Risk Management Report

March 2022 (Revised)

<u>Revisions to PACICC's Risk Management Report</u>

PACICC has undertaken a review of its Risk Management Report with a view to focusing only on those risks that would cause the Corporation to fail to deliver on its three-part Mission:

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.

PACICC used the March 2021 issue of the Risk Management Report as a starting point for revisions, focusing more narrowly on PACICC-specific major risks that could prevent the organization from meeting its goals and objectives. The number of risks being actively monitored has decreased from 37 down to 22, including:

- Section 1 (Major Risks) – Now identifies five Major Risks, down from eight.
- Section 2 (Risks to be Monitored) – Now identifies 14 Risks to be Monitored, down from 18.
- Section 3 (Emerging Risks) – Now identifies three Emerging Risks, down from 11.

A table summarizing changes to the March 2021 Risk Management Report appears on the next page.

Revisions Made to PACICC's March 2021 Risk Management Report

Former Risk #	Risk	Risk Type	Revisions Made/Actions Taken	Now Risk #…
Major Risks				
1-1	Earthquake – insolvency costs exceed PACICC's capacity	Financial	Revised	1-1
1-1	Externality – insolvency costs exceed PACICC's capacity	Financial	Revised	1-2
1-2	Supervisory practices below IAIS standards	Regulatory	Revised and Reordered	1-5
1-3	Rate regulation causes an insolvency (Regulatory)	Regulatory	Deleted	-
1-4	Outdated winding-up legislation	Regulatory	Deleted	-
1-5	Adverse changes in insurance legislation	Regulatory	Deleted	-
1-6	PACICC forced to increase coverage and benefits	Regulatory	Revised and Reordered	1-3
1-7	Extraordinary demands placed on human resources	Operational	Revised and Reordered	1-4
1-8	Lack of specialists with P&C liquidation experience	Operational	Deleted	-
Monitored Risks				
2-1	Collecting Member Assessments	Operational	Deleted	-
2-2	New products affect Members	Financial	Revised and Reordered	2-1
2-3	Financial shock impacts Members	Financial	Revised and Reordered	2-2
2-4	Property and liability insurance coverage	Operational	Revised and Reordered	2-3
2-5	Operating expenses exceed Budget	Operational	Revised and Reordered	2-4
2-6	Insolvency costs greater than anticipated	Operational	Deleted	-
2-7	Use of unlicensed reinsurance in Canada	Regulatory	Revised and Reordered	2-5
2-8	Non-profit tax exemption for investment income	Regulatory	Deleted	-
2-9	Regulators' influence over PACICC governance	Regulatory	Revised and Reordered	2-6
2-10	Attract/retain knowledgeable/experienced staff	Operational	Deleted	-
2-11	Reliance on outsourced IT operations	Operational	Revised and Reordered	2-7
2-12	Disaster Recovery Plan	Operational	Merged with 2-13 and 2-6	2-6
2-13	Inadequate/insufficient resources and/or funding	Operational	Merged with 2-12 and 2-6	2-6
2-14	Ineffective governance	Operational	Revised and Reordered	2-8
2-15	Insurers fail for various reasons	Operational	Deleted	-
2-16	Failure of conglomerate involving other guarantee funds	Operational	Revised and Reordered	2-9
2-17	Key suppliers of services and outsourced arrangements	Operational	Revised and Reordered	2-10
2-18	Compensation Fund proves to be inadequate	Financial	Revised and Reordered	2-11
New	Members lose confidence in PACICC	Financial	New Risk	2-14
Emerging Risks				
3-1	Risk of non-covered policies impacting covered lines	Operational	Revised and Moved	2-12
3-2	PACICC coverage limits may prove inadequate	Financial	Merged with former 1-7	1-3
3-3	PACICC coverage may need to be clarified	Fin/Reg/Oper	Merged with former 2-2	2-1
3-4	Increased requirements for consumer education/awareness	Regulatory	Deleted	-
3-5	P&C insurance industry consolidation	Financial	Revised and Moved	2-13
3-6	Peer-to-peer commerce – new/disruptive insurance risks	Regulatory	Merged with former 2-2	2-1
3-7	Insurtech introduces solvency risks	Financial	Merged with 3-8 and Reordered	3-1
3-8	New financial technologies threaten financial stability	Financial	Merged with 3-7 and Reordered	3-1
3-9	Environmental/Social/Governance risks/opportunities	Financial	Revised and Reordered	3-2
3-10	Insurance risks related to cannabis legalization in Canada	Financial	Merged with former 2-2	2-1
3-11	COVID-19 pandemic creates possible solvency risks	Financial	Revised and Reordered	3-3

Contents

Risk Profile Grid and Rating Criteria (March 2022)

Impact Rating

Very High	**Financial Risk** **1-1** Earthquake causes Insolvency where costs exceed PACICC's risk limit-risk appetite	**Financial Risk** **1-2** External factor causes insolvency where costs exceed PACICC's risk limit-risk appetite		
High		**Regulatory Risk** **1-3** Benefits enhanced to unsupportable levels		
Medium		**Operational Risk** **1-4** Resource demands		
Low				**Regulatory Risk** **1-5** Solvency supervision
	Very Low	**Low**	**Medium**	**High**

Likelihood Rating

PACICC's Priority Risks (Risk Profile)

1-1 – Financial Risk
A catastrophic earthquake causes a very large insurer to fail, or leads to multiple, smaller insolvencies; resulting in insolvency costs which exceed PACICC's risk limit-risk appetite (twice our annual General Assessment capacity)

1-2 – Financial Risk
A major external factor (e.g. cyber attack, wildfire, flood, geo-political risk) causes a very large insurer to fail, or leads to multiple, smaller insolvencies; resulting in insolvency costs which exceed PACICC's risk limit-risk appetite (twice our annual General Assessment capacity)

1-3 – Regulatory Risk
PACICC could be compelled to increase coverage and benefits beyond levels that its Members would support

1-4 – Operational Risk
The insolvency of a larger Member, group, or concurrent multiple Member failures, or another event, places extraordinary demands on human resources

1-5 – Regulatory Risk
Supervisory practices are below minimum IAIS standards

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 the five Significant 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	Mitigation Strategies/Actions	Implementation Responsibility	Timing/Milestones
1-1 Financial Risk: A catastrophic earthquake causes a very large insurer to fail, or leads to multiple, smaller insolvencies; resulting insolvency costs exceed PACICC's risk limit-risk appetite (twice its Annual General Assessment capacity)	**EARTHQUAKE/MEGA-CATASTROPHIC LOSS** ○ A Board-approved workplan is in place to guide staff efforts on this issue ○ PACICC released its latest estimate for industry capacity in May 2021. The $35 billion "tipping point" is widely accepted by industry and in government policy circles ○ The Federal Department of Finance is considering "how to limit the system-wide risks an extreme earthquake could pose to federal P&C insurers." It is still unknown whether the government will agree to provide a financial backstop; in what form; or with what timing ○ PACICC has a strong working relationship with the policy team at the Department of Finance ○ PACICC briefed senior officials at Bank of Canada, OSFI, CDIC and CMHC on this issue ○ PACICC encouraged IBC to create a CEO-level Committee to manage the industry's approach to "tail risks" ○ PACICC actively participates in IBC's Earthquake Working Group ○ PACICC worked with IBC and ICLR to flesh out the details of changes to the insurance product	Alister Campbell Grant Kelly	Federal Government recommendations are still to be made. PACICC continues to work closely with IBC to ensure industry alignment and consensus on a levy mechanism. We continue to engage with key decision makers in an effort to move this issue forward on the public policy agenda
1-2 Financial Risk: A major external factor (e.g. cyber attack, wildfire, flood, geo-political risk) causes a very large insurer to fail, or leads to multiple, smaller insolvencies; resulting insolvency costs exceed PACICC's risk limit-risk appetite (twice its Annual General Assessment capacity)	**FAILURE OF A LARGE MEMBER** ○ PACICC's Board of Directors approved a Resolution Protocol to allow the Corporation to consider alternatives to liquidation ○ The Pre-Insolvency Regulatory Liaison (PIRL) Committee was created in 2015 to improve communication with regulators ○ PACICC 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	Alister Campbell Grant Kelly	○ PACICC is conducting desktop simulation exercises with regulators (OSFI and AMF) to test and troubleshoot its Guides to Intervention ○ Changes to PACICC's governance are being implemented in order to facilitate alternatives to liquidation, prior to the

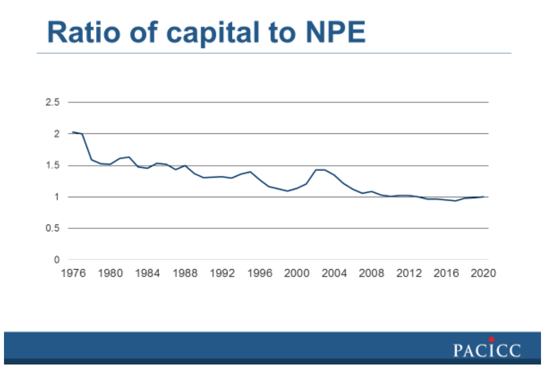
	include communication with regulators, beginning in Stage 2 ○ PACICC created a formal Resolution Protocol that would allow the Corporation the opportunity to develop alternatives to liquidation prior to the liquidation of a large Member Insurer ○ PACICC seeks to enhance industry risk management best practices through information sharing at its Risk Officer's Forum Meetings and Emerging Risks Webinars		liquidation of a large Member Insurer
1-3 Regulatory Risk: PACICC could be forced to increase coverage and benefits beyond levels its Members would support	○ PACICC coverage limits ($500,000 for Personal Property; $400,000 for all other covered lines) were updated in March 2020 ○ The PACICC Board mandated that benefits would be next reviewed in 2023, and every five years thereafter ○ PACICC's Actuarial Advisory Committee developed an industry survey (by line of coverage) to measure the high percentage of claims protected ○ In 2021, the PACICC Board of Directors approved a formal "Hardship" Policy that details how the Corporation will consider claims exceeding PACICC limits ○ PACICC's Memorandum of Operation details lines of coverage that are excluded. Any new coverages that are not specifically excluded are covered by PACICC ○ PACICC maintains a strong working relationship with the Canadian Council of Insurance Regulators Assuris-PACICC Committtee ○ PACICC maintains a good understanding of financial guarantee fund best practices in other countries through its involvement with the International Forum of Insurance Guarantee Schemes (IFIGS) ○ PACICC educates stakeholders on best practices ○ PACICC continues to advocate that moral hazard risk be minimized and that protection apply to personal lines and business policyholders, but exclude large corporations ○ PACICC's Board can decide to cover losses beyond PACICC's limits in exceptional circumstances	Alister Campbell Grant Kelly Ian Campbell	Completion of 2019 coverage and benefits review mitigates the risk in the medium term. A review of coverage will now be undertaken in 2023, and every five years thereafter
1-4 Operational Risk: The insolvency of a larger Member, group, or concurrent multiple Member	○ PACICC has developed a Claims Management Contingency Plan to address this risk. The Plan was approved by the Board in November 2010. The Plan provides an effective framework for mitigating this risk	Ian Campbell Grant Kelly	○ Desktop simulation exercises with regulators will continue in 2021 and 2022

failures, or another event, places extraordinary demands on human resources	○ 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 ○ Frequent dialogue takes place with regulators to discuss troubled Members and to ensure adequate preparedness ○ PACICC is conducting desktop simulation exercises with OSFI in 2021 and AMF in 2022 to assess the readiness of the organizations		○ PACICC's Claims Management Contingency Plan will be reviewed in 2022 ○ Regular dialogue will continue with regulators ○ Standing offer agreements with third-party service providers will be renewed every five years, beginning in 2025
1-5 Regulatory Risk: Certain provincial regulators have limited solvency supervision resources and expertise, falling below minimum IAIS standards	○ PACICC advocates that P&C provincial solvency supervision must meet IAIS standards ○ PACICC has developed an Intervention Guide and updated its Model Winding-Up Order ○ PACICC's Pre-Insolvency Regulatory Liaison (PIRL) Committee (consisting of the non-Industry Directors of the Board) facilitates the sharing of sensitive information by regulators. The PIRL Committee meets annually with OSFI, AMF and FSRAO ○ Intervention Guides have been completed by PACICC with AMF, OSFI, BCFSA, 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 ○ 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	Grant Kelly	Intervention Guides are in place with Quebec, OSFI, BCFSA, Alberta and Ontario and are under discussion with Saskatchewan. First Regulator Training session held in 2021

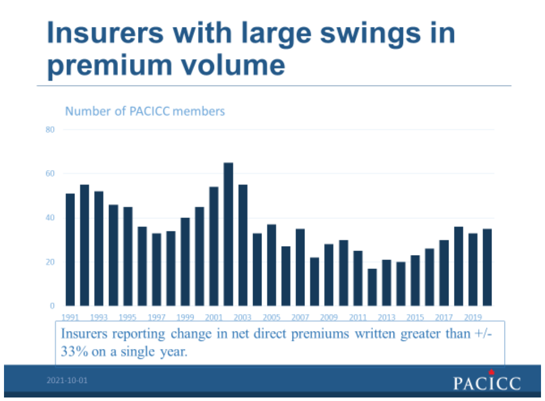
Risk Limit-Risk Appetite

PACICC's current Risk Limit-Risk Appetite is $2.04 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 $1.02 billion (as stated in Note 9 to PACICC's audited financial statements for the year ended December 31, 2020). As of this Report, two times PACICC's annual assessment capacity of $1.02 billion thus yields a Risk Limit-Risk Appetite of $2.04 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, 2021) is $58.9 million.

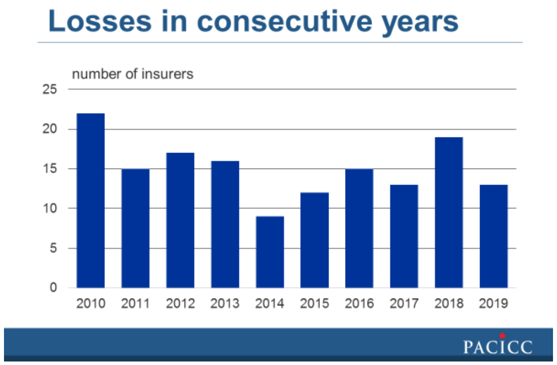
Key Indicators of P&C Solvency Risk



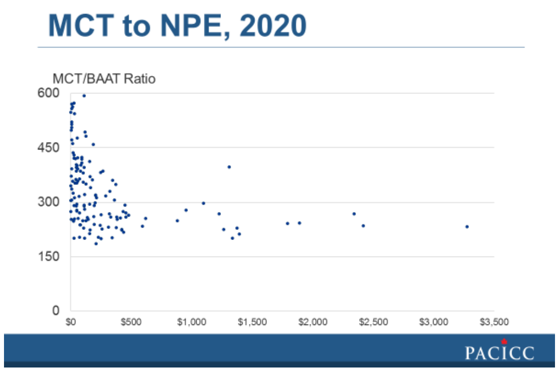
There has been a steady "deleveraging" of P&C premiums in relation to capital over the past 40 years – from a ratio of 2 to 1 in the mid-1970s, to an approximate 1 to 1 ratio now.



Large swings in premium volume for individual insurers is a key indicator of solvency risk. (PACICC defines "large" in this context as greater than +/- 33% in a single year). This indicator of solvency risk peaked in 2002. It has been trending down in Canada for more than a decade, but has shown a slight uptick since 2015.



The number of PACICC Member Insurers incurring losses in (two) consecutive years has trended down over the past decade, despite a slight reversal of that trend in the period 2015-18.



Most PACICC Members currently maintain a MCT/BAAT ratio that is well above the regulatory minimum of 150%.

Section 1: Major Risks (Red) and Significant Risks (Yellow) to be Addressed

Risk Priority Coding

(Red)	Major risks
(Yellow)	Significant risks
(Green)	Risks to be monitored
(White)	Emerging risks

Risk #	Inherent Risk and Description	Triggers for Adverse Impact	Mitigation/Controls	Rating	
				Impact	Likelihood
1-1	**Financial Risk:** A catastrophic earthquake causes a very large insurer to fail, or leads to multiple, smaller insolvencies; 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)	**EARTHQUAKE/MEGA-CATASTROPHIC LOSS** ○ A Board-approved workplan is in place to guide staff efforts on this issue ○ PACICC released its latest estimate for industry capacity in May 2021. The $35 billion tipping point is widely accepted in government policy circles ○ The Federal Department of Finance is considering "how to limit the system-wide risks an extreme earthquake could pose to federal P&C insurers." It is still unknown whether the government will agree to provide a financial backstop; in what form; or with what timing ○ PACICC has a strong working relationship with the policy team at the Department of Finance ○ PACICC briefed senior officials at the Bank of Canada, OSFI and CMHC on this issue ○ PACICC encouraged IBC to create a CEO-level Committee to manage the industry's approach to "tail risks" ○ PACICC actively participates in IBC's Earthquake Working Group ○ PACICC worked with IBC and ICLR to flesh out the details of changes to the insurance product	Very high	Very low

Risk #	Inherent Risk and Description	Triggers for Adverse Impact	Mitigation/Controls	Rating	
				Impact	Likelihood
1-2	**Financial Risk:** A major external factor (e.g. cyber attack, wildfire, flood, geo-political risk) causes a very large insurer to fail, or leads to multiple, smaller insolvencies; resulting insolvency costs exceed PACICC's risk limit-risk appetite (twice its Annual General Assessment capacity)	○ Insolvency of one or multiple PACICC Member companies (or their parent companies) ○ The failure of one of PACICC's largest (top-five) Member companies – regardless of the cause(s) ○ Systemic model error – Most Canadian insurers use the same catastrophic risk models ○ An extensive major financial crisis leading to multiple insolvencies ○ Triggering factors could include: higher inflation, adverse reaction to market volatility, and a sharp rise in interest rates	**FAILURE OF A LARGE MEMBER** ○ PACICC's Board of Directors approved a Resolution Protocol to allow the Corporation to consider alternatives to liquidation ○ The Pre-Insolvency Regulatory Liaison (PIRL) Committee was created in 2015 to improve communication with regulators ○ PACICC 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 ○ 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 ○ PACICC seeks to enhance industry risk management best practices through information sharing at its Risk Officer's Forum Meetings and Emerging Risks Webinars	Very High	Low
1-3	**Regulatory Risk:** Benefits unilaterally enhanced by government regulators beyond levels that PACICC Members would support	○ Broader interpretation of insurance policy wording by Courts and regulators ○ Benefits could be raised beyond reasonable limits ○ Reglators force coverage of certain specialty lines, where the assessment base could be insufficient to fund the insolvency costs ○ Price of homes and insurance cover increasing – Claims limits could be inadequate, especially in the case of total property losses	○ PACICC coverage limits ($500,000 for Personal Property; $400,000 for all other covered lines) were updated in March 2020 ○ The Board mandated that benefits would be next reviewed in 2023, and every five years thereafter ○ PACICC's Actuarial Advisory Committee developed an industry survey (by coverage line) to measure the high percentage of claims protected ○ In 2021, the PACICC Board of Directors approved a formal "Hardship" Policy that details how the Corporation would consider claims exceeding PACICC limits ○ PACICC's Memorandum of Operation details lines of coverage that are excluded. Any new coverages that are not specifically excluded are covered by PACICC	Medium	Low

Risk #	Inherent Risk and Description	Triggers for Adverse Impact	Mitigation/Controls	Rating	
				Impact	Likelihood
			○ PACICC maintains a strong working relationship with the Canadian Council of Insurance Regulators Assuris-PACICC Committtee ○ PACICC maintains a good understanding of financial guarantee fund best practices in other countries through its involvement with the International Forum of Insurance Guarantee Schemes (IFIGS) ○ PACICC educates stakeholders on best practices ○ PACICC continues to advocate that moral hazard risk be minimized and that protection apply to personal lines and business policyholders, but exclude large corporations ○ PACICC's Board can decide to cover losses beyond PACICC's limits in exceptional circumstances		
1-4	**Operational Risk:** Extraordinary demands on human resources with insolvency of larger Member, group, or concurrent multiple Member failures	○ 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 ○ PACICC needs to outsource functions and could have difficulty administering this with existing staff ○ Loss of "key persons" at PACICC could exacerbate this risk	○ 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 ○ Regular dialogue takes place with regulators to discuss troubled Members and to ensure adequate preparedness ○ 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	Medium	Low

Risk #	Inherent Risk and Description	Triggers for Adverse Impact	Mitigation/Controls	Rating	
				Impact	Likelihood
			○ PACICC conducted desktop simulation exercises with OSFI in 2021 to assess readiness of both organizations		
1-5	**Regulatory Risk:** Certain provincial regulators have limited solvency supervision resources and expertise	○ Insurance legislation and/or regulations at the provincial level do not contain adequate standards for insurance solvency supervision ○ Practices do not meet the minimum standards of the International Association of Insurance Supervisors (IAIS) ○ Failure to execute supervisory activities due to inadequate staffing and resources	○ PACICC advocates that P&C provincial solvency supervision must meet IAIS standards ○ PACICC has developed an Intervention Guide and updated its Model Winding-Up Order ○ PACICC's Pre-Insolvency Regulatory Liaison (PIRL) Committee (consisting of the non-Industry Directors of the Board) facilitates sharing of sensitive information by regulators. The PIRL Committee meets annually with OSFI, AMF and FSRAO ○ Intervention Guides have been completed by PACICC with AMF, OSFI, BCFSA, 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 ○ 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	Low	High

Section 2: Risks to be Monitored (not currently considered 'Major' or 'Significant')

Risk #	Inherent Risk and Description	Triggers for Adverse Impact	Mitigation/Controls	Rating	
				Impact	Likelihood
2-1	**Financial Risk:** New insurance products may be hard to estimate and price in the absence of greater claims experience	○ Peer-to-peer (P2P) service providers pose different insurance risks compared to traditional service providers, have the potential to disrupt traditional forms of insurance and over-leverage Insurtech ○ New insurance products are poorly developed and generate large unexpected or unintended losses ○ Inadequate pricing and reserving remain the principal causes of P&C insurer insolvencies ○ Risks associated with cannabis (legalized recently) include: frequency/severity of motor vehicle collisions, large-scale property contamination, medical costs related to consumption, fire/theft related to grow operations and business interruption issues	○ PACICC will continue to monitor developments in the P2P sector and their impact on the financial condition of Members ○ Monitor efforts by legislators and solvency regulators to address the underlying causes of economic downturn ○ Key issues related to P2P insurance start-ups/networks include: how they will be licensed in Canada and requirements to join a Compensation Scheme	Low	Low
2-2	**Financial Risk:** Financial shock that impacts the industry (impact on PACICC)	A financial shock could cause cost uncertainty for numerous PACICC Member companies, and could have solvency implications for the industry. There is a potential that PACICC may not be able to access the money in the Compensation Fund	PACICC's Audit & Risk Committee actively monitors the operating environment for companies in the industry, and the risks faced by PACICC	Low	Low
2-3	**Operational Risk:** Property and liability insurance coverage	○ PACICC's coverage could prove inadequate for insurable losses (e.g. business interruption, loss of records, cyber attack) ○ Improper actions (e.g. breach of duty or conflict of interest) by Officers or Directors	○ Annual review of insurance policies and limits ○ PACICC's By-laws provide that Member Assessments can be made if claims exceed the D&O insurance policy limit	Low	Low

Risk #	Inherent Risk and Description	Triggers for Adverse Impact	Mitigation/Controls	Rating	
				Impact	Likelihood
2-4	**Operational Risk:** Operating expenses exceed budget	○ Unanticipated large capital or operating expenditure, e.g. IT ○ Accounting changes (for example, Board decision to pay investment management fees from the operating budget rather than from the Compensation Fund)	○ Operating Fund surplus (targeted at one year's budgeted expenses) can, with Board approval, fund a short-term budget deficit without requiring Members to pay additional assessments	Low	Low
2-5	**Regulatory Risk:** Use of unlicensed reinsurance in Canada	○ Unlicensed reinsurance is difficult to collect for an insolvent insurer ○ Unlicensed reinsurers not subject to Canadian insurance regulation ○ Unlicensed reinsurance contract may not contain an insolvency clause ○ OSFI Guideline B-3 has removed the 25 percent limit on unlicensed reinsurance	○ Monitor changes in the use of unlicensed reinsurance and review with OSFI changes in the share of unlicensed reinsurance ○ OSFI Guideline B-3 requires each insurer to file a Reinsurance Risk Management Plan (RRMP), which addresses use of unlicensed reinsurance	Low	Low
2-6	**Regulatory Risk:** Regulators seek to exert more influence over PACICC governance	○ Insurance regulators seek to expand PACICC mandate to address restructuring ○ Regulators are encouraged by other stakeholders to merge PACICC with larger financial guarantee funds ○ Regulator requires all Board members to be non-Industry Directors	○ 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) ○ Regulators invited to attend Board meetings and they receive copies of proceedings ○ PACICC's *Code of Ethics and Business Conduct* is attested to annually by Directors and staff ○ International P&C guarantee fund boards typically have a majority of industry Directors	Low	Low
2-7	**Operational Risk:** Reliance on IT outsourced operation	○ Service provider removes service ○ Equipment issues not readily resolved ○ Unauthorized access ○ Cyber attack: viruses, hacker, data breach	○ PACICC uses an externally hosted, secure, internet-based server that provides full back-up and recovery ○ All staff is equipped to work offsite when required using their own computers ○ 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) and shared results with PACICC ○ The SOC 2 audit findings confirm that F12 has taken reasonable steps to protect the security of client files	Low	Low

Risk #	Inherent Risk and Description	Triggers for Adverse Impact	Mitigation/Controls	Rating	
				Impact	Likelihood
			○ PACICC regularly reviews the cyber security measures it has in place		
2-8	**Operational Risk:** Ineffective governance	○ Fraud is not prevented or detected ○ Security breach not prevented or detected ○ Unauthorized access causes loss of data or compromises integrity ○ Incomplete or inaccurate reports prepared	○ PACICC Board places significant emphasis on good governance practices ○ PACICC has followed the lead of OSFI for enhancing governance in the industry – OSFI Guideline E-13 and CSA Guidelines	Low	Low
2-9	**Operational Risk:** Failure of a financial conglomerate involving multiple Guarantee Funds	○ International failure of organization with Canadian branch or subsidiary ○ Domestic conglomerate with Life and or deposit-taking affiliates ○ Powers of various Guarantee Funds are inconsistent, e.g. CDIC has more extensive powers and can create a “bridge bank” in the event of a failure	○ While PACICC maintains regular contact with other financial guarantee funds in Canada (including CDIC), the organization’s ability to mitigate this risk is limited	Low	Low
2-10	**Operational Risk:** Key suppliers of services and outsourced arrangements	○ Unanticipated failure could impair PACICC operations in the short-term while alternate arrangements are made (new supplier contracted or new equipment sourced) ○ Key outsourced service areas include: IT supplier, Accounts Payable, Investment Management, Banking and Legal	○ PACICC retains established, reputable suppliers with proven experience ○ PACICC has standing offers in place with Advisory & Restructuring, Actuarial Consulting, Legal Services and Claims Management service providers ○ Service level agreements are in place (e.g. IT, Investment Management, Accounts Payable) ○ While the loss of service by a supplier could be disruptive in the short term, Management believes that PACICC’s current outsourced service arrangements could be replaced quickly (in most cases within one month)	Low	Low
2-11	**Financial Risk:** Compensation Fund proves to be inadequate	○ Failure of one of the 70 largest PACICC Member Insurers ○ Large failure results in UEP liabilities > the size of the current Compensation Fund ○ Catastrophic event (e.g., a severe earthquake) results in sizeable UEP liabilities and triggers contagion (e.g. among smaller regional insurers in B.C. and Alberta)	○ PACICC has identified the size and scope of the Compensation Fund as the Corporation’s priority issue for 2022 ○ A 2021 study commissioned by PACICC found that the current Fund is large enough to handle an insolvency up to the 71st largest Member Insurer ○ Use of monthly plans to pay premiums limits the extent of UEP liabilities, although failure of a large	Medium	Medium

Risk #	Inherent Risk and Description	Triggers for Adverse Impact	Mitigation/Controls	Rating	
				Impact	Likelihood
			Member could still exceed PACICC's current Compensation Fund size ○ PACICC has surveyed its Members on the possible use of reinsurance in order to mitigate earthquake risk – work on this initiative is continuing		
2-12	**Operational Risk:** Risk of non-covered policies impacting covered portfolios	Members that participate in the Nuclear Insurance pool in Canada incur major losses, leading to possible insolvency	While covered lines are clearly defined in PACICC's Memorandum of Operation, it is difficult to mitigate potential "spillover" solvency risk from non-covered lines. Analysis of potential impacts could help PACICC better understand this risk	Low	Low
2-13	**Financial Risk:** P&C industry consolidation	P&C industry consolidation results in PACICC having a greater number of "large" Member Insurers. Could some PACICC Members be "too small to succeed" in a rapidly consolidating, technology-driven environment?	○ Data show that P&C industry concentration in Canada has increased over the past decade ○ DWP for Canada's largest 10 P&C insurers increased from 37.9% of total premiums in 2006 to 48.9% in 2020 ○ The number of PACICC Member Insurers reporting total unpaid claims reserves > twice PACICC's annual assessment capacity (its risk limit-risk appetite) increased from 11 companies in 2006 to 15 companies in 2020 ○ PACICC could probe the "too small to succeed" issue by examining key performance measures by size of firm	Low	Low

Risk #	Inherent Risk and Description	Triggers for Adverse Impact	Mitigation/Controls	Rating	
				Impact	Likelihood
2-14	**Financial Risk:** PACICC Member companies lose confidence in PACICC's ability to fulfill its mandate	PACICC Members express concern to regulators and and other industry stakeholders about the Corporation's ability to protect policyholders' financial interests	PACICC undertakes numerous initiaves to ensure that Members are updated regulartly on ways that the Corporation is able to actively fulfill its mandate, including: ○ Quarterly newsletter (*Solvency Matters*) which provides an overview of current and emerging industry issues and PACICC actions to address same ○ Risk Officer's Forum Meetings and Emerging Risks Webinars featuring subject-matter experts who share information on industry risk managememt best practices ○ Annual publication of PACICC *Why Insurers Fail* research series reports, examining reasons for notable industry insolvencies and learnings from same ○ Cyber Risk Webinars presented jointly with the Global Risk Institute in Financial Services, wherein Chief Information Officers from PACICC's largest Member firms discuss cyber risks and attacks, and preventative/remedial measures to address this growing risk area. Fndings are then shared with the industry.	Medium	Low

Section 3: Emerging Risks

Most of the risks below have been preliminarily rated "low." As more information develops – particularly about the potential of these risks to cause solvency problems for PACICC Members – the ratings could change.

<table>
<tr><th rowspan="2">Risk #</th><th rowspan="2">Inherent Risk and Description</th><th rowspan="2">Triggers for Adverse impact</th><th rowspan="2">Comments</th><th colspan="2">Rating</th></tr>
<tr><th>Impact</th><th>Likelihood</th></tr>
<tr><td>3-1</td><td>Financial Risk:

New financial technologies could pose risks to the stability of the financial system and introduce solvency risks</td><td>○ P&C insurance companies that fail to adopt these new technologies (encompassing Artificial Intelligence, data analytics, and the Internet of Things) may be uncompetitive with respect to underwriting expertise and expenses, and out-of-step with younger customers
○ There may be a risk of P&C insurance companies "over-leveraging" Insurtech in an attempt to gain competitive advantage – underpricing and inadequate reserving remain the principal causes of P&C insurer insolvency
○ FINTECH has the potential to disrupt the stability of bank funding, credit quality – and possibly even the stability of the broader economy
○ FINTECH developments could outpace regulatory efforts</td><td>○ Insurtech is both a potential disruptor (imagine a "digital" insurance company) and a loss prevention / cost reduction tool. The latter explains why established insurers are investing in and partnering with Insurtech start-ups. Insurtech may encourage customers to focus so much on price and convenience that they neglect (or are not properly advised about) coverage
○ PACICC will continue to monitor Insurtech developments for potential industry disruption, new business products, and possible solvency implications
○ Warnings related to the potential systemic risks of FINTECH have been sounded recently, for example, by the Financial Stability Board</td><td>Low</td><td>Low</td></tr>
</table>

Risk #	Inherent Risk and Description	Triggers for Adverse impact	Comments	Rating	
				Impact	**Likelihood**
3-2	**Financial Risk:** Institutional investors face growing pressures to address so-called ESG (environmental, social and governance) risks and opportunities in their investment policies and portfolios. This could result in lower returns to the Compensation Fund	○ Lack of regulatory clarity with respect to ESG factors may cause uncertainty ○ ESG-related regulatory constraints could be tightened ○ PACICC may be expected to mirror ESG best practices being followed by its Members	○ PACICC does not have specific liabilities in the manner of an insurance company or a pension fund. ESG factors are therefore less likely to prevent PACICC from meeting its obligations to policyholders ○ PACICC's investment manager (CIBC Asset Management) follows ESG best practices and became a signatory to the *UN Principles for Responsible Investment* (UNPRI) in November 2017 ○ Application of CIBC Asset Management's own rating analytics to PACICC's Compensation Fund investments showed that 89% of PACICC's holdings received average or above-average ESG scores (as of November 4, 2019)	Low	Low
3-3	**Financial Risk:** COVID-19 pandemic depresses economic activity and increases insurance exposures, creating possible solvency risks. Class-action lawsuits result in settlements requiring payments far in excess of industry capital reserves and reinsurance	○ Available information suggests that business interruption coverages are unlikely to be triggered by the COVID-19 pandemic. However, the exclusions are likely to be challenged	○ The Insurance Information Institute's short-term outlook expects significant increases in line-specific claims related to the COVID-19 pandemic. Improved insurance industry profitability since Q1 of 2020 will help to offset reductions in liquidity ○ PACICC is actively monitoring class-action lawsuit initiatives and has profiled this risk issue in its Risk Officer's Forum programming	Medium	High

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.