced Mutual Insurance Co., Merced sold a variety of insurance policies, including property, automobile, marine and farm. The company had particularly concentrated risks – its business strategy relied heavily on homeowners' insurance sold in California. At the end of 2017, the company's homeowner coverage accounted for 60.5 percent of its active policies, and 81.4 percent of its direct written premiums (DWP).[34] Merced's insured risks were heavily concentrated in areas that were classified as "high severity zones" by the California Department of Forestry and Fire Protection.[35] Although very risky, this lack of business and geographical diversity was common for many small, regional insurers in California.

Due to deteriorating economic conditions in California's Central Valley, Merced's DWP continued to decline from 2006 onward. To ensure its sustainability, it demutualized after agreeing to an acquisition proposed by the United Heritage Financial Group, Inc (UHFG). UHFG owned three other insurers: United Heritage Life Insurance Company; United Heritage Property & Casualty Company; and Sublimity Insurance Company (UHFG, 2013). Table 10 shows the profiles of the four insurers under UHFG.

[33] Knutson, Thomas R., Maya V. Chung, Gabriel Vecchi, Jingru Sun, Tsung-Lin Hsieh, and Adam JP Smith. "Climate change is probably increasing the intensity of tropical cyclones." In *Critical Issues in Climate Change Science, ScienceBrief Review*, 2021. Phelan, Liam, 2011, "Managing climate risk: extreme weather events and the future of insurance in a climate-changed world," Australasian Journal of Environmental Management, 18(4), 223-232. Intergovernmental Panel on Climate Change (IPCC), *Special Report on the Ocean and Cryosphere in a Changing Climate*, 2022. Available at https://www.ipcc.ch/srocc/.

[34] Zawacki, Tim, "Insolvent California Insurer 'Small' But Hardly Insignificant," *S&P Global Market Intelligence Reports*, December 18, 2018.

[35] Koren, James Rufus, "California Plans Takeover of Property Insurer Overwhelmed by Camp Fire Claims," *Los Angeles Times*, December 3, 2018.

Table 10 – Insurers in the United Heritage Financial Group, Inc. (UHFG)

Insurer	Founded	Type	Headquarters
United Heritage Life Insurance Company	1934	Life & Health	Meridian, Idaho
United Heritage P&C Company	1908	P&C	Meridian, Idaho
Sublimity Insurance Company	1896	P&C	Sublimity, Oregon
Merced Property & Casualty Company	1906	P&C	Atwater, California

UHFG's acquisition of Merced appeared to help it improve its financial performance. From 2012 to 2017, financial indicators (Table 11) suggested a good underwriting company hampered by lack of scale. While Merced maintained an average loss ratio over the period of 32.6 percent, which was half of the industry average (72.8 percent), its combined ratio, averaging 111.4 percent, was 10 percent higher than the industry average – dragged upwards by an uncomfortably high expense ratio. At the end of 2017, Merced had total assets of USD 23 million. It had also achieved strong (23.8 %) growth in DWP compared with the previous year. [36]

Table 11 – Key financial ratios – Merced Property and Casualty Company (2012-2017)

Key ratio	2017 %	2016 %	2015 %	2014 %	2013 %	2012 %
Expense Ratio (*SAP)	53.25	58.68	59.19	58.62	58.10	52.09
Loss & Loss Adjustment Expense Ratio	61.19	46.46	66.42	55.65	45.60	53.09
Combined Ratio (*SAP)	114.44	105.14	125.62	114.27	103.70	105.19
Operating Ratio	100.83	87.02	106.16	91.55	86.66	99.18
Retention Ratio (NPW/GPW)	85.89	85.17	85.86	86.86	85.12	85.13
Return on Equity (ROE)	–1.07	3.24	1.18	4.97	18.42	0.90

Notes: "*SAP" indicates that a ratio is calculated using the Statutory Accounting Principles (SAP); Expense Ratio (SAP) = Other Underwriting Losses / Net Premium Written; Loss & Loss Adjustment Expense Ratio = (Loss Incurred + Loss Adjustment Expenses Incurred) / Net Premium Earned; Combined Ratio (SAP) = Loss & Loss Adjustment Expense Ratio + Expense Ratio (SAP).

Source: SNL Insurance

[36] Op. Cit.

As a result of climate change, California's fire season (lasting roughly from late spring until early fall) is now two months longer, compared with the 1970s and 1980s. The hot weather has given rise to more incidents of wildfires in the fire season. From 1987 to 2018, affected areas increased dramatically (more than doubling) and in 2018, 1.9 million acres of land were affected.[37]

At around 6:30 a.m. on November 8, 2018, a powerline owned by utility firm Pacific Gas & Electric Co. sparked a massive fire around Camp Creek Road in the Pulga area of Butte County, California. The wildfire was subsequently referred to as the "Camp Fire."[38] Facilitated by Diablo winds, dry weather and combustible vegetation, the Camp Fire quickly swallowed up three nearby towns in Butte County – Concow, Magalia and Paradise.[39]

The wildfire turned out to be one of the most disastrous wildfires ever. It scorched more than 150,000 acres, killed 86 people, destroyed 18,793 buildings (including every building in the town of Paradise) and resulted in USD 17 billion in insured losses.[40] Overwhelmed by an estimated USD 30 billion in wildfire liabilities, Pacific Gas & Electric Co. filed for bankruptcy protection in January of 2019.

Estimated losses for Merced in the town of Paradise alone totaled USD 64 million and overall, Merced had an estimated USD 87 million in liabilities – far in excess of its USD 23 million of capital.[41] Although Merced had a potential recovery of USD 17 million from two reinsurance programs (individual property risk and catastrophe programs), this was insufficient to cover its claims liabilities. As a result of its clear insolvency, Merced was put into liquidation on November 30, 2018. A liquidation order was delivered on December 3, 2018. At that time, some 7,436 policyholders were seeking claims payments or premium refunds from Merced.

On December 10, 2018, the California Insurance Guarantee Association (CIGA) stepped in to assume Merced's policyholder obligations. CIGA would pay individual claims up to USD 500,000. To expedite claims processing, CIGA hired former Merced staff to help manage the liquidation. By March of 2019, CIGA had paid USD 66 million in losses, loss adjustment

[37] Kaufman, Leslie and Eric Roston, "Wildfires Are Close to Torching the Insurance Industry in California," *Bloomberg Businessweek*, November 10, 2020.

[38] Ibid.

[39] Hagerty, Colleen, "The Survivors," *VOX*, Oct 23, 2019.

[40] Swiss Re, "Natural Catastrophes and Man-Made Disasters in 2018: 'Secondary' Perils on the Frontline," *Sigma*, April 2019.

[41] Ho, Vivian, "Bankrupt California Utility Blamed for Deadly Wildfires Agrees to $11bn Payout," *The Guardian*, September 14, 2019.

expenses, returned premiums and incurred administrative expenses, with additional estimated losses and loss adjustment reserves of USD 21 million.[42]

The threat of future wildfires caused many Californian insurers to increase their property insurance rates, refuse coverage to high-risk areas and deny renewals of existing policies. Between 2018 and 2019, property insurance non-renewals in California increased by 31 percent, with high-risk areas increasing by 61 percent.[43] To protect policyholders, the State of California introduced the *Wildfire Safety and Recovery Act* (CA SB-824) in 2019, imposing a one-year moratorium on the cancellation or non-renewal of homeowner insurance policies.

California homeowners in high-risk areas who are unable to obtain insurance from the voluntary market can purchase basic coverage from the California FAIR Plan Association. The FAIR Plan is a private entity created in 1968 that serves as an insurer of last resort, with premiums that are much higher than traditional carriers.[44] Due to increased wildfire risk, more Californian homeowners have had to resort to the FAIR Plan. In November of 2019, the FAIR Plan was ordered to provide comprehensive homeowners insurance, but it refused to do so. This complex public policy issue will likely continue to evolve as the wildfire risk continues to climb.

Causes of the Merced failure

There were two principal causes of the Merced failure, that worked in tandem:

- **Natural disaster** – The primary cause of failure for Merced was, of course, catastrophic loss from the 2018 Camp Fire.
- **Poor underwriting** – Merced suffered from an over-concentration of risk, both geographically and by line of business. Homeowner insurance concentrated in high-severity risk zones (flagged by the California Department of Forestry and Fire Protection) accounted for most of Merced's business – 60 percent of policies and 81 percent of DWP. Poor risk selection was also cited as a primary cause of failure for Maplex General Insurance Company, Advocate General Insurance Company, Markham General Insurance Company, Canadian Millers' Mutual Insurance Company and HIH Insurance Limited.

[42] Merced Superior Court, "Insurance Commissioner of the State of California v. Merced Property & Casualty Company," Notice of Application (Case No. 18CV-04739), August 7, 2019.

[43] Baron, Ethan, "California shields millions of homeowners in fire areas from property insurance denials," *The Mercury News*, November 5, 2020.

[44] Shokraee, Saumi, "Six Things to Know About the Recent Impasse Between Regulators and Insurers in the Aftermath of California's Devastating Wildfires," *Insurance Journal*, April 17, 2020.

Table 12 – Causes of insurer failures

Cause of Failure	Merced Property and Casualty Company (2018)	Anbang Insurance Group Co., Ltd. (2020)	CBL Insurance Limited (2018)	Gefion Insurance A/S (2001)	Advocate General Insurance Company (1989)	Maplex General Insurance Company (1995)	Canadian Millers' Mutual Insurance Company (2001)	HIH Insurance Limited (2002)	Reliance Insurance Company (2001)	Markham General Insurance Company (2002)
1. Internal operations										
Poor underwriting	P		P		P	P	P	P		P
Inefficient reserving					P	P		P	P	S
Rapid growth (New markets)		P		P	P	P	P	S	P	
Inappropriate diversification (New lines of business)							S	S	P	
Risky acquisitions/joint ventures								S		
Cost control			P				P			P
Corporate governance deficiencies		P	P	P	S	P	S	S	P	P
Bad investments									P	
Poor capital management				P		P	P		P	P
Reinsurance misuse/mismanagement				P			S	S		P
Fraud		P				S				
2. Organizational structure			P					P		
3. Adequacy of regulatory oversight		P	P		S	P		S	S	
4. Natural disaster	P									

P Primary S Secondary

Source: PACICC *Why Insurers Fail* Studies (2008, 2010, 2012, 2014, 2018, 2020 and 2022)

Lessons learned from the Merced failure

- **Geographical concentration of risk –** Insurers should seek to spread coverage geographically and to avoid over-concentration of risk in areas deemed to be highly susceptible to natural disasters.
- **Climate Change is increasing solvency risk –** Insurers need to increase their stress-testing of property portfolios to incorporate rapidly changing models for natural catastrophe events and scenarios involving both "model risk" and "unmodeled risks."
- **Lines of coverage –** Insurers should seek to diversify coverage, spreading risk across lines of business.

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Conclusion

This study examined the cases of four insurers that failed over the past five years – Gefion Insurance A/S in Denmark (2021); CBL Insurance Limited in New Zealand (2018); Anbang Insurance Group Co., Ltd. in China (2020); and Merced Property & Casualty Company in the U.S. (2018).

Four interesting points can be made when one compares these failures to those of the six insurers previously profiled in our Why Insurers Fail studies – Advocate General Insurance Company (1989); Maplex General Insurance Company (1995); Canadian Millers' Mutual Insurance Company (2001); HIH Insurance Limited (2001); Reliance Insurance Company (2001); and Markham General Insurance Company (2002).

1. **Despite improvements in the business environment, P&C insurers can still fail**
   The risk of failure continues, despite numerous general improvements in the business environment over the past 20 years, including: risk-based regulation, risk management best practices, statutory financial reporting and technological advancements.
2. **Common causes of P&C insurer failures have not changed over time**
   The actors may have changed, but the script remains the same. Issues with internal operations, organizational structure and/or the adequacy of regulatory supervision remain leading causes of P&C insurer failures.
3. **By fueling increases in natural disasters, climate change adds a new source of potential insurance failure**
   Exposure aggregation and inadequate stress-testing of capital and reinsurance requirements can lead directly to sudden insurer failure.
4. **The causes of P&C insurer failure are not unique to one country or a single business model**
   They have universal application. Possible "roads to ruin" exist in all insurance jurisdictions around the world – including Canada.

It is for these reasons that PACICC continues to draw attention to troubled P&C insurer situations through its *Why Insurers Fail* research series. PACICC remains ever-vigilant as it seeks to identify the root causes of company failures and the lessons to be learned, for both insurers and regulators. This focus on effective risk management, good corporate governance and industry best practice underscores PACICC's continuing commitment to enhancing industry solvency and protecting insurance policyholders.

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of the Farm Mutual Reinsurance Plan – 2016

Exit Strategies for P&C Insurers – 2017

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