



# PACICC Risk Management Report

February 2024

## **PACICC Risk Management Report**

At the direction of its Audit and Risk Committee, PACICC has revised its Risk Management Report (RMR) into two documents – one focusing on PACICC-only risks and one that identifies broader industry risks.

### **This document identifies PACICC Risks.**

The PACICC RMR focuses on two risks that could cause the Corporation to fail to deliver on its Mission, and eight other risks that could negatively affect PACICC operations. PACICC's three-part Mission includes:

1. Protecting eligible policyholders from undue financial loss in the event that a Member Insurer becomes insolvent
2. Working to minimize the costs of insurer insolvencies
3. Seeking to maintain a high level of consumer and business confidence in Canada's property and casualty (P&C) insurance industry through the financial protection that PACICC provides to policyholders.

Risks identified in this document are divided into three categories:

1. Section 1 – Major Risks (2)
2. Section 2 – Significant Risks (3)
3. Section 3 – Moderate Risks (5).

A table summarizing the risks appears on the next page.

## PACICC Risk Management Report

Risk #	Risk	Risk Type
<b>MAJOR RISKS</b>		
1-1	Catastrophic earthquake leads to serial Member failure – insolvency costs exceed PACICC's risk-limit appetite	Financial
1-2	Major externality causes failure of one or more large companies – insolvency costs exceed PACICC's risk-limit appetite	Financial
<b>SIGNIFICANT RISKS</b>		
2-1	Major/concurrent failures or another event (e.g. COVID-19) places extraordinary demands on human resources	Operational
2-2	Faulty risk modelling fails to fully anticipate the impacts of climate change and exposes smaller regional companies to greater risk of failure	Financial
2-3	Certain provincial solvency supervisory practices fall below IAIS standards and result in industry insolvencies	Regulatory
<b>MODERATE RISKS</b>		
3-1	Regulators seek to exert more influence over PACICC governance	Regulatory
3-2	Reliance on outsourced operations (IT, AP, Investment, Bank, Legal)	Operational
3-3	Ineffective governance (fraud not prevented/detected, security breach, incomplete/inaccurate reports)	Operational
3-4	PACICC Member companies lose confidence in PACICC's ability to fulfil its mandate	Financial
3-5	PACICC could be forced to increase coverage and benefits beyond levels its Members would support	Regulatory

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## PACICC Risk Profile Grid and Rating Criteria (February 2024)

Impact Rating	Very High	<b>Financial Risk</b> 1-1 Earthquake causes serial Member failure, where costs exceed PACICC's risk limit-risk appetite		<b>Financial Risk</b> 1-2 External event causes insolvency of one or more large companies, where costs exceed PACICC's risk limit-risk appetite		<b>PACICC's Priority Risks (Risk Profile)</b>  <b>1-1 – Financial Risk</b> A catastrophic earthquake leads to serial Member failure, where resulting insolvency costs exceed PACICC's risk limit-risk appetite (twice its Annual General Assessment capacity) <b>1-2 – Financial Risk</b> A major external event (e.g. cyber attack, wildfire, flood, geo-political risk) causes the failure of one or more large companies, resulting in insolvency costs that exceed PACICC's risk limit-risk appetite (twice our annual General Assessment capacity) <b>2-1 – Operational Risk</b> The insolvency of a larger Member, group, or concurrent multiple Member failures, or another event (e.g. COVID-19), places extraordinary demands on human resources <b>2-2 – Financial Risk</b> Faulty risk modelling fails to fully anticipate the impacts of climate change and exposes smaller regional companies to greater risk of failure <b>2-3 – Regulatory Risk</b> Supervisory practices are below minimum IAIS standards
	High					
	Medium		<b>Operational Risk</b> 2-1 Extraordinary demands on human resources	<b>Financial Risk</b> 2-2 Faulty risk modelling fails to fully anticipate the impacts of climate change		
	Low				<b>Regulatory Risk</b> 2-3 Inadequate solvency supervision, below minimum IAIS standards	
		Very Low	Low	Medium	High	
Likelihood Rating						

Impact Criteria Ranking	Low	Medium	High	Very High
a) Financial Risk	< \$5 million	\$5 million to \$500 million	\$500 million to \$1.5 billion	> \$1.5 billion
b) Operational Risk	< \$100,000	\$100,000 to \$1.0 million	\$1.0 million to \$2.0 million	> \$2.0 million
c) Reputation Risk	Isolated complaints	Regulatory involvement	Widespread media involvement	Government intervention
Likelihood Criteria Ranking	Very Low	Low	Medium	High
All risks	Occur < 1-in-100 years	Occur within 10 years	Occur within 5 years	Occur within 2 years

## Responding to Significant Risks: Actions, Responsibility and Timing

The table below summarizes all Major/Significant/Moderate Risks in PACICC's risk profile, with attention on mitigation strategies and actions; responsibility for implementation; and the expected timing for implementation, or the achievement of specific milestones.

### Risk Priority Coding

	Major risks (2)
	Significant risks (3)
	Moderate risks (5)

### Section 1: Major Risks (Red) to be Addressed

Risk #	Inherent Risk and Description	Triggers for Adverse Impact	Mitigation/Controls	Rating	
				Impact	Likelihood
1-1	<b>Financial Risk:</b>  A catastrophic earthquake leads to serial Member failure; resulting insolvency costs exceed PACICC's risk limit-risk appetite (twice its Annual General Assessment capacity)	Earthquake leading to mega-catastrophic losses; causing the insolvency of one or multiple PACICC Member companies (or their parent companies)	<b>EARTHQUAKE/MEGA-CATASTROPHIC LOSS</b> <ul style="list-style-type: none"> <li>○ A Board-approved workplan is in place to guide staff efforts on this issue</li> <li>○ PACICC released its latest estimate for industry capacity in May 2021. The \$35 billion tipping point is widely accepted in government policy circles</li> <li>○ The Federal Department of Finance is considering "how to limit the system-wide risks an extreme earthquake could pose to federal P&amp;C insurers." It is still unknown whether the government will agree to provide a financial backstop? Form? Timing?</li> <li>○ PACICC has a strong working relationship with the policy team at the Department of Finance</li> <li>○ PACICC has briefed senior officials at the Bank of Canada, OSFI and CMHC on this issue</li> <li>○ PACICC encouraged IBC to create a CEO-level Committee to manage the industry's approach to "tail risks"</li> <li>○ PACICC actively participates in IBC's Earthquake Working Group</li> <li>○ PACICC worked with IBC and ICLR to flesh out the details of changes to the insurance product</li> </ul>	Very high	Very low

Risk #	Inherent Risk and Description	Triggers for Adverse Impact	Mitigation/Controls	Rating	
				Impact	Likelihood
1-2	<b>Financial Risk:</b>  A major external event (e.g. cyber attack, wildfire, flood, geo-political risk) causes the failure of a “Top-15” Member; resulting insolvency costs exceed PACICC’s risk limit-risk appetite (twice its Annual General Assessment capacity)	<ul style="list-style-type: none"> <li>○ Insolvency of one or multiple PACICC Member companies (or their parent companies)</li> <li>○ The failure of one or more of PACICC’s largest Member companies – regardless of the cause(s)</li> <li>○ Systemic model error – Most Canadian insurers use the same catastrophic risk models</li> <li>○ An extensive major financial crisis leading to multiple insolvencies</li> <li>○ Triggering events could include: higher inflation, adverse reaction to market volatility, and a sharp rise in interest rates</li> </ul>	<b>FAILURE OF A LARGE MEMBER</b> <ul style="list-style-type: none"> <li>○ PACICC’s Board of Directors approved a Resolution Protocol to allow the Corporation to consider alternatives to liquidation</li> <li>○ The Pre-Insolvency Regulatory Liaison (PIRL) Committee was created in 2015 to improve communication with regulators</li> <li>○ PACICC has worked with regulators to be included throughout the regulatory process in Guides to Intervention. Guides to Intervention signed with Quebec, British Columbia, Alberta, Ontario and OSFI include communication with regulators, beginning in Stage 2</li> <li>○ PACICC created a formal Resolution Protocol that would allow the Corporation the opportunity to develop alternatives to liquidation prior to the liquidation of a large Member Insurer</li> <li>○ PACICC seeks to enhance industry risk management best practices through information sharing at its Risk Officer’s Forum Meetings and Emerging Risks Webinars</li> </ul>	Very High	Medium

## Section 2: Significant Risks (Yellow) to be Addressed

Risk #	Inherent Risk and Description	Triggers for Adverse Impact	Mitigation/Controls	Rating	
				Impact	Likelihood
2-1	<b>Operational Risk:</b>  Extraordinary demands on human resources with insolvency of larger Member, group, or concurrent multiple Member failures, or another event (e.g. COVID-19 pandemic)	<ul style="list-style-type: none"> <li>Large or multiple insurer failures could require: high volume of requests for claims settlement authority and/or resolution of related issues; complicated assessment process; extensive queries</li> <li>PACICC needs to outsource functions and could have difficulty administering this with existing staff</li> <li>Loss of “key persons” at PACICC could exacerbate this risk</li> </ul>	<ul style="list-style-type: none"> <li>PACICC has developed a Claims Management Contingency Plan to address this risk. The Plan was approved by the Board in November 2010. Management believes that the Plan remains up-to-date and provides an effective framework for mitigating this risk</li> <li>Regular dialogue takes place with regulators to discuss troubled Members and to ensure adequate preparedness</li> <li>In 2020, PACICC developed a pre-approved pool of qualified firms that could be called upon to provide professional service support to the Corporation (or a third party) in the management of any Member Insurer insolvency that may occur over the next five years. PACICC issued Requests for Standing Offer to leading firms across four disciplines: Actuarial Consulting Services; Advisory and Restructuring Services; Claims Management Services; and Legal Services. The Corporation now has a comprehensive list of qualified firms, with a clear understanding of proposed costs and potential value-added services</li> <li>PACICC recently conducted desktop simulation exercises with AMF and OSFI to assess readiness of each organization</li> </ul>	Medium	Low

Risk #	Inherent Risk and Description	Triggers for Adverse Impact	Mitigation/Controls	Rating	
				Impact	Likelihood
2-2	<b>Financial Risk:</b>  Faulty risk modelling fails to fully anticipate the impacts of climate change and exposes smaller regional companies to greater risk of failure	<ul style="list-style-type: none"> <li>○ Unmodelled major risk events (e.g., Wildfire, flood, etc.) resulting from climate change lead to multiple industry failures</li> <li>○ Similar to the risk of Earthquake affecting the largest 15 companies in the industry, risks from other unanticipated extreme weather events are a direct threat to the operations of smaller regional companies</li> </ul>	<b>FAILURE OF A SERIES OF SMALLER MEMBERS</b> <ul style="list-style-type: none"> <li>○ PACICC's Board of Directors approved a Resolution Protocol to allow the Corporation to consider alternatives to liquidation</li> <li>○ PACICC has worked with regulators to be included throughout the regulatory process in Guides to Intervention, beginning in Stage 2</li> <li>○ PACICC created a formal Resolution Protocol that would allow the Corporation the opportunity to develop alternatives to liquidation prior to the liquidation of a large Member Insurer</li> <li>○ PACICC seeks to enhance industry risk management best practices through information sharing at its Risk Officer's Forum Meetings and Emerging Risks Webinars</li> </ul>	Medium	Medium
2-3	<b>Regulatory Risk:</b>  Certain provincial regulators have limited solvency supervision resources and expertise	<ul style="list-style-type: none"> <li>○ Insurance legislation and/or regulations at the provincial level do not contain adequate standards for insurance solvency supervision</li> <li>○ Practices do not meet the minimum standards of the International Association of Insurance Supervisors (IAIS)</li> <li>○ Failure to execute supervisory activities due to inadequate staffing and resources</li> </ul>	<ul style="list-style-type: none"> <li>○ PACICC advocates that P&amp;C provincial solvency supervision must meet IAIS standards</li> <li>○ PACICC has developed an Intervention Guide and updated its Model Winding-Up Order</li> <li>○ PACICC's PIRL Committee (consisting of the non-Industry Directors of the Board) facilitates sharing of sensitive information by regulators. It meets annually with OSFI, AMF and FSRAO</li> <li>○ Intervention Guides have been signed with AMF, OSFI, BCFS, Alberta and Ontario. While these initiatives may encourage provinces with weaker solvency supervision to strengthen their practices, PACICC remains concerned about under-resourcing of supervisory staff</li> <li>○ PACICC developed a training session for regulators to improve their understanding of the Own Risk and Solvency Assessment (ORSA) Report and setting Minimum Capital Test (MCT) target levels. A similar training session on performance metrics (IFRS 17) is planned for 2024</li> </ul>	Low	High



### Section 3: Moderate Risks (Green) – Not currently considered ‘Major’ or ‘Significant’

Risk #	Inherent Risk and Description	Triggers for Adverse Impact	Mitigation/Controls	Rating	
				Impact	Likelihood
3-1	<b>Regulatory Risk:</b>  Regulators seek to exert inappropriate influence over PACICC governance, with adverse consequences	<ul style="list-style-type: none"> <li>Insurance regulators seek to expand PACICC mandate to address restructuring</li> <li>Regulators are encouraged by other stakeholders to merge PACICC with larger financial guarantee funds</li> <li>Regulator requires all Board members to be non-Industry Directors</li> </ul>	<ul style="list-style-type: none"> <li>PACICC has changed the terms of reference for its Board Chair. (The Chair will now be a non-Industry Director on a permanent basis, and will serve a three-year term)</li> <li>Regulators invited to attend all Board meetings and they receive copies of proceedings</li> <li>PACICC's <i>Code of Ethics and Business Conduct</i> is attested to annually by Directors and staff</li> <li>International P&amp;C guarantee fund boards typically have a majority of industry Directors</li> </ul>	Low	Low
3-2	<b>Operational Risk:</b>  Reliance on IT outsourced operation	<ul style="list-style-type: none"> <li>Service provider removes service</li> <li>Equipment issues not readily resolved</li> <li>Unauthorized access</li> <li>Cyber attack: viruses, hacker, data breach</li> </ul>	<ul style="list-style-type: none"> <li>PACICC uses an externally hosted, secure server that provides full back-up and recovery</li> <li>All staff is equipped to work offsite when required using their own computers</li> <li>PACICC's supplier of IT services (F12.net) has conducted an independent audit of its "System and Organization Controls for Service Organizations" (SOC 2® Type 2 Report)</li> <li>The SOC 2 audit findings confirm that reasonable steps have been taken to protect client files</li> <li>PACICC regularly reviews the cyber security measures it has in place</li> </ul>	Low	Low

Risk #	Inherent Risk and Description	Triggers for Adverse Impact	Mitigation/Controls	Rating	
				Impact	Likelihood
3-3	<b>Operational Risk:</b>  Ineffective governance	<ul style="list-style-type: none"> <li>○ Fraud is not prevented or detected</li> <li>○ Security breach not prevented or detected</li> <li>○ Unauthorized access causes loss of data or compromises integrity</li> <li>○ Incomplete or inaccurate reports prepared</li> </ul>	<ul style="list-style-type: none"> <li>○ PACICC Board places significant emphasis on good governance practices</li> <li>○ PACICC has followed the lead of OSFI for enhancing governance in the industry – OSFI Guideline E-13 and CSA Guidelines</li> </ul>	Low	Low
3-4	<b>Financial Risk:</b>  Key PACICC stakeholders lose confidence in PACICC's ability to fulfill its mandate	Key PACICC stakeholders (e.g. Members, federal and/or provincial regulators) express concern about the Corporation's ability to protect policyholders' financial interests	<p>PACICC undertakes numerous initiatives to ensure that Members and regulators are updated regularly on ways that the Corporation actively fulfills its mandate, including:</p> <ul style="list-style-type: none"> <li>○ Quarterly newsletter (<i>Solvency Matters</i>) which provides an overview of current/emerging industry issues and PACICC actions to address same</li> <li>○ Risk Officer's Forum Meetings and Emerging Risks Webinars featuring subject-matter experts who share information on industry risk management best practices</li> <li>○ Annual publication of PACICC <i>Why Insurers Fail</i> research series reports, examining reasons for notable industry insolvencies and learnings</li> </ul> <p>Cyber Risk Webinars (now ad hoc) are presented jointly with the Global Risk Institute in Financial Services. The webinars focus on cyber risks and attacks, and preventative/remedial measures to address this growing risk area. Findings are then shared with the industry.</p>	Medium	Low

Risk #	Inherent Risk and Description	Triggers for Adverse Impact	Mitigation/Controls	Rating	
				Impact	Likelihood
3-5	<b>Regulatory Risk:</b>  Benefits unilaterally enhanced by government regulators beyond levels that PACICC Members would support	<ul style="list-style-type: none"> <li>○ Broader interpretation of insurance policy wording by Courts and regulators</li> <li>○ Benefits could be raised beyond reasonable limits</li> <li>○ Regulators force coverage of certain specialty lines, where the assessment base could be insufficient to fund the insolvency costs</li> <li>○ Price of homes and insurance cover increasing – Claims limits could be inadequate, especially in the case of total property losses</li> </ul>	<ul style="list-style-type: none"> <li>○ PACICC coverage limits were updated in March 2020 and reviewed in 2023</li> <li>○ PACICC's Actuarial Advisory Committee developed an industry survey (by coverage line) to measure the high percentage of claims protected</li> <li>○ In 2021, the PACICC Board approved a formal "Hardship" Policy to consider claims exceeding PACICC limits; being reviewed in 2024</li> <li>○ PACICC's Memorandum of Operation details excluded lines of coverage. Any new coverages not specifically excluded are covered by PACICC</li> <li>○ PACICC maintains a strong working relationship with the CCIR Assuris-PACICC Committee</li> <li>○ PACICC monitors financial guarantee fund best practices in other countries through its involvement with the International Forum of Insurance Guarantee Schemes (IFIGS)</li> <li>○ PACICC continues to advocate that moral hazard risk be minimized and that protection apply to personal lines and business policyholders, but exclude large corporations</li> <li>○ PACICC's Board can decide to cover losses beyond PACICC's limits in exceptional circumstances</li> </ul>	Medium	Low

### **PACCIC Risk Limit-Risk Appetite**

PACICC's current Risk Limit-Risk Appetite is \$2.54 billion. PACICC measures its Risk Limit-Risk Appetite in relation to its ability to collect funds from Members over a two-year period, to pay for the eligible claims of insolvent Members. PACICC's maximum annual assessment capacity is 1.5 percent of the total covered premiums of Members. Based on the most recent annual industry results, 1.5 percent of covered premiums equates to \$1.27 billion (as stated in Note 9 of PACICC's audited financial statements for the year ended December 31, 2023). As of this Report, two times PACICC's annual assessment capacity of \$1.27 billion thus yields a Risk Limit-Risk Appetite of \$2.54 billion. In addition, PACICC maintains a Compensation Fund to address liquidity issues in the period immediately following a Member insolvency. The current market value of the Compensation Fund (as at December 31, 2023) is \$60.5 million.

## Appendix

### **PACICC Risk Management Definitions**

**Note:** The following definitions are based on the ISO 31000 2009 Plain English Risk Management Dictionary, with minor edits as appropriate for PACICC's risk management environment.

#### **Risk**

*Risk* is the “effect of uncertainty on objectives” and an *effect* is a positive or negative deviation from what is expected. Organizations strive to reduce uncertainty as much as possible. *Uncertainty* is a state or condition that involves a deficiency of information and leads to inadequate or incomplete knowledge or understanding. In the context of risk management, uncertainty exists whenever the knowledge or understanding of an event, consequence, or likelihood is inadequate or incomplete.

#### **Risk management (Enterprise Risk Management – ERM)**

*Risk management* refers to a co-ordinated set of activities and methods that is used to direct an organization and to mitigate or control the many risks that can affect its ability to achieve objectives. The term *risk management* also refers to the architecture that is used to manage risk. This architecture includes risk management principles, the risk management framework and risk management processes.

#### **Risk management framework (Risk Management Statement)**

A *risk management framework* is a set of components that support and sustain risk management throughout an organization. There are two types of components: foundations and organizational arrangements. *Foundations* include the risk management policy, goals and objectives, mandate, and commitment (Mission and Principles). *Organizational arrangements* include the plans, relationships, accountabilities, resources, processes and activities used to manage the organization's risks.

#### **Risk management policy**

A *risk management policy* documents an organization's commitment to risk management and clarifies its general direction and intention. Components include procedures, practices, controls, responsibilities and activities (including their sequence and timing).

#### **Risk management process**

A *risk management process* is one that systematically applies management policies, procedures, controls and practices to a set of activities intended to establish the context of risks, communicate with stakeholders and identify, analyze, evaluate, treat, monitor and review risks. To establish the *context* means to define the external and internal parameters that organizations must consider when they manage risk. External context includes external stakeholders, local, national, and international environment, as well as any external factors that influence an organization's objectives. Key drivers and trends include stakeholder views, perceptions and relationships, as well as social, cultural, political, legal, regulatory, financial, technological, economic, natural, and the competitive environment factors. Internal *context* includes an organization's internal stakeholders, the approach to governance, contractual relationships, capabilities, culture and standards. *Governance* includes the organization's structure, policies, objectives, roles, accountabilities and decision-making processes. Capabilities include knowledge and resources; human, technological and capital.

## **Risk assessment**

*Risk assessment* is a three-part process consisting of risk identification, risk analysis and risk evaluation. *Risk identification* is a process that is used to find, recognize and describe the risks that could affect the achievement of objectives. It also includes the identification of possible causes and potential consequences. Historical data, theoretical analysis, informed opinions, expert advice and/or stakeholder input could be used to identify an organization's risks. *Risk analysis* is a process that is used to understand the nature, sources and causes of the risks that are identified, and to estimate the level of risk. Analysis is also used to study impacts and consequences and to examine the mitigation and controls that currently exist. *Risk evaluation* is a process that is used to compare risk analysis results with risk appetite in order to determine whether or not a specified level of risk is acceptable or tolerable.

## **Risk Register (as defined by PACICC)**

PACICC has compiled a *Risk Register* identifying risks that could cause PACICC not to meet its goals and objectives, including a brief assessment of each risk. More significant risks are then selected for in-depth review and, if deemed appropriate, escalated to PACICC's Risk Profile.

## **Risk Profile (as defined by PACICC)**

PACICC's *Risk Profile* is a graphic presentation and written description of the major risks which could potentially have a significant, adverse impact on PACICC's ability to meet its goals and objectives. The description includes a comprehensive risk assessment (see definition), ranking of the impact and likelihood (probability) of the risk occurring, a description of consequences, and a description of the treatment (action plan) showing owners and timelines. The *Risk Profile* includes any risks that the organization must monitor and manage, regardless of type of risk (for example, financial, operational or reputational). A *consequence* is the outcome of an event and has an effect on objectives. A single event can generate a range of consequences that can positively or negatively affect goals and objectives. Initial consequences can also escalate through ripple effects. *Likelihood* (probability) is the chance of a risk occurring. *Likelihood* can be defined, determined, or measured objectively or subjectively; and it can be expressed qualitatively or quantitatively. *Severity* refers to the magnitude of a risk. Severity is estimated by considering and combining consequences and likelihoods. It can be assigned to a single risk or to a combination of risks. Severity is described as Level of risk per ISO 39000. *Risk treatment* is a risk modification process. It involves selecting and implementing one or more treatment options – for example, avoiding the risk, reducing the risk, removing the source of the risk, modifying the consequences, changing the probabilities, sharing the risk with others, or simply retaining the risk.

## **Risk appetite**

(As defined by PACICC, with adaption / modification of ISO definitions of Risk Attitude and Risk Criteria). *Risk appetite* is a point of reference used to assess and evaluate the significance or importance of an organization's risks. It is used to determine whether a specified level of risk is acceptable or tolerable. An organization's *risk appetite* also defines its general approach to risk, for example, whether risks should be retained, shared, reduced or avoided, and whether or not risk treatments are implemented or postponed.

## **Residual risk**

*Residual risk* is the risk left over by determining the inherent risk of an activity, then reducing the risk based on the organization's governance and control processes, and specific risk-mitigation measures. The key objective in monitoring risks on the Risk Profile is to ensure that action plans serve to reduce residual risk. Mitigation strategies may include removing the source of the risk, modifying the consequences, changing the probabilities, transferring the risk or retaining the risk.