AUTORITÉ DES MARCHÉS FINANCIERS

INTERVENTION GUIDELINES FOR QUEBEC CHARTERED P&C INSURERS AND PACICC MEMBER COMPANIES

April 2016

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Preface

The intervention guidelines in the present document will help stakeholders in understanding the actions and measures that can be implemented, either by the Autorité des marchés financiers (the "AMF") or the Property and Casualty Insurance Compensation Corporation ("PACICC"), when a Quebec-chartered P&C insurer and PACICC member company ("P&C insurer[1]") experiences difficulties that may jeopardize its ability to meet its commitments to its policyholders, claimants and other beneficiaries ("Policyholders"). Additionally, this document clearly defines the roles and responsibilities of the key stakeholders.

Any intervention taken by the AMF with a P&C insurer must be efficient and effective, and it must be implemented expediently to maintain the confidence and minimize losses for Policyholders. In the event of insolvency a protection program instituted in Quebec and offered by PACICC applies to insurance contracts written by a P&C insurer. These intervention guidelines will come into effect as of April 30, 2016.

1. Autorité des marchés financiers

As part of its mandate, the AMF must ensure that insurers comply with the solvency standards applicable to them as well as with the obligations imposed on them by law in view of protecting the interests of consumers of financial products and services. The AMF will take any measures provided by law for those purposes.

The AMF is responsible for regulating and monitoring insurers and intervening particularly if an insurer fails to exercise sound and prudent management practices, sound commercial practices or experiences difficulties, if its solvency is threatened or seriously compromised, or if it is being wound up.

The AMF must also ensure that consumers of financial products and services are protected by adequate protection programs.

1.1 Supervisory framework

To prevent the risk of insurer insolvency, the AMF establishes the monitoring tools it needs to anticipate, for example, the development of risks to which insurers are exposed and intervenes in a timely manner. In that regard, the AMF implements the first phase of its Supervisory Framework[2] comprising seven steps that will result in the establishment of the P&C insurer's risk profile. These steps are as follows:

1. Identify the P&C insurer's significant activities;
2. Identify and assess the P&C insurer's inherent risks;
3. Evaluate P&C insurer's quality of risk management;

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1 The expressions "P&C Insurer" and "P&C Insurance" used throughout the document have the exact same meaning respectively as the expressions "Damage Insurer" and "Damage Insurance" used in the Act respecting Insurance (valid Gen)

2 Autorité des marchés financiers. *Financial Institutions Supervisory Framework*, November 2014.

4. Evaluate the net risk of significant activities and the aggregate net risk of the P&C insurer;
5. Analyze the P&C insurer's financial condition;
6. Assess the P&C insurer's commercial practices;
7. Establish the P&C insurer's risk profile.

Thus, the risk profile corresponds to the combination of ratings given to the P&C insurer's overall net risk, its financial condition and its commercial practices. It is the primary input as to the assignement of the intervention stage.

2. PACICC

The protection program instituted by PACICC is intended to minimize the loss for Policyholders. PACICC co-ordinates its actions with those of the AMF when intervention is needed with one of its member companies.

PACICC is governed by its By-law No. 1 and Memorandum of Operation. Any changes to these documents must be analyzed and discussed within a meeting of the Assuris-PACICC Standing Committee of the Canadian Council of Insurance Regulators, of which the AMF is a member.

Since PACICC's Board of Directors is partially composed of members affiliated with P&C insurance companies, PACICC has created a committee comprising only the members of the Board of Directors who are not affiliated with any PACICC member company to discuss and share sensitive information with regulators.

2.1 PACICC's Pre-insolvency Regulatory Liaison Committee

The Pre-insolvency Regulatory Liaison Committee provides a secure forum for P&C insurance regulators to discuss confidential information with only the members of PACICC's Board of Directors who are not affiliated with any member insurance companies of PACICC. The Committee would be available to share information and to provide PACICC's input to solvency regulators regarding a particular P&C insurance member company distress situation. The Committee would also have access to the report prepared annually by PACICC management analyzing member company solvency.

At every step of an intervention with a P&C insurer, except when its assets are insufficient or it is insolvent, the content of the exchanges between the AMF and PACICC is to be considered confidential and made available only to the AMF representatives, PACICC's staff members or PACICC's Pre-insolvency Regulatory Liaison Committee members.

All changes regarding the Pre-insolvency Regulatory Liaison Committee members are promptly disclosed to the AMF.

2.2 Protection of Policyholders in case of insolvency[3]

In order to protect Policyholders, with regard to their insurance in the unlikely event of the failure of their P&C insurer, PACICC provides a guarantee to every individual covered with the same member insurance company. In line with the *Regulation under the Act respecting insurance*[4] *("RARI")*, all P&C insurers active in Québec must be a PACICC member company and comply with the conditions stipulated in the membership agreement with PACICC. The member companies throughout Canada assume the costs inherent to an insurer's insolvency.

The proportional coverage provided by PACICC provides 100% protection when claims are below certain dollar values, as follows: [5]

- auto and commercial insurance policies: up to $250,000 per policy;
- home insurance policies: up to $300,000 per policy.

PACICC will also refund 70% of the unearned (unexpired) portion of Policyholders' premiums calculated from the date of the wind-up order. The maximum refund is $700 per policy.

PACICC maintains at all times a liquid Compensation Fund. This fund provides immediate cash to meet PACICC's obligations in any future insolvency before assessing members.

To cover the cost of providing protection to Policyholders in the event of the insolvency of one of its member insurers, PACICC has the capacity to levy assessments. Where necessary, it will assess members in proportion to their covered direct written premiums to raise the funds needed to provide its protection to Policyholders. PACICC's assessment system is designed to have the financial capacity to raise sufficient funds to deal with any failure, up to a limit, which is intended to prevent undermining the capital of P&C insurers so that one company's insolvency does not result in additional failures.

3. Actions through intervention stages

The AMF determines a certain number of indicators to assess the P&C insurer's sound and prudent management practices and sound commercial practices (the "sound management practices") to prevent potential solvency-related issues. Based on this assessment, an intervention stage will be assigned and corresponding actions could be undertaken in order to prevent or manage insolvency. The intervention stages are identified as follows:

- Stage 1 "No Significant Problems"
- Stage 2 "Early Warning"

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3 For more details on PACICC's coverage, please refer to PACICC's website at http://www.pacicc.ca.

4 CQLR, c. A-32, r.1 A.

5 Coverage limits as of April 2016.

- Stage 3 “Watch Condition”
- Stage 4 “Solvency Seriously Compromised”
- Stage 5 “Insufficient Assets or Insolvent”

3.1 Stage 1 “No Significant Problems”

When the AMF considers that the P&C insurer generally employs sound management practices, that observed deficiencies, if any, should not impact the P&C insurer’s solvency, and that its financial condition is satisfactory, the intervention stage for that P&C insurer will then be categorized as “No Significant Problems.” At this stage, no intervention is specifically required.

3.1.1 Identification

On the basis of its supervisory activities, the AMF will categorize the level of intervention with a P&C insurer as Stage 1 “No Significant Problems” based notably on the following key criteria:

- The aggregate net risk associated with the P&C insurer’s significant activities is situated at a low levelé.
- No significant deficiencies have been detected when assessing the P&C insurer’s supervisory functions.
- No special concerns have been raised notably regarding the P&C insurer’s sound management practices and financial condition. The P&C insurer complies notably with the AMF’s capital adequacy requirements and capital exceeds the target ratio.[6]
- The AMF’s Supervisory Report with regard to the P&C insurer raises no weaknesses expected to have a material impact on its solvency in the short term. Corrective actions should be carried out in accordance with a timetable determined by the P&C insurer.

3.1.2 Actions

Based on its Supervisory Framework, the AMF will revise the P&C insurer’s risk profile as needed and will ensure that the intervention stage continues to be appropriate.

PACICC will pursue its analysis activities based on the information disclosed directly by the P&C insurer. If necessary, it will discuss the results of its analysis with the AMF representatives. PACICC will also inform the AMF of any material fact that may be brought to its attention regarding the P&C insurer.

6 Autorité des marchés financiers. *Capital Adequacy Requirements Guideline* and *Capital Management Guideline.*

3.2 Stage 2 “Early Warning”

When the AMF determines that one or more deficiencies in a P&C insurer’s sound management practices may have a significant impact on its solvency, should corrective actions not have been taken with due care, or concerns have been raised in respect of the P&C insurer’s financial condition, the intervention stage will be categorized as “Early Warning”.

At this stage, no intervention is specifically required.

3.2.1 Identification

On the basis of its supervisory activities, the AMF will categorize the level of intervention with a P&C insurer as Stage 2 “Early Warning” based on the following key criteria:

- The aggregate net risk associated with the P&C insurer’s significant activities is situated at a moderate level.
- One of the P&C insurer’s supervisory functions has been judged ineffective, or some supervisory functions require improvement. One or more significant deficiencies have been detected upon assessment.
- Although the P&C insurer complies with the AMF’s capital requirements, concerns have been raised with regard to its current or future financial condition.
- The AMF’s Supervisory Report with regard to the P&C insurer reveals one or more deficiencies that are not expected to have a material impact in the short term on its solvency if they are corrected with due care, or within the timeframes prescribed by the AMF, if any.

3.2.2 Actions

The AMF will forward the Supervisory Report to the P&C insurer’s chief executive officer, with a copy to the audit committee chair. Within 30 days of receipt of the final report, the P&C insurer will be required to submit an action plan including a timetable and/or a description of actions already taken. The AMF will monitor the corrective actions detailed in the action plan.

PACICC will pursue its analysis activities based on the information disclosed directly by the P&C insurer if necessary and will discuss the results of its analysis with the AMF representatives. PACICC will also inform the AMF of any material fact that may be brought to its attention regarding the P&C insurer.

3.3 Stage 3 “Watch Condition”

When the AMF determines that substantial deficiencies in terms of a P&C insurer’s sound management practices may potentially have a material impact on its solvency, should they not be corrected promptly, or the P&C insurer’s financial condition raises serious concerns to the point where its solvency is threatened, the intervention stage will be categorized as “Watch Condition”.

At this stage, more rigorous actions should be implemented. Effective and prompt intervention will be needed from the AMF for the P&C insurer to correct the detected deficiencies and improve its financial condition as expeditiously as possible.

The AMF and PACICC, through its Pre-insolvency Regulatory Liaison Committee, will exchange information on the P&C insurer as needed, depending on the gravity of the issue raised.

3.3.1 Identification

On the basis of its supervisory activities, the AMF will categorize the level of intervention with a P&C insurer as Stage 3 “Watch Condition” based on the following key criteria:

- The aggregate net risk associated with the P&C insurer’s significant activities is situated at a high level.
- Significant deficiencies are detected upon assessment of the P&C insurer’s supervisory functions. Many supervisory functions are judged ineffective.
- The P&C insurer’s financial condition is problematic, not to say unsatisfactory. For example, the P&C insurer’s capital falls below its target ratio, actuarial liabilities are considered insufficient or profitability has deteriorated substantially.
- The P&C insurer’s Supervisory Report reveals weaknesses that may have a material impact in the short term on the P&C insurer’s solvency should they not be corrected promptly.

These problems, in case of unfavourable economic climate, could result in the P&C insurer experiencing significant difficulties. For example, deficient capital management accentuated by a high level of major claims, resulting in a substantial solvency problem.

3.3.2 Actions

The AMF informs the P&C insurer that it has been placed under Stage 3 “Watch Condition” and discusses the situation. In addition to intensified scrutiny of the P&C insurer and depending on the gravity of the situation, the AMF may:

- ask for additional information on a periodic basis;
- conduct special inspections;
- meet with the P&C insurer’s senior management or Board of Directors;

- request a valuation by an independent actuary;
- order audit activities by an outside firm;
- ask the P&C insurer to submit an action plan to remedy the situation. The AMF will ensure that the remedial measures are appropriate, that they are applied correctly and that the situation is subsequently rectified. Where applicable, it may determine that the P&C insurer is no longer in distress.

When the action taken has not yielded the anticipated results, the problems persist and the P&C insurer's solvency is threatened, the AMF has the following powers under the terms of the *Act respecting insurance*[7] ("*ARI*"):

- give written instructions to a P&C insurer concerning the adequacy of and the elements which compose its capital base and the proportion represented by each element;
- issue an order for the P&C insurer to cease a course of action or implement corrective measures in respect of practices that are not sound or prudent or failure to comply with the *ARI*, a regulation or a written instruction;
- request an injunction in respect of the *ARI* and its regulations;
- impose restrictions or conditions associated with the permit.

For its part, PACICC may:

- analyze in detail all the relevant public information and the collected information;
- ask the AMF, in order to make its compensation analysis, to provide certain key information such as:
  - a) reports and results of the AMF's regulatory and special inspections;
  - b) the most recent actuarial reports and dynamic capital adequacy testing;
  - c) the mandate of actuaries, as well as the scope and results of their work;
  - d) the mandate given to the independent auditor, as well as the scope and results of the auditor's work;
  - e) the P&C insurer's corporate business plan outlining the remedial measures.
- hire expert advisors who will be tasked with conducting a detailed analysis on fundamental issues. The expert advisors will be considered senior executives of PACICC to the extent that relevant confidentiality agreements exist.

Additionally, as soon as the P&C insurer reaches this stage, members of PACICC's Pre-insolvency Regulatory Liaison Committee will be informed accordingly. The AMF and PACICC will thus conduct more in-depth and more frequent discussions regarding the P&C insurer's situation.

[7] CQLR, c. A-32 A.

At this stage, PACICC will evaluate the compensation risk presented by the P&C insurer and plan for the funding of its commitments in the event of the P&C insurer's insolvency. It will inform the AMF of its compensation capacity in respect of the P&C insurer.

3.4 Stage 4 "Solvency Seriously Compromised"

> When the AMF determines that the difficulties outlined in the previous section have deteriorated to such an extent that the P&C insurer's solvency is seriously compromised, and that the P&C insurer may, in the short term, be unable to meet its commitments to its Policyholders, the intervention stage for that P&C insurer will be categorized as "Solvency Seriously Compromised."
>
> At this stage, in the interest of Policyholders, the AMF may take various preventive actions to ensure the P&C insurer's viability.
>
> A working group composed of the AMF staff members and PACICC staff members reporting to PACICC's Pre-insolvency Regulatory Liaison Committee may then be created to effectively co-ordinate actions.

3.4.1 Identification

On the basis of its supervisory activities, the AMF will categorize the level of intervention for a P&C insurer as Stage 4 "Solvency Seriously Compromised" when the substantial deficiencies raised up to that point have not been corrected and the financial condition has not been rectified. The P&C insurer fails to meet regulatory capital requirements.

Risk situations of that nature may be reported publicly, possibly resulting in a substantial loss of confidence in the institution concerned, and panic by Policyholders, which could lead to a mass cancellation of their insurance policies.

3.4.2 Actions

3.4.2.1 Autorité des marches financiers

To promote expeditious resolution of a P&C insurer's situation when its solvency is seriously compromised, the AMF may, in accordance with the statutes it administers, initiate actions such as applying to the Superior Court for receivership of the registered P&C insurer.

The AMF may also suspend or cancel the operating licence of a P&C insurer that, in the AMF's opinion, is in an unsatisfactory situation.

Receivership

Under sections 19.1 and following of the *Act respecting the Autorité des marches financiers*[8], the AMF may ask the Superior Court to order the appointment of a receiver

[8] CQLR, c. A-33.2 A.

in respect of a P&C insurer if it can show that it has reasonable grounds to believe that the assets of the P&C insurer are insufficient to meet its obligations, that an officer or director of the P&C insurer has committed embezzlement, a breach of trust or another offence, or that the management exercised by the officers and directors is unacceptable in view of generally accepted principles and could endanger the rights of the Policyholders. The AMF will recommend the names of persons who could act as receiver.

The receiver may be granted the power, by the Superior Court, to proceed with winding-up of the P&C insurer.

3.4.2.2 PACICC

PACICC also assesses its compensation risk and holds discussions with the AMF regarding the actions it might initiate to respect its commitments in relation to the protection it offers. It plans, as needed, the funding of its commitments. In accordance with its By-law No. 1 and Memorandum of Operation, PACICC co-ordinates its actions, such as financial compensation, with the AMF’s actions in view of protecting Policyholders.

3.4.2.3 Working Group

At this stage, a working group may be set up by the AMF and PACICC, through its Pre-insolvency Regulatory Liaison Committee, to co-ordinate the intervention with a P&C insurer. The group is composed of at least two representatives from the AMF and a representative from PACICC, and it is chaired by the AMF.

It shall be the responsibility of the working group members from the two organizations to ensure that the appropriate decision-making bodies in the respective organizations are kept appropriately informed of the discussion and provided with timely recommendations.

The working group co-ordinates activities and facilitates the sharing of information. The AMF informs the P&C insurer’s management, designated actuary, Board of Directors and independent auditor with regard to formation of this working group.

The working group conducts its activities for as long as the P&C insurer’s situation has not been rectified or where appropriate until completion of the winding-up and compensation process.

3.4.2.4 Additional Considerations

The AMF and PACICC should analyze the pros and cons of each intervention option and compare them against those that may arise from winding up the P&C insurer, including the costs that may be absorbed by PACICC.

In addition, if the P&C insurer conducts activities outside Québec or if the P&C insurer belongs to a financial group, the AMF should notify the other regulatory authorities concerned, as needed, that the P&C insurer’s solvency is seriously compromised.

3.5 Stage 5 "Insufficient Assets or Insolvent"

When a P&C insurer's situation can not be rectified as a result of the actions and interventions taken at Stage 4, the AMF may be of the opinion that the P&C insurer's assets are insufficient to effectively protect Policyholders.

The P&C insurer may then be wound up voluntarily or in an orderly fashion upon the application of a shareholder or by reason of receivership under the *ARI* and the *Winding-up Act* ("*WUA*"). The P&C insurer may also be under a winding-up order by virtue of the *Winding-up and Restructuring Act ("WURA")* and be insolvent. The intervention stage is then categorized as "Insufficient Assets or Insolvent".

At this stage, the P&C insurer is wound up. The assets and claims are entrusted to a liquidator who sees to their liquidation and settlement, respectively. The AMF and PACICC collaborate with the liquidator and ensure an orderly winding-up. The compensation of Policyholders should be planned and carried out in accordance with the provisions set forth in the applicable statutes and regulations.

3.5.1 Identification

The AMF categorizes the intervention level as Stage 5 "Insufficient Assets or Insolvent" when, in its opinion, the P&C insurer's assets are insufficient or when it is insolvent.

At this stage, the P&C insurer's assets are insufficient to meet its commitments to Policyholders. In their best interest, the P&C insurer may be wound up voluntarily or in an orderly fashion in accordance with the *WUA* and the *ARI*.

However, it may also be that a winding-up order has been issued by the Superior Court by reason of the P&C insurer's insolvency, in which case the P&C insurer will then be wound up pursuant to the *WURA*.

3.5.2 Actions

In that context, the AMF and PACICC will work together in the best interest of Policyholders. As a P&C insurer with insufficient assets or an insolvent P&C insurer is being wound up, the AMF will inform PACICC of how winding-up is moving forward.

The AMF and PACICC will collaborate together in the winding-up process. The court will appoint a liquidator for the orderly winding-up. The working group, formed in the preceding stage (see section 3.4.2.3) or else newly set up, will ensure co-ordination of the actions taken by the AMF and PACICC.

3.5.2.1 Winding-up of a P&C insurer with Insufficient Assets

Despite all the actions taken to restore the P&C insurer's financial condition, it may be possible that a receivership period ends up unsuccessful and no viable solution can put the P&C insurer back on the road to viability.

Under such circumstances, the P&C insurer should be wound up under the terms of the *WUA* and the *ARI*. That winding-up, governed by the *WUA* and the *ARI*, may be carried out voluntarily or, when necessary, be ordered.

According to section 398 of the *ARI*, the liquidator shall act under the control and direction of the AMF which may, even if it alleges no particular interest, act before the courts in all matters respecting the winding-up and exercise, on behalf of any shareholder, member, insured or creditor of the legal person, the rights that such a one has against the legal person. In a situation of that nature, the AMF supervises the winding-up. Additionally, in accordance with section 405 of the same Act, the liquidator must make a summary report of its activities to the AMF on a quarterly basis.

3.5.2.2 Winding-up of an Insolvent P&C insurer

When a P&C insurer's insolvency is deemed or determined, a winding-up order is issued by virtue of the *WURA*. In accordance with that act, a court will appoint a liquidator and one or many inspectors.

In that context, the AMF and PACICC will work together in the best interest of Policyholders. The AMF and PACICC will collaborate together in the winding-up process and may possibly act as inspectors for the winding-up. For an orderly winding-up, they may, via the working group in particular, co-ordinate their actions and make recommendations.

3.5.3 Coverage Provided by PACICC

The protection of Policyholders must be planned and carried out in accordance with the provisions set forth in the applicable statutes and regulations. The AMF and PACICC must be aware of the costs of compensating Policyholders based on their obligations to guarantee the P&C insurer's operations. In addition, PACICC will use its resources to determine and validate the estimated amounts needed.

PACICC will obtain a commitment from its Board of Directors to provide coverage in the event of liquidation if it is determined that Policyholders are at risk of loss and the resulting PACICC assessment will not cause additional insurers to fail. In anticipation of the winding-up order being issued, PACICC will proceed with planning an assessment to raise funds required to meet coverage obligations.

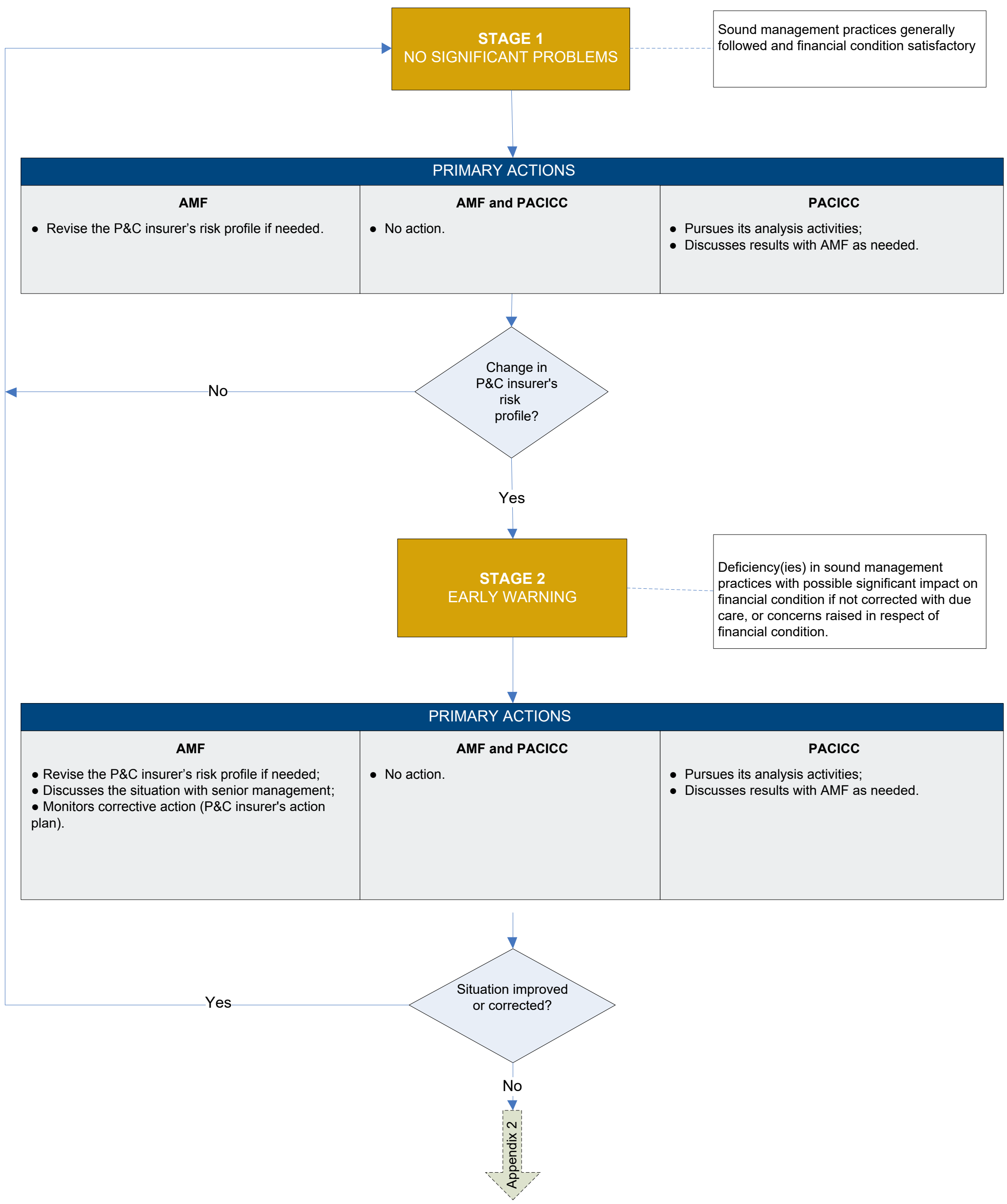
If a P&C insurer becomes insolvent, the PACICC Board of Directors can authorize the payment of benefits or provide a financial commitment to the liquidator in compliance with its Memorandum of Operation. From a practical standpoint, PACICC will collaborate with the liquidator to allow for claims to be settled quickly and efficiently.

3.5.4 Working Group

At this stage, the PACICC working group members, as described in section 3.4.2.3, will now report to PACICC's Board of Directors instead of PACICC's Pre-insolvency Regulatory Liaison Committee. The working group may make recommendations for an orderly winding-up, in addition to serving as a forum for co-ordination and exchanging information. It should be aware of the winding-up costs and, as mentioned above, the costs of protecting Policyholders.

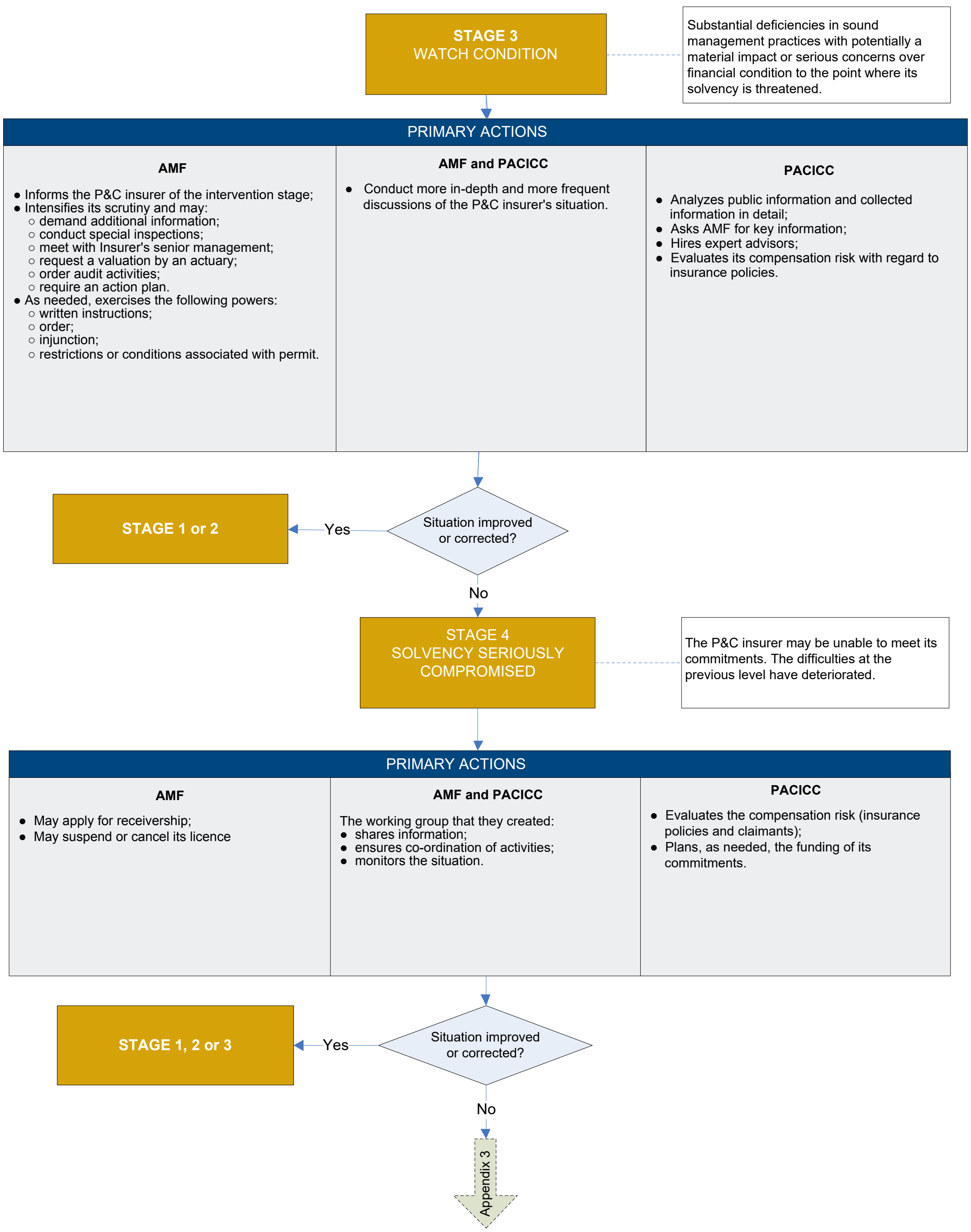
Appendix 1

Intervention Process Map
Stage 1 “No Significant Problems” and Stage 2 “Early Warning”



Appendix 2

Intervention Process Map
Stage 3 “Watch Condition” and
Stage 4 “Solvency Seriously Compromised”



Appendix 3

Intervention Process Map
Stage 5 “Insufficient Assets or Insolvency”

STAGE 5
INSUFFICIENT ASSETS OR INSOLVENT

The P&C insurer's assets are deemed insufficient to effectively ensure the protection of Policyholders . The P&C insurer may be wound up voluntarily or in an orderly fashion or may be under a winding-up order.

PRIMARY ACTIONS

AMF

- Cancels the P&C insurer's operating licence;
- Collaborates to the P&C insurer's winding-up process;
- Develops an external communication plan.

Winding-up Act, Act respecting insurance and Act respecting the Autorité des marchés financiers (voluntarily or orderly wind-up):

- Supervises winding-up;

- or -

*Winding-up and Restructuring Act (W 11, Parts I and III) (**orderly wind-up**).*

AMF and PACICC

The working group created:
- co-ordinates activities;
- exchanges information and holds discussions;
- monitors how the wind-up is moving forward;
- ensures evaluation of losses to be covered and amounts to be compensated.

PACICC

- Collaborates on the Insurer's winding-up process;
- May act as inspector for the winding-up (W-11).

With regard to Policyholders:
- obtains commitment from its Board of Directors to provide coverage;
- plans funding of its commitments in accordance with its By-Law No. 1 and Memorandum of Operation;
- proceeds with planning an assessment to raise funds required for compensation;
- compensates Policyholders.