SOLVENCY MATTERS

A quarterly report on solvency issues affecting P&C insurers in Canada

PACICC

Issue 13 - April 2021

Insolvency protection for home, automobile and business insurance customers

PACICC

From the Desk of the President (Alister Campbell)

With Great Power Comes…Added Stress?

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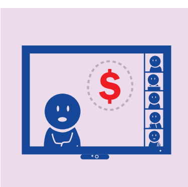

PACICC Priority Issues: Updates

Priority Issue – 2021

Contingency Planning and Desktop Simulations

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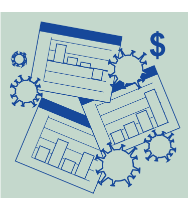
Emerging Issues (Sara K. Manske)

International Resolution Activity

Although the last year was dominated by COVID-19, international insurance standard-setters continued to be active on resolution matters, including specifically with respect to insurance guarantee schemes (IGSs). ...Continued on Page 7.



2020 in review (Olga Kanj and Grant Kelly)

The Canadian P&C insurance industry showed great resiliency during the pandemic year of 2020. At the end of the year, the industry's capital base grew to more than $54.8 billion. This increase in the amount of capital is significant and should allow insurers to underwrite the risks necessary to assist in Canada's economic rebound in 2021 and beyond. ...Continued on Page 9.

PACICC

P&C Risk Officer's Forum

Risk Officer's Forum (Ian Campbell)

Upcoming Risk Officer's Forum meetings and webinars

Next Emerging Risks Webinar – Wednesday, May 19

Topic: ESG Scores – Implications for Investments and Underwriting ...Continued on Page 12.

Industry Events
(subject to confirmation)

April 8
PACICC Annual General Meeting

April 22-23
InsurTech North

April 27
IBC Financial Affairs Symposium

May 12
PACICC Publication Event
Major Update to Systemic Risk Contagion Paper - *Why Insurers Fail, Natural Disasters and Catastrophes*

May 19
PACICC Emerging Risks Webinar - ESG Scores – Implications for Investments and Underwriting

June 10
CatIQ Connect

September 15
PACICC Risk Officer's Forum Meeting

September 21-22
CIAA Annual Conference

From the Desk of the President

With Great Power Comes…Added Stress? - by Alister Campbell

The past year saw Direct Written Premium for the Canadian P&C insurance industry jump more than 8%. With this significant increase, PACICC's Annual Assessment Limit for 2021 – which is set at 1.5% of total DWP for the previous year for all covered lines of business – reached a new milestone and surpassed $1 billion Canadian dollars for the first time. Which means that the PACICC "Risk Appetite Limit" – as established by our Board and set at two times the Annual Assessment Limit – is now $2 Billion ($2.034B to be precise)!

An Assessment so large as to reach the "Risk Appetite Limit" has, thankfully, never been required, but it is important for all industry participants to appreciate that, in fact, PACICC's legal authority extends far beyond this number. Going strictly by the book, PACICC can assess 1.5% of DWP every year and for as many consecutive years as is required – as determined by our Board – in pursuit of its fiduciary obligations as Canada's policyholder protection plan for the P&C insurance industry. And it is a legal obligation for each PACICC Member Insurer to pay that Assessment within 30 days of receipt of the invoice…or lose its license as an insurer – in every province and territory in Canada.

It has been some years now, since our Member Insurers have received such an unwelcome Assessment invoice. So, it is easy to forget the existence of this potential obligation. And for a new generation of insurance leaders, who have risen to senior levels of executive authority in a time long after the three consecutive Assessments required by the failure of Markham General, it is possible that, rather than forgetting this obligation, they in fact never knew of it at all. In either case, the idea that each Member Insurer is potentially on the hook for their market share's worth of such a substantial Assessment is sobering.

> **"…the PACICC 'Risk Appetite Limit' – as established by our Board and set at two times the Annual Assessment Limit – is now $2 Billion ($2.034B to be precise)!"**

For PACICC, the ever-enlarging scope of the potential Assessment is always an area of substantial concern. In 2016, we published a paper highlighting the potential for a severe earthquake event to result in serial Member Insurer failures, resulting in systemic contagion – partly fueled by our Assessments. In 2019, we published another significant piece of research, showing that, as a result of continued industry consolidation, there were now 17 Member Insurers so large that, should they fail, the required Assessment would render other Member Insurers technically insolvent. So, what can such a small organization with such potentially large impact actually do to mitigate this risk?

First of all, we can actively monitor the constantly evolving risks which our industry faces. Through our Risk Management Advisory Committee and with oversight from our Audit and Risk Committee of the Board, we produce, distribute and regularly update, a comprehensive Industry Risk Register. And through our bi-annual Enterprise Risk Management Survey and our carefully curated series of Risk Officer's Fora and Webinars, we seek to ensure the constant exchange of dialogue on risk management best practice among all industry participants – large and small. We also know that one can draw important lessons from history – so we publish a regular research series entitled *Why Insurers Fail* – so that "worst practices" are clearly documented and egregious failures chronicled as cautionary tales.

Alister Campbell is President and Chief Executive Officer at PACICC

Second, we can work with regulators to make the solvency regulation system stronger/more effective. Over the years, we have advocated for more resources for provincial supervisors – firmly aware that the vast majority of Canadian insurer failures over the years have been companies under provincial oversight. We have successfully lobbied to strengthen the role of the actuary within provincial legislation in Alberta, Ontario and Saskatchewan. And we have encouraged OSFI to require a solvency clause within reinsurance contracts.

Third, we can actively monitor specific Member Insurers that may be demonstrating early signs of distress. We maintain and regularly update an industry watchlist, which is reviewed in strict confidence by a special committee of our Board which is composed entirely of our independent Directors (known as the Pre-Insolvency Regulatory Liaison (or "PIRL") Committee). And we discuss individual cases of potential concern with the appropriate regulatory supervisor (e.g. OSFI, AMF, BCFSA, FSRA, etcetera) during our regular "check-in" meetings with each of them.

Fourth, we can ensure that we have advance warning. Our monitoring of industry participants is limited to publicly available information. Prudential supervisors have better access to more information than we do and will, as a result, have a much more accurate assessment of the potential for short-term corporate setbacks for any insurer to become larger losses and potentially lead to insolvency. Over the past few years, PACICC has evolved its model to ensure more effective collaboration with most of Canada's prudential supervisors – in the form of signed Non-Disclosure Agreements and published Intervention Guides – which mean that PACICC Management and the members of our PIRL Committee can be notified when an insurer is "staged" by a regulator (once concerns have been elevated to a certain level) and we can then engage directly with the regulator to ensure effective alignment, if and as things deteriorate further.

Finally, we can seek to help to avert insolvencies. When PACICC was first conceived by the industry in 1989, we were given many of the powers of a "resolution authority" – with the mandate to explore potential uses of industry funds which might avert the much more costly (in terms of industry capital and reputation) need to resort to liquidation. These powers have never been used, but over the course of last year, we conducted a comprehensive industry consultation exercise around certain "remote-but-plausible" scenarios and the potential for PACICC to use certain tools to achieve "resolution," rather than simply pay compensation to policyholders after a Member Insurer failure. The result of this consultation was a documented "Protocol," adopted formally by our Board and to be used by PACICC Management and the members of our PIRL Committee in the case of a looming and potentially costly insolvency.

That brings us to today – when, with a simple vote of our Board, our Member Insurers would be legally obligated to pay their share of up to a $1 billion Assessment (per year, for as many years as is required). And there are more ideas on our radar – more avenues to explore as we seek to further mitigate this significant industry risk. Ideas include:

- establishing a "bridge insurer" in advance – to be available in a crisis scenario where a sale of some or all of a distressed insurer might not be possible immediately
- exploring the scope and scale of our current Compensation Fund – a larger PACICC fund accumulated through annual levies over time might be a better option for the industry than receiving a large General Assessment invoice after a major natural catastrophe event has caused the failure of a Member Insurer but is straining the resources of all or,
- purchasing reinsurance on behalf of the industry to mitigate the potential scale and scope of a required Assessment after a natural catastrophe-triggered default.

We will be exploring these and other ideas in the months and years ahead – and for good reason. As the saying goes… "With Great Power Comes Great Responsibility." The power to invoice for $1B annually certainly helps to amplify the responsibility that the PACICC team and Board own – to do everything we can to ensure that day never comes.

PACICC Priority Issues: Updates

Permanent Priority Issue

Mitigating Systemic Risk from Quake

PACICC continues to work with IBC to resolve the largest single risk facing PACICC and the Canadian P&C industry – systemic contagion caused by a large earthquake. In April of 2020, the PACICC Board approved an Action Plan ("Mitigating Systemic Risk") with two broad initiatives intended to address both potential trigger events:

1. Developing an industry-consensus proposal regarding a Government mechanism to protect consumers from industry failure caused by a major earthquake
2. Investigating incremental changes to PACICC's governance model to mitigate contagion risk.

In late 2020, Finance Canada committed to work with the insurance industry throughout 2021 to develop policy "options" for consideration by the Federal Government, including:

- Developing insurance-based strategies for addressing broader natural disaster protection gaps, including earthquakes
- Leveraging Canada's robust private insurance market
- Responding to evolving protection gaps and insurance issues as climate change-related perils intensify over time.

They will evaluate these policy options based on their contribution to the stability of the financial sector, the degree to which they impact the protection gap and the potential fiscal impact on government.

Included in the table-setting section of their presentation was an explicit recognition of PACICC and a clearly-stated concern regarding the potential that PACICC could not respond in a scenario above its defined Risk Appetite Limit. PACICC will engage with Finance Canada to ensure a common understanding of this element of our model's current design and to explore options to evolve our model to better address systemic risk.

Finance Canada plans to present multiple policy options to the Federal Government by the end of the year. These policy options will be evaluated based on their contribution to the stability of the financial sector, the degree to which they impact the protection gap for policyholders and the potential fiscal impact on government. PACICC's Action Plan will be revisited annually until a Federal backstop mechanism is secured and is in place.

Priority Issue – 2021

Contingency Planning and Desktop Simulations

With the 2020 Priority Issue addressed and a comprehensive resolution "toolkit" now in place, our focus has turned to Contingency Planning and Desktop Simulation exercises with Regulators – to address scenarios other than simple insolvency. Our goal is to develop a modernized Insolvency Contingency Plan that will guide Management step-by-step through the resolution process. This includes the development of an associated Communications Plan, with pre-prepared materials and support infrastructure to enhance PACICC's insolvency preparedness. PACICC staff is working closely with the Board's PIRL Committee members on this file. This important groundwork will help to ensure that we are capable of responding efficiently and effectively in the event of a larger industry insolvency.

It is standard operating procedure for staff in leading emergency preparedness organizations to road-test their response procedures to ensure their readiness to assist when the call for help comes. To this end, PACICC will be testing its Contingency Plans is via "desktop" simulations with Regulators in the coming months. PACICC staff has been planning a series of simulation exercises with staff from the AMF and OSFI. We will later seek to engage in simulations with other provincial regulators. The learnings from these exercises will help to ensure that our Contingency Planning capabilities are robust, and our response mechanisms are aligned with the actions of our key regulatory partners.

Priority Issue – 2022
Review the Scope and Scale of PACICC's Compensation Fund

The PACICC Compensation Fund was established through a capital levy of Member Insurers over a period of three years, between 1998 and 2000 ($10M a year, assessed by market share of covered lines). The primary purpose of the Fund was to ensure that PACICC is in a position to rapidly refund Unearned Premiums to policyholders affected by an insolvency, and thus enable PACICC to materially reduce the number of adversely impacted consumers in the days/weeks immediately following an insolvency. While the Fund has been earning a steady return since its initial founding (almost doubling in size), recent actuarial analysis indicates that it would not be adequate to handle the timely refund of Unearned Premiums after the failure of any of Canada's 70 largest insurers.

In discussions with government over the past year, IBC and PACICC have included an expanded PACICC Compensation Fund as a possible component of an overarching joint public/private solution to the systemic risk issues we face as a country after a major earthquake. As our Priority Issue for 2022, we will conduct a comprehensive review of the adequacy of PACICC's Compensation Fund in the context of potential:

- Scale of possible future defaults
- Required size to potentially mitigate the risks associated with systemic contagion, post-quake (based on an updated Contagion Model)
- Source of funds to ensure capacity for possible resolution actions
- Source of funds for PACICC reinsurance purchases on behalf of the industry
- Source of funds for capitalization of PACICC Corp (bridge insurer)
- Changes to PACICC's tax status as not-for-profit entity.

*Priority Issue – 2023**
*To Be Determined by the PACICC Board in 2022

PACICC's Priority Issue for 2023 will be determined by the PACICC Board in 2022. Annual Board Performance Survey feedback indicated an appetite for an additional Board meeting to focus on strategic priorities. More clarity on the Earthquake Backstop issue will be very useful to inform such a strategic review. Management is planning to organize a Special Board Meeting in June 2022 to review and revise the Strategic Plan for the Corporation. PACICC's Priority Issue(s) will be determined through this process.

Priority Issue for 2020 (Update)
Expanding PACICC's Resolution "Toolkit"

Last year, our Strategic Priority was to explore options to "Expand our Resolution Toolkit." A 2019 research paper, authored by our Chief Economist Grant Kelly, noted that there are now 17 insurers in Canada large enough that, should they fail, the required PACICC Assessment to handle all Unpaid Claims and refund Unearned Premiums would render some other Members Insurers technically insolvent. The research paper identified a series of resolution options for PACICC to pursue, prior to liquidation. As a result of this important research, we executed diligently against a 2020 Action Plan to develop our "resolution toolkit."

The idea of an expanded "toolkit" did not mean that we were asking for broader powers. In fact, when PACICC was first conceived back in 1989, the industry conferred on us substantial authority to engage in precisely these types of resolution actions. Over the past five years, we have partnered with numerous regulators (including Quebec, OSFI, British Columbia and Alberta) to publish updated Intervention Guides which specifically name PACICC and grant us a seat at the table in the period prior to any final liquidation determination. As a result, PACICC now has both the means and time necessary to explore possible resolution alternatives, other than simple liquidation.

Last year, we engaged the industry in consultation to develop an effective protocol and decision-making framework to help guide PACICC actions in such special circumstances. A Consultation Paper published in July facilitated thoughtful and comprehensive feedback from almost 80% of our industry (by market share), as well as a substantive response from a Special Working Group of the Insurance Bureau of Canada. PACICC sought guidance on several key points, including:

- How should PACICC respond to a range of remote but credible insolvency scenarios?
- What resolution tools/options might best suit these insolvency scenarios?
- What are the implications for our governance model and what, (if any) changes might be required?
- What are the criteria by which the various options should be evaluated by the PACICC Board?

PACICC now has in place a Board-approved final Protocol and accompanying Criteria that reflects the invaluable input received from its Member Insurers. As we move forward, this new Protocol will help to ensure that, should our Board choose to engage in resolution actions to support the PACICC Mission, we will do so in a manner aligned with industry expectations.

Priority Issue for 2019 (Follow up)
Coverage and Benefits Review

Work is continuing on bringing closure to two remaining Coverage and Benefits action items approved earlier by PACICC's Board of Directors. The Board recognized that the following issues were complicated and would take time to resolve:

1. **Aggregate Reinsurance** – Since the November 5, 2020 Board meeting, PACICC staff has been working closely with representatives from Guy Carpenter Canada to develop options for aggregate reinsurance cover in the case of a single-company, natural catastrophe-triggered insolvency. The Board was updated on this file at its March 4, 2021 Pre-AGM meeting. The reinsurance coverage now being contemplated would be triggered only by a natural catastrophe, apply only to valid loss claims in excess of specific PACICC coverage limits, and would be capped with a specific annual aggregate coverage dollar limit. PACICC staff is seeking Board approval in April for in-depth consultation with the industry on key elements of the reinsurance proposal (including funding sources for the reinsurance coverage), before the matter is taken back to the Board at its Fall meeting (November 4) to determine next steps.
2. **Auto Accident Benefit Claims** – PACICC is continuing to assist the Insurance Bureau of Canada in encouraging provincial policymakers to move payment of auto accident benefit claims to the Uninsured Motorist Compensation Fund in Alberta, New Brunswick, Nova Scotia, Prince Edward Island and Newfoundland and Labrador. This would be consistent with the approach taken in Ontario. Auto Accident Benefits claims represent the largest single component of insurer claims reserves (and thus unpaid claims) in the Canadian P&C industry. Reducing the amount that PACICC must assess for unpaid claims would significantly increase the capacity of Canada's P&C insurance industry to address a catastrophic earthquake.

Emerging Issues

International Resolution Activity - by Sara K. Manske

Although the last year was dominated by COVID-19, international insurance standard-setters continued to be active on resolution matters, including specifically with respect to insurance guarantee schemes (IGSs).

International Association of Insurance Supervisors (IAIS)

The resolution elements of the IAIS's Insurance Core Principles (ICPs) and the Common Framework for the Supervision of Internationally Active Insurance Groups (ComFrame) have been stable since 2018. Since that time, the IAIS Resolution Working Group (ReWG) has been working to supplement those resolution elements by drafting application papers on resolution-related topics. In November 2019, ReWG's paper on recovery planning was adopted. In November 2020, ReWG published a consultation paper on resolution powers and planning, which was open for a 90-day comment period and is scheduled to be adopted in June 2021.

Application Paper on Resolution Powers and Planning (Resolution Paper)

The goal of the Resolution Paper is to provide guidance on supervisory practices related to resolution (defined by the IAIS as "actions taken by a resolution authority towards an insurer that is no longer viable, or is likely to be no longer viable, and has no reasonable prospect of returning to viability"). It focuses on (1) resolution powers – the toolkit that resolution authorities should have at their disposal when faced with an insurance company resolution; and (2) resolution plans – methods for identifying in advance the options for resolving all or parts of an insurer or insurance group with the aim to be better prepared for resolution.

The Resolution Paper consultation draft specifically addresses IGSs. Consistent with previous IFIGS input, the Resolution Paper expresses the following themes: (1) policyholder protection must be a resolution priority, as opposed to a singular focus on financial stability; (2) an IGS should be brought into a proposed resolution early so that the IGS can do its job more effectively; and (3) a IGS is not just a checkbook, but instead can be a source of information and experience in planning for a resolution. While IFIGS supports these themes, IFIGS further sought to emphasize the importance of involving IGSs in resolution planning and addressed suggestions that resolution planning and resolvability assessments may require specific information from IGSs, including coverage and capacity.

Next Steps

ReWG will draft an application paper specifically focused on the role of IGSs in resolution, with a public consultation expected in the second or third quarter of 2022.

Financial Stability Board (FSB)

In August 2020, the FSB published the Key Attributes Assessment Methodology for the Insurance Sector (Insurance KAAM). The Insurance KAAM sets out the methodology to assess whether a jurisdiction complies with the Key Attributes of Effective Resolution Regimes in the insurance sector. The Insurance KAAM will be used in a jurisdiction's resolution regime self- and peers assessments and IMF/World Bank assessments, including the Financial Sector Assessment Program.

The Insurance KAAM sets out five "pre-conditions" that a jurisdiction should have in place to support an effective resolution regime. One of those pre-conditions focuses on the need to have a mechanism for protecting policyholders. Jurisdictions that have an IGS should (1) promote a high level of co-ordination and co-operation between an IGS and other agencies to support clear allocation of responsibilities, accountability, and effective crisis management; and (2) ensure the involvement of an IGS at a sufficiently early stage of a crisis if it is necessary to facilitate the resolution of an insurer.

Sara K. Manske, Partner, Faegre Drinker Biddle & Reath LLP.

European Insurance and Occupational Pensions Authority (EIOPA)

In February 2020, EIOPA invited IFIGS to present at a workshop focused exclusively on IGSs. The workshop – which included financial supervisors and resolution authorities from Belgium, Denmark, Finland, France, Hungary, Ireland, Malta, the Netherlands, and Spain, as well as officials from EIOPA – went very well. IFIGS – which was represented by Canada, Denmark, Germany, Romania, Spain, the UK and the United States – demonstrated critical expertise.

In December 2020, EIOPA called for a European network of national IGSs with minimum harmonization (along with minimum harmonization of the EU's recovery and resolution framework). EIOPA accepted some suggestions and expressly cited guidance developed by IFIGS. In February 2021, IFIGS participated in another (albeit virtual) EIOPA workshop that focused on how to operationalize EIOPA's IGS recommendations. Specifically, the agenda addressed geographical coverage, eligible policies, coverage levels and funding. The EIOPA representatives clearly appreciate getting input from IFIGS, even though they don't agree on all counts.

The European Commission will produce recommendations on recovery and resolution matters for the EU by December 2021; it remains to be seen whether and to what degree minimum harmonization regarding IGSs will be included.

Solvency Analysis

2020 in review- by Olga Kanj and Grant Kelly

The Canadian P&C insurance industry showed great resiliency during the pandemic year of 2020. At the end of the year, the industry's capital base grew to more than $54.8 billion. This increase in the amount of capital is significant and should allow insurers to underwrite the risks necessary to assist in Canada's economic rebound in 2021 and beyond.

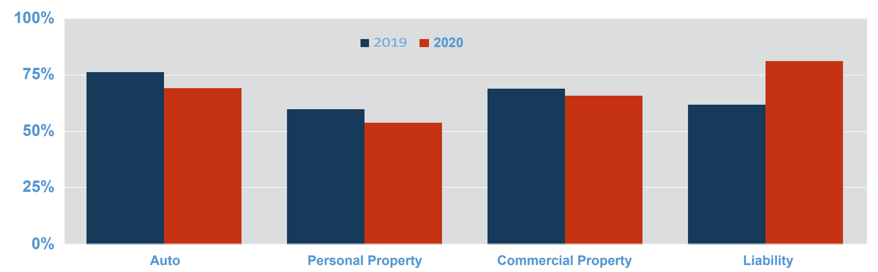
Overall, the average return on equity for insurers increased from 7.5% in 2019 to 10.8% in 2020. This increase in profitability was driven by the increase in industry net premiums earned, which increased by 9.5% from 2019 and by direct premiums written which increased 7.4%. Net claims incurred increased by only 5.5% and operating expenses increased by 6%. The industry's combined ratio fell from 98.3% in 2019 to 94.9% in 2020.

The news was not uniformly positive for all of PACICC's 175 Member Insurers. Insurers that focus on writing Auto and Homeowners' insurance had a strong year. The loss ratio for Auto insurance fell from 76.0% in 2019 to 69.2% in 2020. The loss ratio for Personal Property also fell, from 59.8% in 2019 to 53.6% in 2020.

Insurers that offered Commercial liability coverages did not report a good year. The loss ratio for Lability insurance rose significantly, from 61.7% in 2019 to 81.2% in 2020. Insurers report on 10 different types of Liability insurance. In nine of the 10 categories, results were worse in 2020 compared to 2019. In particular, the Cyber liability loss ratio more than doubled from 65.1% in 2019 to 152.6% in 2020.

These differences were also seen in the solvency of insurers across the industry. Most of Canada's personal lines insurers reported higher Minimum Capital Test (MCT) ratios compared to 2019. The overall industry MCT ratio rose from 237.0% in 2019 to 253.9% in 2020. Many of Canada's Commercial lines insurers and reinsurers reported weakened solvency ratios. The average Branch Adequacy of Assets Test (BAAT) dropped from 378.1% in 2019 to 365.2% in 2020.

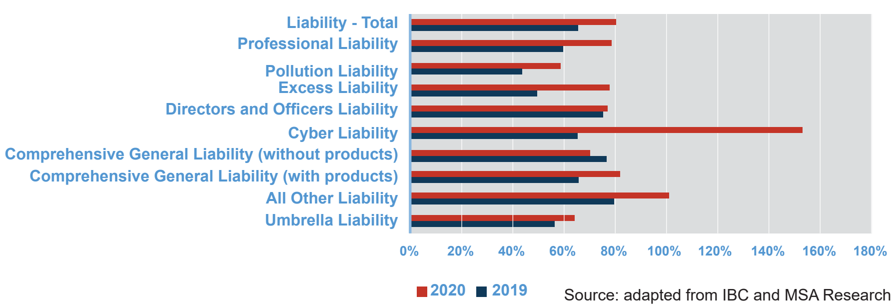
Loss ratios by line



Source: PACICC based on data from MSA Research

Liability Loss Ratios

Loss Ratios by Types of Liabilities



Source: adapted from IBC and MSA Research

Key Financial Indicators (in $ millions)

($ millions)	2020	2019	2018	2017	2016
Direct Premiums Written (DPW)	$69,913	$65,120	$59,093	$54,478	$52,571
Net Pemiums Earned (NPE)	$58,271	$53,235	$51,334	$46,684	$46,225
Net Claims Incurred	$37,445	$35,513	$34,824	$29,940	$31,439
Operating Expenses	$17,846	$16,827	$15,954	$15,243	$14,813
Underwriting Income	$3,171	$1,157	$787	$1,745	$459
Net Investment Income	$4,344	$3,982	$2,244	$3,333	$2,935
Net Income	$5,918	$3,855	$3,134	$3,866	$2,350
Combined Ratio	94.90%	98.30%	98.90%	96.80%	99.60%
Net Loss Ratio	64.30%	66.70%	67.80%	64.10%	67.70%

Select Solvency Indicator Ratios

($ millions)	2020	2019	2018	2017	2016
Average Equity	$54,852	$51,694	$49,136	$49,538	$48,787
Return on Equity (ROE)	10.80%	7.50%	6.40%	7.80%	4.80%
Return on Investment (ROI)	3.70%	3.60%	2.10%	3.10%	2.70%
Comprehensive ROE	13.30%	9.40%	3.90%	6.70%	5.10%
Comprehensive ROI	4.80%	4.50%	0.90%	2.60%	2.80%
MCT Ratio (Capital Available/Capital Required)	253.90%	237.00%	237.20%	243.20%	256.70%

Source: adapted from IBC (2021), PACICC Solvency Matters (2018-2020), and MSA Research as of March 24, 2021.

Significant differences in profitability across Canada's P&C insurers - by Olga Kanj and Grant Kelly

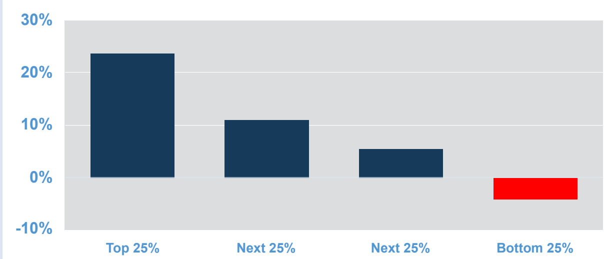
Canada's property and casualty (P&C) insurance industry comprises more than 180 different companies that actively compete against each other. While the P&C insurance industry's average return on equity (ROE) for 2020 was 10.8%, not all insurers in the industry enjoyed increased profits and capital. Some companies underperformed, ending up with losses for 2020. PACICC keeps an eye on those companies which are consistently bottom-quartile performers.

PACICC ranked all insurers based on their 2020 ROE. There were 46 insurers (25% of the sample) that reported an average ROE of 23.5% in 2020. The second tier of companies reported a ROE that was less than half of that, at 11.0%. The third tier of companies reported an average ROE of 5.4%. The lowest 47 insurers reported losses. They reported an average ROE of negative 4.0%. In a highly competitive industry, differences in profitability are normal. However, the gap between profitable and unprofitable insurers was wider than normal in 2020.

The key difference between the financial performance of insurers was underwriting performance. The average combined ratio of the top performers was 80.2%. The next tier of profitable insurers reported a combined ratio of 89.3%. The third tier of profitable insurers reported an average combined ratio of 94.5%. This means that approximately three quarters of P&C insurers reported profitable underwriting results in 2020. It also means that some 25% of Canada's P&C insurers did not manage to underwrite insurance risks profitably in 2020. The average combined ratio of this group was 158.0%. Most of these companies wrote commercial liability insurance lines that were significantly impacted by the COVID-19 pandemic.

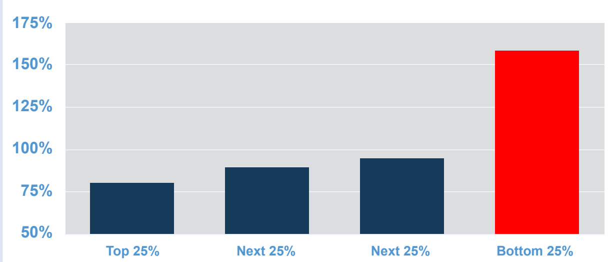
The question facing regulators (and PACICC) is whether the financial losses of these insurers represent a temporary blip that can be corrected, or are part of a longer trend of losses that undermines confidence. A core finding of PACICC's *Why Insurers Fail* research series is that the number one reason why insurers have failed, in Canada and internationally, has been poor underwriting and reserving of insurance risks. Two of the insurers in this bottom quartile have reported underwriting losses in each of the last five years. Four companies in this quartile have reported underwriting losses in four of the past five years. And another six of these insurers reported underwriting losses in three of the past five years.

Average ROE, by quartile



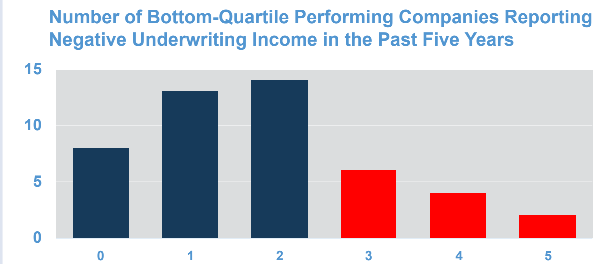
Source: PACICC based on data from MSA Research

Combined ratio, by quartile



Source: PACICC based on data from MSA Research

Insurers with sustained underwriting losses



Source: PACICC based on data from MSA Research

Insurers that reported consistently poor underwriting did not necessarily have losses with investments and underwriting. In fact, only seven of them also recorded investment income losses, and that was only for one or two years over the past five years. This is not surprising, given the strict regulations for Canadian insurers that govern their investment strategies. But investment income did not necessarily help those insurers' bottom line. 25 of those with at least two years of negative underwriting income also had negative net income in at least two of the five past years. Given the importance of successful underwriting to an insurer's profitability, PACICC will continue to closely monitor the solvency of insurers that report consistently poor underwriting results.

PACICC Risk Officer's Forum

Upcoming Risk Officer's meetings and webinars - by Ian Campbell

The Risk Officer's Forum seeks to enhance risk management within the P&C insurance industry by:

- Discussing and sharing risk management best practices within the industry
- Reviewing and communicating topical risk management information
- Serving as a risk management resource for PACICC and for insurance regulators
- Discussing major existing risks and significant emerging risks within the industry
- Providing resources and information to facilitate research of risk management and related governance topics.

Risk Officer's Forum Meetings

Forum Meetings include a keynote speaker on a topical industry issue, followed by industry/expert presentations on current ERM issues.

Next Forum Meeting – Thursday, April 1 (Virtual Meeting using MS Teams):

Keynote: **Jacqueline Friedland**, Sr. Director, P&C Insurance Group, Ins. Supervision Sector, OSFI Supervision Sector, OSFI

Topic: *Update on Current P&C Insurance Industry Issues*

Panel Discussion 1

- **Craig Pinnock**, CFO, Northbridge Financial Group and Chief Agent, Tokio Marine & Nichido Fire Ins. Co. Ltd. (Canadian Branch)
- **Anya Sri-Skanda-Rajah**, Managing Director, GC Analytics & Advisory, Guy Carpenter Canada
- **Sean Russell**, Managing Director, Guy Carpenter Canada

Topic: *How Companies Ration and Allocate Capital for Earthquake Risk*

Panel Discussion 2

- **Jimmy Jean**, Macro Strategist, Desjardins General Insurance Inc.
- **Michael Cook**, VP, Client Relations & LDI Client Portfolio Manager, CIBC Asset Management
- **Gaurav Dhiman**, Portfolio Manager, Global Fixed Income, CIBC Asset Management

Topic: *Risk of Long-Term Low Interest Rates*

Emerging Risks Webinars

Three Emerging Issues Webinars are held each year, connecting Forum members across Canada in a deep-dive discussion on technical aspects of a specific ERM issue.

Next Emerging Risks Webinar – Wednesday, May 19

Panel Discussion

- **Carl Lussier**, Assistant Vice President, Personal Lines Projects, Economical Insurance
- **Alyson Slater**, Senior Director, Sustainable Finance, Global Risk Institute in Financial Services
- **Aaron White**, Client Portfolio Manager, Equities, CIBC Asset Management

Topic: *ESG Scores – Implications for Investments and Underwriting*

For event registration information (pre-registration is required) or to be included in future Risk Officer's Forum member advisories, please contact Ian Campbell, Vice President, Operations, PACICC at icampbell@pacicc.ca or 416/364-8677, Ext. 3224.