SOLVENCY MATTERS

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

PACICC

Issue 15 - September 2021 Insolvency protection for home, automobile and business insurance customers

From the Desk of the President (Alister Campbell)
Do We Need To Aim Higher? Way back in 1997 and drawing upon the painful lessons learned from a series of insurer failures, where the delay in responding to policyholder claims for the refund of unearned premium led to adverse reputational consequences for the entire industry...
...Continued on Page 2.

PACICC Priority Issues: Updates
Update – 2021 Industry Consultation Paper on Reinsurance
In July 2021, PACICC released an industry Consultation Paper seeking feedback from Member Insurers on the merits of purchasing reinsurance as a means of ensuring a more efficient and cost-effective response to future industry insolvencies.
...Continued on Page 4.

Emerging Issues (Ruvimbo Mutangadura and Janis Sarra)
Climate Change and the Canadian Insurance Industry
One only needs to look at the recent wildfire in Lytton, British Columbia during the highest-ever-recorded temperature in Canada of 49.6 C°, which destroyed 90% of the town and generated an estimated $100 million in insurance claims (*Globe & Mail*, July 2021)
...Continued on Page 8.

Solvency Analysis (Grant Kelly)
Sunshine and rainbows for most (but not all) insurers
The annualized return on equity for the past four quarters sits at an impressive 19.0%. This is a significant outlier particularly when you comtrast it with average Canadian P&C industry returns - over the past 40 years - of less than 10 percent.
...Continued on Page 10.

Many insurers making hay while the sun shines (Grant Kelly)
Farming wisdom suggests that you should make hay while the sun shines. In other words, you make good use of your time or make the most of an opportunity while you have the chance. How have Canadian P&C insurers made use of their recent good fortune?
...Continued on Page 11.

Risk Officer's Forum (Ian Campbell)
Upcoming Risk Officer's Forum meetings and webinars
Next Emerging Risks Webinar – Wednesday, October 20
Topic: Threats to Canada's Electrical Power Grids and Communications Networks
...Continued on Page 13.

Industry Events
(subject to confirmation)

October 7
Insolvency Institute of Canada Annual Meeting

October 20
PACICC Emerging Risks Webinar - Threats to Our Grid Systems (Internet, Electrical)

November 17
PACICC Risk Officer's Forum Meeting

From the Desk of the President

Do We Need To Aim Higher? - by Alister Campbell

Way back in 1997 and drawing upon the painful lessons learned from a series of insurer failures, where the delay in responding to policyholder claims for the refund of unearned premium led to adverse reputational consequences for the entire industry, the PACICC Board, provincial regulators and the Canadian insurance industry agreed upon the need to establish the PACICC Compensation Fund. Its express purpose was to ensure the capacity of PACICC to respond immediately to the needs of affected policyholders after an insolvency, without the need to delay while waiting for required funds to be collected via a PACICC General Assessment. A target of roughly $30 million was set and the Fund was then established via a series of industry capital levies – $10 million a year – over a period of three years, from 1998-2000 – with each PACICC Member's Assessment being equal to 0.15% of their net written premium during 1997. The Fund, which is currently managed for PACICC by CIBC Asset Management, is overseen by PACICC's Audit & Risk Committee and governed by a strict Investment Policy focused exclusively on fixed income securities, with a high priority placed on security and liquidity. As of this month, the Fund has grown to nearly $60 million.

The PACICC Board has asked Management to complete a formal review of the scope, scale and mandate of this Fund as our "Priority Issue for 2022." We had already secured the results of a review by Eckler Ltd. which established that the current Fund was no longer adequate to achieve its primary purpose – rapid refund of unearned premium – after the failure of any one of Canada's largest 70 insurers. So, the direction from our Board was driven by an appreciation that the current Fund was no longer fit for its original stated purpose.

> **"Our research indicates that a fund of approximately $225 million could materially mitigate the systemic risk for our industry after a massive quake with between $30 billion and $35 billion of insured losses."**

But the Board was not necessarily saying that the Fund needs to be larger. The absence of any recent insurer failures might indicate that the Fund, as it is currently constituted, may no longer be necessary at all. And perhaps the industry capital currently resident in the Fund could be allocated (with regulatory approval) to other productive PACICC purposes – such as paying reinsurance premiums, or capitalizing a new PACICC bridge insurer?

Our *Tipping Point* paper, published earlier this year, added further grist for the mill on this important topic. In the paper, we modelled the size of a PACICC Compensation Fund which would be required to obviate the need for a Special Assessment for 12 months after a mega-quake in BC or QC. Our research indicates that a fund of approximately $225 million could materially mitigate the systemic risk for our industry after a massive quake with between $30 billion and $35 billion of insured losses. N.B. It is important to note that the same research also confirmed that there is no credibly-sized fund to mitigate systemic risk for a mega-catastrophe event with losses above $35 billion – at this scale of event, there is simply no viable alternative except a federal backstop mechanism. Discussions with the Federal Government remain ongoing but, certainly, I suspect our industry would be ready to contemplate a staggered process for establishing an increased Compensation Fund of this size (say, over a period of 15 years) as part of the quid pro quo for a federal backstop to protect Canada in a worst-case tail scenario.

As the PACICC Board contemplates the idea of potentially establishing a new and higher target for our Fund, we can look to other examples in the Canadian financial services sector safety net. The comparable organization to PACICC in the Canadian life insurance industry is *Assuris*. When it was founded, a $100 million Liquidity Fund was established to give the organization immediate access to funds to deal with a "Troubled Member" situation. The $100 million figure approximated the maximum one-year Specific Assessment that Assuris could levy on its Members to deal with an insurer in financial difficulty. The Fund was to be used in the first 45 days following a Troubled Member situation. By that point, surviving Members would be properly assessed to resolve the distress situation. A number of years ago, internal stress testing revealed a need to grow the Assuris Liquidity Fund to remain in step with its maximum one-year Assessment capacity (which had risen to approximately $250 million). Over the past five years, Assuris undertook to increase its Liquidity Fund by $86 million (to $200 million) through pro-rated annual Assessments based on each Member's solvency buffer – a process which was completed in 2020.

"Assuris undertook to increase its Liquidity Fund by $86 million (to $200 million) through pro-rated annual Assessments based on each Member's solvency buffer – a process which was completed in 2020."

It is certainly possible that, upon sober and balanced reflection, our Board may conclude that the current Fund is entirely adequate as it is today, given the deep capital resources of the industry and the very low probability of a Member Insurer default. And, of course, no decision will be made without comprehensive dialogue with Insurer Members and all relevant industry regulators. But it is also possible to see an outcome where together – in response to clear indications regarding the potential benefits for our industry, and Canada as a whole – we collectively decide that it is time to "aim higher." I am looking forward to the conversation!

PACICC Priority Issues: Updates

Update – 2021
Industry Consultation Paper on Reinsurance

In July 2021, PACICC released an industry Consultation Paper seeking feedback from Member Insurers on the merits of purchasing reinsurance as a means of ensuring a more efficient and cost-effective response to future industry insolvencies.

Shortly after the Fort McMurray Wildfire in 2016, and amidst rumours regarding potential financial distress of a Canadian insurer, PACICC received correspondence from the Government of Alberta, and then follow-on enquiries from CCIR, regarding potential consequences for consumers, should there be a natural catastrophe-triggered default. Specifically, regulators wanted clarity on whether the PACICC Board of Directors would choose to strictly enforce the PACICC Benefits Limit (then $250,000 for Auto and Commercial policies and $300,000 for Personal Property policies), and what would be the possible implications for the many potentially affected policyholders with total-loss claims.

These inquiries were a significant driver of the decision by our Board to conduct a comprehensive review of our Coverage and Benefits – which was initiated in 2019. Industry input, solicited in the form of a Member Survey, as well as through the work of a Special Working Group at IBC, was central to our Board's decisions regarding both a measured broadening of coverage as well as material increases in benefit limits, all of which were approved at our Annual General Meeting in April 2020.

At that time, our Board also asked PACICC staff to follow up on several other options/ideas directly connected to the natural catastrophe-triggered default scenario. Under our founding By-Law, the PACICC Board is authorized to pay "hardship" claims in excess of our defined benefit limits. So, PACICC staff was asked to formally document a Hardship Claim Policy and associated processes such that, should PACICC ever be in a position requiring us to respond to large numbers of "hardship" claims in excess of our defined benefit limits, our Board would have a formal mechanism in place to manage these appeals. This Policy was adopted unanimously by our Board last Fall.

Second, PACICC staff was asked to explore the possibility of PACICC purchasing reinsurance, on behalf of the industry, with the idea that under certain defined circumstances, the Board would have access to an additional pool of funds to address policyholder claims – without having to resort to a General Assessment.

In 2020, PACICC selected Guy Carpenter Canada to assist with this exploratory exercise and, after extensive modelling work, went to market last Fall. There was never any doubt that seeking to place a new cover, without obvious comparators and in a "hard" market, would pose a challenge. And indeed, several of our initial ideas for product design failed to find underwriter support. However, earlier this year, one possible solution – a parametric cover with a defined aggregate limit – was developed, received support from several major reinsurers, and resulted in specific coverage and pricing indications. At our Board meeting in April of this year, it was agreed that it would now be appropriate to consult the industry more broadly – in order to understand whether there was Member support for PACICC moving forward with such a purchase on our Members' behalf.

There are two additional elements to be noted as PACICC's Member Insurers consider this question. First, the Board has asked PACICC staff to formally review the adequacy of our current Compensation Fund in 2022. It did this after receiving a report from Eckler Ltd. indicating that the current Fund was not large enough to adequately achieve its original objective (rapid refund of policyholders' unearned premiums) in the case of a failure of any one of Canada's 70 largest insurers. Second, earlier this year, PACICC released an update to our P&C Industry Model in a research paper entitled, "*How Big is Too Big? The Tipping Point for Systemic Failure*." In that paper, we modelled – for BC and QC, and for the first time – how large our Compensation Fund (currently totalling $60 million) would need to be, to enable us to avoid having to make a General Assessment for 12 months after a mega-catastrophe event, such as an earthquake. The findings were significant. For an event generating losses of between $30 billion and $35 billion, the Fund would "only" need to total $225 million in order to avert an urgent General Assessment, and thus be in a financial position to materially mitigate the risk of systemic contagion.

PACICC Priorities Con't

In 2022, we will be discussing with the industry the net benefits of a strategy to adjust the current mandate of our Fund, and potentially to expand its scope and scale – hopefully, in alignment with successfully securing a federal backstop mechanism for events above a defined dollar threshold. Our initial Fund was created via a capital levy of roughly $10 million a year for three years (between 1998-2000). One option to be discussed would see a new annual PACICC Capital Levy – for a period of say 10 to 15 years – which would allow our Fund to reach a new, higher target level based on a dollar requirement, as defined via our P&C Industry Model. The Canadian life insurance policyholder protection fund – Assuris – recently successfully completed such a process. Or, we could purchase reinsurance instead – similar to other Canadian policyholder protection programs, such as the Canadian Investor Protection Fund (CIPF), which already does so.

The purpose of this Consultation Paper and online Member Survey is to secure Member Insurer input regarding how the PACICC Board should approach the question of whether and/or how best to utilize reinsurance in pursuit of our Mission.

The questions are as follows:

1. **Are you open to the idea of PACICC purchasing reinsurance to avert the need for initial Assessments after a natural catastrophe-triggered, insurer default...**
   a. If the funds were to be used to manage claims costs of an insolvency?
   b. If the funds were to be used to pay policyholders some "hardship" claim amounts in excess of defined benefit limits?
   c. If the funds were to be used to manage claims costs and thus avert the need for a Special Assessment after a mega-catastrophe (e.g. BC/QC earthquake)?

2. **(i) Do you see value for money in the specific transaction marketed successfully by our broker? If not, why not (price too high/limit inadequate/opposed in principle/et cetera)?**

   (ii) If you do see value, what are the most attractive attributes of the proposed transaction? In order of preference:
   a. An efficient way to avoid untimely Special Assessments?
   b. Quick liquidity for PACICC after an event?
   c. Potential increase to Compensation Fund without a capital levy?
   d. Access to global reinsurance capital at a challenging time for domestic capital sources?

3. **If the PACICC Board determined that reinsurance purchases were appropriate, would you prefer that the costs were funded by...**
   a. Increasing Annual Administrative Assessments?
   b. Using investment income from PACICC's existing Compensation Fund and top-up (if/as required) via an Administrative Assessment?
   c. Using investment income from PACICC's existing Compensation Fund and additional capital from the Compensation Fund (if/as required)?

4. **If the PACICC Board determined that there was an imperative to increase the size of our Compensation Fund to ensure that greater resources were available to mitigate systemic contagion after a major catastrophe event, would you prefer...**
   a. An annual Capital levy of a defined amount for a defined period of years?
   b. An annual Administrative Assessment to fund the purchase of reinsurance?

The deadline for Member Insurers to complete the online Survey was Friday, September 10.

"Permanent Priority" Issue
Mitigating Systemic Risk from Quake

PACICC is working with Finance Canada to address the largest single risk facing PACICC and the Canadian P&C insurance industry – systemic contagion caused by a large earthquake. Central to our work with the Federal Government this year has been an update to our P&C Industry Model – to ensure that we can accurately identify the threshold beyond which our private sector industry would not be able to adequately respond. In May, we published a major update to this Model, entitled "*How Big is Too Big? – The Tipping Point for Systemic Failure*." The update included – for the first time – detailed scenarios for an event in BC and QC, as well as sensitivity analysis examining the outcomes of five alternative public policy responses. The results help to illustrate the compelling rationale for a federal backstop mechanism as Canada's best option.

PACICC co-ordinates its work on this file with both Insurance Bureau of Canada (IBC) and the Institute for Catastrophic Loss Reduction (ICLR) as the industry seeks to develop policy options. Recent joint efforts have included work to determine the potential impacts on our Model from various possible insurance "pool" designs being explored by ICLR and IBC.

PACICC has also initiated direct contact on this critical issue with Finance Canada, the Bank of Canada, OSFI, Canadian Deposit Insurance Corporation and the Canada Mortgage Housing Corporation. PACICC will revisit its Action Plan annually until such time as a federal backstop mechanism has been secured and is in place.

Priority Issue – 2021
Contingency Planning and Desktop Simulations

PACICC's 2021 Priority is to develop Contingency Planning and Desktop Simulation exercises with Regulators – to address scenarios other than simple insolvency. Proper emergency preparedness calls for the road-testing of response procedures to ensure their relevance and readiness when the call for help arrives. PACICC staff will be testing the Corporation's Contingency Plans through a series of "desktop" simulation exercises with staff from OSFI in 2021 and the AMF in early 2022.

OSFI Desktop Simulation is Underway

The planned 2021 desktop simulation with OSFI is currently underway. In the first six months of 2021, PACICC and OSFI staff created a fictional "troubled" insurer with all of the necessary supporting materials including an OFSI Risk Assessment document, full P&C-1, Appointed Actuary Report and summary Own Risk and Solvency Assessment.

Each organization will create a summary report of learnings from the desktop simulation by March 2022.

AMF Desktop Simulation Delayed Until 2022

The planned desktop simulation exercise with the AMF has been delayed until 2022. As the appropriate materials were being prepared, AMF and PACICC staff identified a series of roadblocks that need to be resolved before conducting a successful simulation. These include:

- The AMF Guide to Intervention needs to be updated. (It refers to laws that have been replaced). AMF and PACICC staff is working on a revised Guide with the goal of producing an update by October 1, 2021
- AMF's current Intervention Guide gives them the option of selecting the Quebec *Winding-Up Act* or the federal *Winding-Up and Restructuring Act (WURA)*. PACICC's legal advisor has confirmed that PACICC's By-Law would not allow the Corporation to respond to a provincial insolvency in Quebec if *WURA* was not selected by the AMF.

These were exactly the kind of lessons that PACICC hoped to learn through the desktop simulation. But, since several of them were potential "showstoppers," we have agreed with the AMF that it would be optimal to tackle them first…and move on with a proper desktop simulation exercise in 2022, once these items have been satisfactorily addressed.

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 between 1998 and 2000. Members were jointly assessed $10M a year for three years, by market share of covered lines. The primary purpose of the Fund was to ensure that PACICC is ready and able to quickly refund Unearned Premiums to policyholders affected by an insolvency. A key driver for PACICC is materially reducing the number of adversely impacted policyholders in the days/weeks immediately following an insolvency. While the Fund has almost doubled in size over the past 20 years, recent actuarial analysis indicates that it would be insufficient to handle the timely refund of Unearned Premiums after the failure of any of Canada's 70 largest insurers.

As detailed above, PACICC's 2021 industry Consultation Paper on reinsurance included a number of questions related to the Compensation Fund. PACICC will review industry responses to these questions as it prepares an Action Plan on this topic for consideration by PACICC's Board of Directors at its November 2021 meeting.

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

Management is planning to organize a Special Board Meeting in June 2022 to review and update the Strategic Plan for the Corporation. PACICC's Priority Issue for 2023 and beyond will be determined through this process.

Emerging Issues

Climate Change and the Canadian Insurance Industry

by Ruvimbo Mutangadura and Janis Sarra

One only needs to look at the recent wildfire in Lytton, British Columbia during the highest-ever-recorded temperature in Canada of 49.6 C°, which destroyed 90% of the town and generated an estimated $100 million in insurance claims (*Globe & Mail*, July 2021) for evidence that climate change is having devastating effects. Sequential catastrophic events such as wildfires and flooding in Fort McMurray leave communities suffering, Fort McMurray's 2016 wildfire destroyed 590,000 hectares and caused $9.9 billion in damages, of which only 36% was covered by insurance (*Globe & Mail*, 2021). Climate change has become a prudential risk for Canadian insurers, requiring their attention as a core business issue. Although the industry has started to move in the right direction, there is still significant work to be done.

Insurance companies are somewhat unique in that they have to manage climate-related risks on both sides of the balance sheet. On the asset side, insurers are significant investors and there are numerous risks to portfolio values as countries transition to net-zero emissions. On the liabilities side, climate change creates multiple risks in product design and delivery, underwriting losses from catastrophic events, and increasing D&O liability risk (Sarra, CCLI, 2021). Less studied are the implications for life and health insurers regarding long-term impacts. Different populations across the globe are suffering increased morbidity and mortality, but Canada is not immune, with growing respiratory difficulties due to wildfires and pollution, and morbidity risks from more sustained heatwaves and the rise in insect-carrying diseases as warming allows them to travel to new regions.

Transition risks include government policies such as carbon pricing, enhanced emissions disclosure requirements, and litigation risks. There are over 1,500 lawsuits globally alleging breach of directors' fiduciary duties, tort, and violations of securities laws, which could become costly if directors, officers, and their accounting professionals do not manage climate-related financial risks. Insurers may face changing capital adequacy and liquidity requirements if prudential supervisors become concerned about the resilience of the insurance sector, protection of policyholders, and/or stability of the financial system, an issue currently being examined by the Office of the Superintendent of Financial Institutions (OSFI).

The insurance sector is important to effective management of climate-related financial risks because it provides the financial safety net for many Canadians suffering losses associated with climate impacts. The tools are still developing, which means insurers are having to build new predictive models and risk analyses at the same time they are having to manage the risks. P&C insurers can model and appropriately price risks because insurance is renewed annually and the industry can account for any unexpected variability. However, because climate impacts are non-linear and less predictable in timing and magnitude, use of historical data and NatCat risk modelling needs to be adjusted. Reinsurance gives P&C insurers a measure of protection, but one question is whether reinsurance will continue to be available at a manageable price.

Canadian insurers have a critically important role in the management of climate-related risks in their capacity as risk managers, risk carriers, and investors. Establishing proper risk pricing is a public good. As insurance capacity becomes constrained, public policy pressure to underwrite unprofitable risks can become significant, with adverse consequences for insurers. Directors need to be alert to the political risks attached to pricing and capacity issues.

Ruvimbo Mutangadura is the Corporate Governance Specialist at Assuris and a Canadian Climate Governance Expert.

Dr. Janis Sarra is Professor of Law at the University of British Columbia and Principal Co-investigator of the Canada Climate Law Initiative.

The board of directors is legally responsible for oversight and management of climate-related risks. Key to fulfilling their duties, it is important to have in place effective governance mechanisms, ensuring that management is assessing climate-related risks and opportunities across all product lines, services, and operations. Directors need to assess risks to investment portfolios in a timeframe commensurate with the insurer's need to have the capital available to meet claims payments, integrating climate risks into the company's investment strategies, core business plan, and financial reporting. Actions taken now could significantly mitigate adverse impacts later. Directors need to embed quantification of material climate-related risks in financial statements. They can take advantage of the growing market in renewable energy and green technologies in their product offerings and diversification of portfolio risk.

Directors already pay careful attention to capital adequacy and liquidity requirements, and this oversight now extends to climate risk. As OSFI observes, building resilience to climate-related risks requires a holistic approach that includes development of a climate-related risk strategy and implementation of governance practices commensurate with the insurance company's circumstances.

An insurer's strategy to implement a climate action plan should be built on the existing risk management and reporting infrastructure. Climate risks should be prioritized in relation to other risks the insurer is facing, so that directors can meet their prudential oversight responsibilities. Risk reports, actuarial reports, financial statements, compliance reports, and investment policies should be adapted to recognize, assess, and disclose long-term climate-related risks. The board should ensure that it is relying on experts using proper models and data. The company's goals to achieve net-zero emissions have to be clear, measured on a regular basis, and validated. Insurers can create new incentives for their insurance clients to shift to risk-reduction measures, such as offering rebates for using resilient construction materials or directly partnering with end customers to develop mitigation strategies. Insurers can use their underwriting products to address protection gaps for climate-related physical risks and reduce business risks associated with complex new clean tech value chains, all of which will enhance protection of policyholders. A useful guide has been issued by UBC-based Canada Climate Law Initiative (CCLI) titled *Life, Health, Property, Casualty: Canadian Insurance Company Directors and Effective Climate Governance*. CCLI offers free sessions from industry climate governance experts for insurer boards of directors on effective climate governance.

Solvency Analysis

Sunshine and rainbows for most (but not all) insurers

- by Grant Kelly

The annualized return on equity for the past four quarters sits at an impressive 19.0%. This is a significant outlier particularly when you comtrast it with average Canadian P&C industry returns – over the past 40 years – of less than 10 percent. PACICC's focus is on assessing the solvency of Canada's P&C insurers which dictates that its analysis will bias toward caution and pessimism. However, it is very difficult to find anything but sunshine and rainbows in the industry's financial results over the first half of 2021.

Over the first six months of 2021, loss ratios in every major line of coverage are at profitable levels. The auto loss ratio was 54.8%. This is down from 74.5% over the same period in 2020. The loss ratio for homeowners' insurance was 48.3% – the lowest national homeowners' insurance loss ratio reported in any quarter available in PACICC's database. The loss ratio for commercial property was 43.8% in the first half of 2021, compared to 77.9% in 2020. The loss ratio for commercial liability was 58.0% in the first six months of 2021, compared to 86.5% one year earlier. The only sobering number available was a 3.9% decline in net investment income.

Most importantly for the long-term, sustainable solvency of Canada's insurance industry, these profits have resulted in improving capital test scores for most insurers. The average Minimum Capital Test (MCT) figure increased from 234.2% in 2020 to 264.4% in 2021. The Branch Adequacy of Assets Test (BAAT) figure also increased (Q1 2020 vs. Q1 2021), from an average of 297.3% to 298.9%. This increasing capital base of Canada's P&C insurers means that the insurance industry is well-positioned to play a positive and productive role in helping to facilitate Canada's economic rebound during the second half of 2021 and beyond.

This remains a PACICC solvency report on the industry. So, we must point out that the sun is not shining equally on all of the 190 insurers that compete in Canada's P&C insurance industry. Buried within these consistently strong results, there were still 20 individual insurers that reported losses. These are among the insurers that PACICC will continue to monitor closely in the quarters and years to come.

2st Quarter 2021 Financial Year Results

($ millions)	Q2 YTD 2021	Q2 YTD 2020	Percentage Change
Direct Premiums Written (DPW)	$36,977	$33,334	10.9%
Net Pemiums Earned (NPE)	$30,172	$27,591	9.4%
Net Claims Incurred	$15,462	$19,930	-22.4%
Operating Expenses	$9,491	$8,649	9.7%
Underwriting Income	$5,305	-$859	717.6%
Net Investment Income	$1,543	$1,605	-3.9%
Net Income	$4,965	$1,057	369.7%
Combined Ratio	82.7%	103.6%	
Net Loss Ratio	51.2%	72.2%	

Source: MSA Research as of August 24, 2021.

Select Solvency Indicator Ratios

($ millions)	Q2 2021	Q2 2020
Average Equity	$52,238	$47,428
Return on Equity (ROE)	19.0%	4.5%
Return on Investment (ROI)	3.7%	3.6%
Comprehensive ROE	20.6%	5.6%
Comprehensive ROI	3.7%	3.6%
MCT Ratio (Capital Available/Capital Required)	264.4%	234.2%
BAAT Ratio (Net Assets/Capital Required)	298.9%	297.3%

Many insurers making hay while the sun shines
- by Grant Kelly

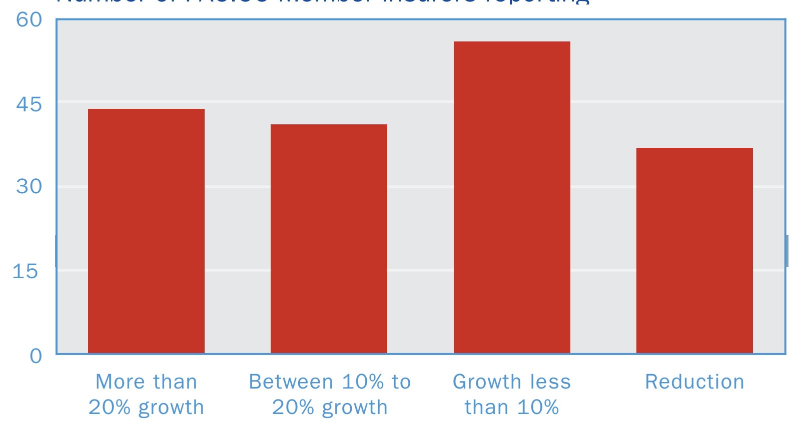
Farming wisdom suggests that you should make hay while the sun shines. In other words, you make good use of your time or make the most of an opportunity while you have the chance. How have Canadian P&C insurers made use of their recent good fortune? It appears that the profitability of the past 18 months has allowed them to pursue one of three distinct strategies.

First of all, and as expected from previous apparently favourable turns in a cycle, the healthy insurance market has allowed insurers to focus on expanding their businesses. The first group, comprising 44 of PACICC's 178 Member Insurers, focused on increasing their market share. These insurers reported growth in direct written premiums (DWP) of higher than 20% over the past 18 months. At the end of 2020, these insurers held a cumulative market share of 13.3%. PACICC monitors growth in DWP because its *Why Insurers Fail* research series findings show that excessive growth is a common early symptom of future insurer failures. An additional 41 PACICC Member Insurers reported growth in DWP of between 10% and 20%. Interestingly however, another 37 PACICC Member Insurers reported the opposite result, and saw their DWP shrink over the past 18 months.

A second large group of PACICC Member Insurers have increased the amount that they hold in reserves, which may be needed to pay future claims. There were 38 PACICC Member Insurers that reported increased unpaid claims reserves of more than 20%. These insurers accounted for 17.5% of the Canadian P&C insurance market share in 2021. Interestingly, another 22 Member Insurers that reported DWP growth of more than 20% also saw a corresponding increase in their reserves of more than 20%. In contrast, 49 PACICC Member Insurers reported a reduction in their reserves.

Change in direct written premiums

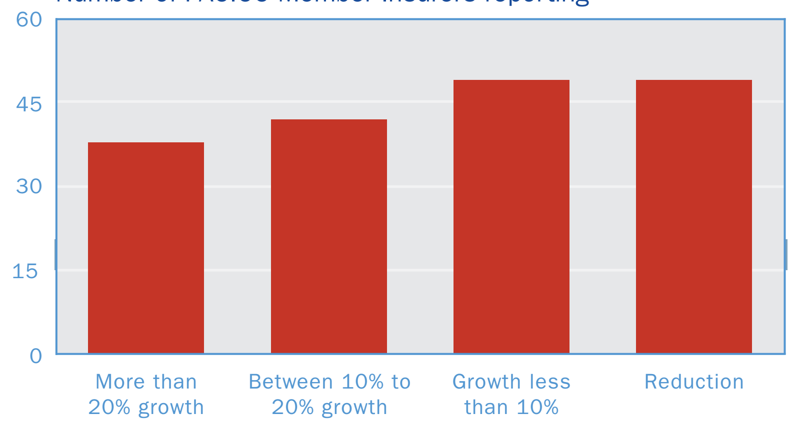
Number of PACICC Member Insurers reporting



Source: PACICC based on data from MSA Research

Change in unpaid claims reserves

Number of PACICC Member Insurers reporting

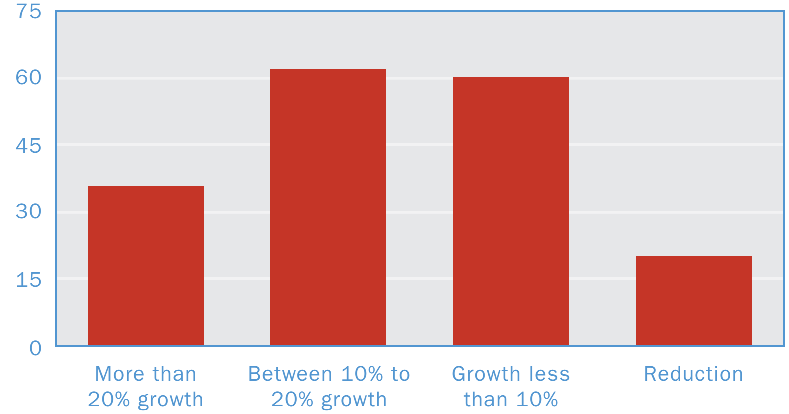


Source: PACICC based on data from MSA Research

A third group of PACICC Member Insurers have used the industry's current period of higher-than-average profitability to expand their capital base. Some 36 PACICC Member Insurers reported that their capital base grew by more than 20% in 2021. These insurers held 22.2% of total industry DWP in 2021. An additional 62 insurers reported that their capital base grew by between 10% to 20% in 2021.

Change incapital

Number of PACICC Member Insurers reporting



Source: PACICC based on data from MSA Research

There were 20 Member Insurers that reported less capital reserves at the end of 2020 than they held at the beginning of the year. Half of these insurers were either exiting the marketplace or involved in a merger transaction in 2021. The other 10 insurers are of special interest to PACICC because they were unable to strengthen their capital reserves in a period of otherwise strong industry profitability. Canada's P&C marketplace is very competitive. History has shown that competitive forces will soon cause the P&C insurance industry's high-level of profitability to gravitate back toward its 40-year average of approximately 10%. There are a small number of insurers that have not been able to make hay while the sun has shone its brightest. And there is always rain in the forecast at PACICC.

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

Next Forum Meeting – Wednesday, November 17 (Virtual Meeting using MS Teams):

Keynote: **Jason Storah**, Chief Executive Officer, Aviva Canada Inc.

Topic: *CEO Perspective on Climate Change*

Discussion

- **Professor Sandra Chapman**, Director, Centre for Fusion, Space and Astrophysics, University of Warwick, Coventry, U.K.

Topic: *Risks of Space Weather Phenomena*

Industry Panel Discussion

- **Marc Lipman**, Attorney in Fact in Canada for Lloyd's Underwriters & President, Lloyd's Canada
- **Bernard McNulty**, Chief Agent of Canada & Head of Claims, Canada, Allianz Global Corporate & Specialty (Canada Branch)
- **Ryan Vekeman**, Vice President, Insurance Risk Management, TD Insurance

Topic: *Review of Agenda Items from OSFI's Annual Risk Management Seminar*

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, October 20

Panel Discussion

- **Eric Durand**, Head, Cyber Center of Competence, Swiss Re Institute
- **Dr. Jan Eichner**, Senior Consultant, Corporate Underwriting Non-Life, Munich Re

Topic: *Threats to Canada's Electrical Power Grids and Communications Networks*

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.

Denika Hall
Editor and graphic design
PACICC

SOLVENCY MATTERS
20 Richmond Street East,Suite 210
Toronto, Ontario, Canada M5C 2R9

Website: www.pacicc.ca
Phone: 416-364-8677
To unsubscribe or for other information
email: dhall@pacicc.ca