Solvency Matters

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

PACICC

Insolvency protection for home, automobile and business insurance customers

Issue 25 - May 2024

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From the Desk of the President (Alister Campbell)

Not all pillars are alike

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All's well that ends well (Grant Kelly)

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From the Desk of the President

Not all pillars are alike - by Alister Campbell

In the wake of the Global Financial Crisis, efforts have been made by global and domestic regulators to extract appropriate lessons learned and implement new and more effective mechanisms for minimizing systemic risk and enhancing prudential oversight. The increased appreciation of the interconnectedness of major financial institutions, the ways in which modern financing structures could compound systemic risk and the mechanisms via which liquidity flowed (or ceased to flow in a crisis) led the Financial Stability Board (FSB) and regulators throughout the developed economies, to require significant changes in levels of required capital for newly designated "Systemically Important Financial Institutions (SIFIs)". They also mandated that designated banks issue whole new levels of contingent capital or "bail-in bonds" with convertible features which could see debt be absorbed into equity (or entirely written off) under defined circumstances of financial distress.

In the wake of the Crisis, the insurance industry has had to fight a rearguard action. The industry has had to make the case to skeptical regulators that insurers are simply not the same as banks – who engage in "maturity transformation" and are thus exposed to rapid infarction should liquidity dry up or a "run" materialize – or investment banks – all too often prone to push their luck on leverage ratios. In contrast, advocates for the insurance sector (such as the Geneva Association) argued that with our careful matching of (largely fixed income) assets to (carefully estimated) liabilities, and with geographically diversified exposure to primary and secondary perils, our global reinsurance and primary companies were fundamentally dissimilar to the systemically interconnected banking sector. This is particularly true because natural catastrophe events are completely uncorrelated with periods of stress in the financial system. And, the industry has a massive contingent capital buffer of its own in such cases – reinsurance! Of course, in the early going, the industry's case was not helped by the outlier example of AIG (whose issues arose as a result of a poorly governanced and inadequately hedged derivatives business unrelated to its core insurance businesses). But the arguments that our unlevered balance sheets, geographic diversification and high levels of reinsurance mean that our biggest players are not "systemically risky" has gained greater credibility in the years since the Crisis.

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Partly as a result of this evolving policy thinking in the past several years, the FSB has referred the matter of "systemic insurers" to the International Association of Insurance Supervisors (IAIS), which has now established a "Holistic Framework" and a list of designated "Internationally Active Insurance Groups (IAIGs). "This list comprises 50+ major, multinational insurance companies that are singled out for greater supervisory oversight by their home prudential supervisor because of their (at least theoretical) systemic risk. Canada has four of these. And each of them is now subject to (even) greater focus from OSFI. Among the added expectations will be the crafting of Recovery Plans and Resolution Plans (think big turnaround action plan for the first and 'living will" for the second).

We at PACICC, and our colleagues at Assuris (our life insurance industry peer organization), have begun to think about if, and how, we could play a role in the latter. After all, our funding would likely be an essential contributor to a successful "resolution" in a worst-case scenario. But as we have been doing this thinking, we have also had to recognize that we start from very different spots, given the substantial differences between the structures of the Canadian Life and P&C sectors.

The Canadian life insurance industry is highly concentrated, with the "big three" – all of whom are designated IAIGs (Sun Life, Manulife and Canada Life) – controlling more than 80% market share here in Canada. It is important to recognize though that all three of these companies generate more of their revenue outside Canada than inside! So, the thought process around how to manage their resolution might need to start in Canada, but will have to address the added complexity of legal requirements around insolvency management in literally dozens of other jurisdictions. The P&C sector by contrast remains much closer to textbook "perfect competition," with only one domestically incorporated IAIG – Intact Financial Corporation (IFC) – with large domestic market share. And IFC has established itself as a holding company here in Canada, with each national entity held separately and subject to domestic capital requirements in the growing number of jurisdictions where they too are active. A smart structure for them…but also a much less stressful one for Canadian supervisors and resolution authorities to oversee. Does this mean that the P&C sector has nothing to worry about on the systemic risk side then (apart from earthquake, which I am contractually obliged to mention in every quarterly issue)? Not so fast!

"Does this mean that the P&C sector has nothing to worry about on the systemic risk side then (apart from earthquake, which I am contractually obliged to mention in every quarterly issue)? Not so fast!"

The P&C industry is in fact a global pool of capital, functioning as a vast international market – enabling both the transfer of risk and the mitigation of that risk through diversification. And the Canadian P&C insurance market reflects exactly how global that market is. There are actually 17 other IAIGs doing business here in Canada – many as OSFI-supervised branches. This situation is totally different than the Canadian Life sector where none of those other 50+ IAIGs around the world have any domestic Canadian presence at all! The new global supervisory framework requires each jurisdiction to fully trust the competency of their prudential oversight partners in other nations. But when a financial crisis happens, trust is often in short supply. One of the last insolvencies PACICC managed in Canada is relevant here. The failure of Reliance led to the closure of the local "branch" by OSFI. Happily, given the firm oversight exercised by OSFI and the high levels of collateral the branch was required to hold in Canada, the Canadian insolvency turned out to be a "solvent liquidation" – a fact confirmed after only 18 expensive years in the courts!

Insolvencies of multinational entities will likely see ring-fencing of assets and lengthy and horribly expensive legal disputation. Thinking through how best to manage these worst-case scenarios in the present period of calm will help. And the thinking has to start by recognizing that not all financial services "pillars" are alike.

Note of Appreciation

Our Annual General Meeting in April will mark the retirement of our Chair Glenn Gibson, after five years as Chair and eight years as a Member of our Board. I would like to use the opportunity presented by this quarterly newsletter to express my profound appreciation for his leadership over this exciting period of modernization here at PACICC. Glenn was part of the CEO Search Committee that recommended me for the job, and while we had interacted socially during our decades in the industry, I had never had the opportunity to work with (much less for) Glenn previously. He has proven to be a great listener, an engaged interlocutor, a supportive colleague and an excellent coach and mentor. Glenn was always willing to give me "lots of rope," but was also always instantly responsive when I needed his help or got "ahead of my skis." The great progress that we have made over the past few years would not have been possible without his measured approach to strategic evolution. The industry has benefitted significantly from his leadership at PACICC, and I have too. Simply put, he was a great boss. Glenn…thank you!

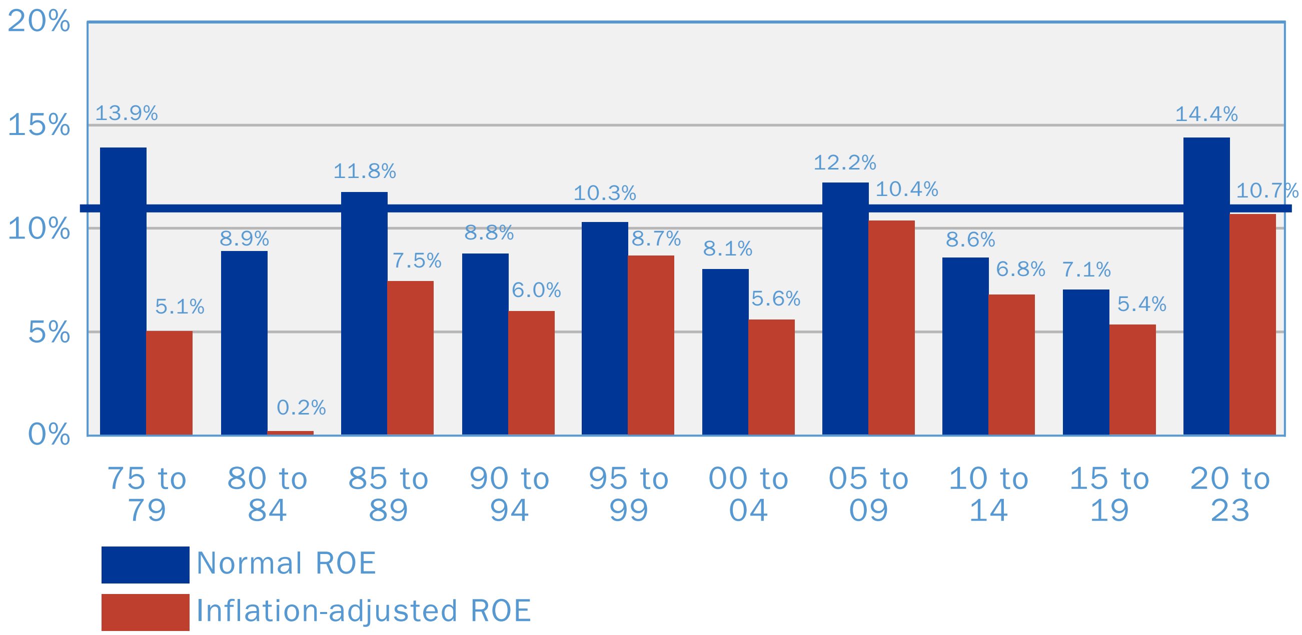
Alister Campbell, President and Chief Executive Officer at PACICC

All's well that ends well - by Grant Kelly

The first three quarters of 2023 were "average" at best. However, a very strong fourth quarter turned an average year into quite a good year for Canada's P&C insurance companies. In fact, nominal ROE of 16.2% is the fifth highest since 1975. It is also the fifth highest inflation-adjusted return on equity recorded by Canada's P&C insurers over this period.

Reflecting on the historical record and recent year's performance, it would be accurate to say that Canada's P&C insurers are experiencing a "golden era" with significantly higher levels of profitability (even after adjusting for the impact of inflation) than the industry's long-run real return on equity (ROE). Since 2020, the industry's real returns are collectively higher than the other 40 years in PACICC's database. Since 2020, the industry's average ROE has been 14.4%. This is the highest sustained level since 1975-1979 in PACICC's database. This remains true even after adjusting for the impact of inflation. The P&C industry's inflation-adjusted ROE between 2000 and 2023 (four years) is 10.7%. This is higher than the previous high of 10.4% -- recorded between 2005-2009.

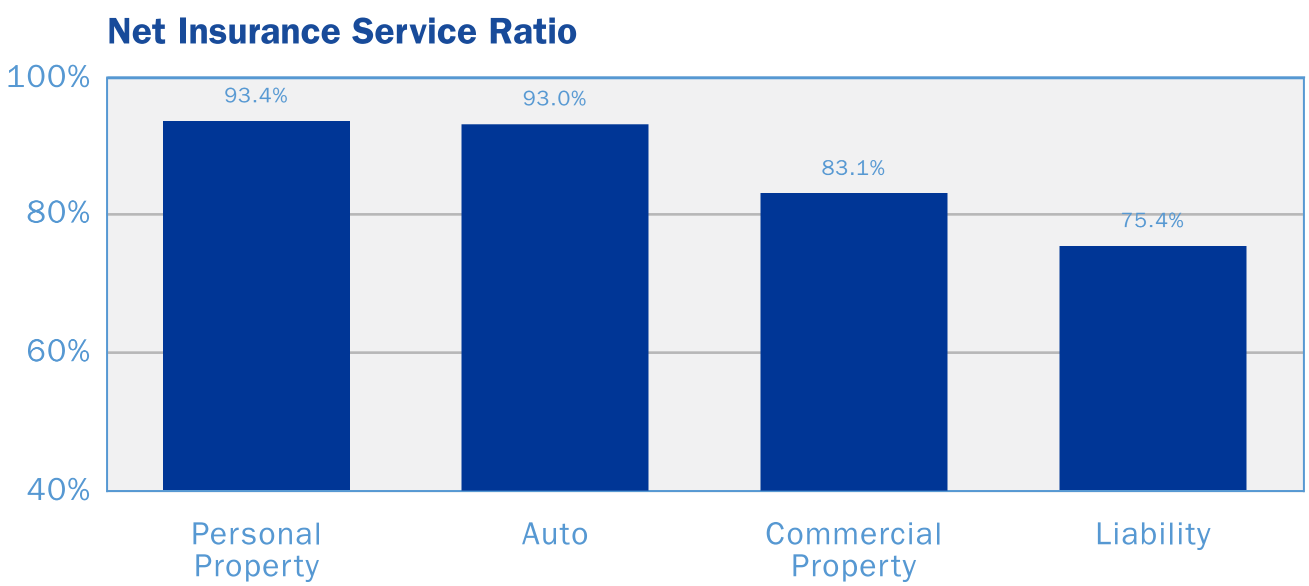
Inflation-adjusted P&C return on equity



Source: PACICC based on data from MSA Research

The main reason for the industry's strong profitability was a rebound in investment income. The year 2022 was the first time in the past 50 years that P&C insurers lost money on their investment portfolio. P&C insurers hold approximately two-thirds of their investments in bonds. In 2022, the Bank of Canada aggressively increased interest rates to combat inflation. This had a dramatic and very negative impact on P&C insurers' investment income. In 2023, interest rates remained steady and the P&C insurance industry return on investment (ROI) rebounded to normal levels. This resulted in a $7.7 billion swing in industry income which represents 72% of total industry profits and 115% of the increase in net income from 2020-2023. Last year's massive increase in interest rates was unprecedented and is not likely to be repeated. This year's jump in investment income is equally unprecedented, and it too is unlikely to be repeated.

2022 was unusual because strong underwriting profits allowed insurers to survive the dramatic increase in interest rates and resulting collapse in investment returns. 2023 was a return to more normal underwriting conditions. Underwriting remained profitable overall, but certainly not for all markets. There is evidence of growing cost pressures in Auto insurance markets in Nova Scotia, New Brunswick, Ontario and Alberta. In addition, insurance results in Personal Property insurance markets in Prince Edward Island, Nova Scotia, Manitoba and British Columbia are eroding the capital base of insurers operating in these markets. Throughout 2023, Property insurers faced the challenges of more than $3.1 billion in catastrophic insurance claims. Conversely, results in Commercial Property and Liability insurance appear to be allowing insurers active in those sectors to significantly grow their capital bases.



The IFRS 17 Net Insurance Service Ratio is similar ro the IFRS 4 Loss Ratio, but the new measure will produce higher numbers as it now includes acquisition expenses, including commissions and reinsurance. It also includes the impact of onerous contracts.

Source: PACICC based on data from MSA Research

Profitability is never shared equally across the insurers competing in Canada's P&C insurance marketplace. In 2023, 20 PACICC Member Insurers reported negative net incomes. This represents 12% of PACICC's 168 Member Insurers. We can take comfort from the fact that this number is better than normal for Canada's P&C insurance industry. In fact, on average over the past five years, some 31.6 insurers report losses each year.

The question facing regulators (and PACICC) is always whether the financial losses of these insurers represent a temporary blip that can be quickly corrected, or are part of a long-term trend of losses that will erode capital and undermine insurer solvency.

IBC 2023 Q4 - Summary of Financial Results

All values are from MSA as of March 22, 2024.
Values exclude mortgage insurers* and are in $millions, except where noted.

	2023	2022	Change
Total Insurance Revenue	86,823	79,950	6,874
Insurance Services Expenses	-69,883	-65,568	-4,315
Net Expenses from Reinsurance Contracts Held	-6,139	-4,869	-1,270
INSURANCE SERVICES RESULT	10,802	9,514	1,289
Investment Return	5,962	-1,809	7,771
Net Finance Income from Insurance/Reinsurance Contracts	-3,232	1,891	-5,122
NET INVESTMENT RESULT	2,730	82	2,648
General and Operating Expenses	-3,480	-2,888	-592
Other Income and Expenses	2,118	933	1,185
NET INCOME	10,083	6,026	4,056
TOTAL COMPREHENSIVE INCOME	10,837	4,080	6,757

	2023	2022
TOTAL NET COMBINED RATIO	89.1%	89.0%
Net Claims Ratio	57.7%	58.2%
Total Net Expense Ratio	30.8%	30.3%

2023 Q3 - Summary of Financial Results

	2023	2022
Return on Investment (ROI)	4.2%	-1.8%
Return on Equity (ROE)	16.2%	13.6%
MCT Ratio (Capital Available / Capital Required)	257.4	
BAAT Ratio *(Applicable to Branches)* (Net Assets Available / Capital Required)	347.6	

Grant Kelly, Chief Economist, Vice President, Financial Analysis and Regulatory Affairs

Emerging Issues

Cyber Insurance: A fast-growing P&C coverage

by Antonio Ferreiro and Karl Meissner-Roloff

Cyber insurance is currently the fastest growing P&C coverage in the United States and the fastest growing product in several Canadian provincial jurisdictions. Cyber insurance is rapidly growing in importance as a critical offset against the significant financial impacts that can result from cyberattacks. As organizations become more digital, cyber risk represents an increasing share of the threat landscape; as such, cyber preparedness and third-party risk management are quickly becoming areas of focus for regulators. In this article, we explore the current cyber insurance market from the perspective of insurers.

Why cyber insurance coverage is important for all businesses

The cyber risk landscape is changing. Now, regardless of their size, businesses are exposed to cyber risk simply if they use digital devices and the internet. Computer attacks, identity theft, data and security breaches, and other cyber incidents can be extremely costly to organizations and can even put smaller firms out of business.

Public and private businesses, regardless of their size, are prone to cyber threats.

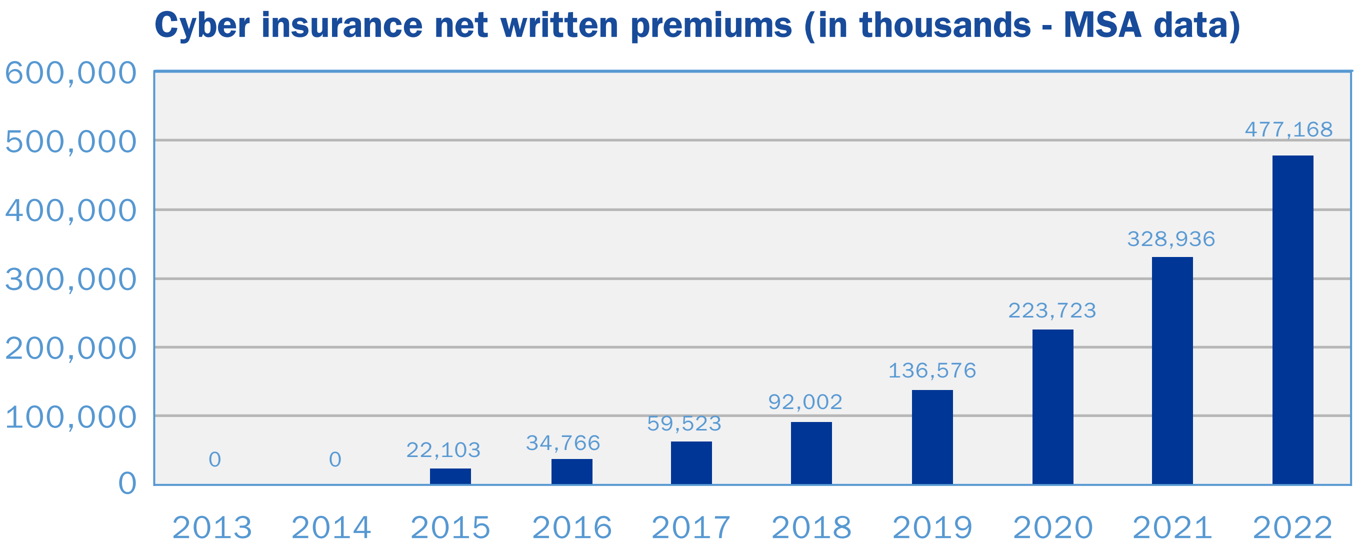
Cyber Insurance importance based on size of business

<table>
<tr><th>Size of business</th><th>Why does cyber insurance matter?</th></tr>
<tr><td>Small</td><td rowspan="2">Cyber attacks on Small to Medium-sized Businesses (SMBs) are common because small and medium-sized organizations have some of the same information and digital infrastructure that draw attackers to larger companies, but they tend to have less IT security, limited resources, backup technology and mitigation services that some of the bigger companies may have.</td></tr>
<tr><td>Medium</td></tr>
<tr><td>Large</td><td>Large organizations are potentially more lucrative targets; however, their increased IT security makes them more difficult to take advantage of. The scope of financial and reputational damage for these large firms can be massive, as well as the potential financial gain for cyber attackers through ransom.</td></tr>
</table>

Due to key, recently emerging technology trends, there's an increasing need for cyber insurance. According to a 2023 report from Munich Re, these technological advances include artificial intelligence (AI) models such as ChatGPT, and the Internet of Things (IoT). Munich Re predicted in their report that the global cyber insurance market would continue to grow, from roughly US$11.9 billion in 2022 to approximately US$33.3 billion in 2027.

The Canadian market

Using industry data for Canada's property and casualty (P&C) sector, we observe a few trends in cyber insurance net written premiums and net loss ratios over the past decade.



Q4 net written premiums, by year (all numeric data in 1000s)

Canada's cyber insurance net written premium total is now close to $500m and has increased dramatically over the last 10 years, with a marked 64% jump between 2019 and 2020. By 2015, based on large-scale cyber incidents such as the highly publicized breaches at Yahoo (2013), Home Depot (2014), and Marriott hotels (2014), it was clear that cyberattacks could be catastrophic for organizations—including from resulting class-action lawsuits and significant penalties and fines from regulators. Ransomware attacks have increased in frequency and severity starting in 2019. Breaches suffered by large, managed service providers such as SolarWinds (2020) and financial institutions including Desjardins (2019) and Capital One (2019) were just the start.

Although organizations now typically recognize cyber insurance as a critical coverage, its high cost is often a barrier to purchase. Since 2020, cyber insurance premiums have increased by 50% or more, largely in response to poor loss experience. There are some signs that the sharp premium increases of recent years have begun to ease as loss ratios have improved.

Most cyber insurance coverages are related to commercial insurance, but a small number of providers are starting to include select personal cyber products on a mass-market basis. Demand for personal lines cyber coverage has seen an uptick in recent years as this coverage is relatively cheap and easy to obtain.

Cyber pricing in an evolving threat landscape

The cyber insurance trends of the past few years, as outlined in the previous section, should trigger insurers to consider changing their underwriting and pricing techniques. To adapt to the dynamic aspect of the cyber market, insurers should consider **refreshing and investing in stronger pricing models**, as current industry models are often overly simple. Using better risk-based pricing techniques can help lower the margin of uncertainty in cyber insurance pricing and can help insurers both improve their understanding of the underlying risks and provide more appropriate coverages for their clients.

Scenario-driven pricing models

One such option for better risk-based pricing, scenario-driven models involve **detailed scenario** narratives that dive deep into loss possibilities, thus helping to enhance estimations of frequency and severity assumptions. For example, one model could be based on a common cyber-loss scenario, such as a larger cloud network services provider being compromised. Detailed scenario models can involve factoring in advice from multi-field experts such as economists, underwriters, security and intelligence officers, and law enforcement, thus helping actuaries to improve on their rate-making assumptions. In addition, actuaries might include an **additional load for cyber catastrophes**—for example, payment-system crashes—when pricing cyber insurance.

Data sources

It can be challenging for insurers to rely solely on their own historical underwriting and loss experiences to analyze cyber claims. Fortunately, they now have access to new cyber risk data from data providers. For example, cyber-data vendors such as CyberCube and Moody's RMS can now provide additional data to supplement an insurer's own historical data, allowing for enhanced data quality and quantity that can improve the insurer's rate-setting and valuation of cyber insurance claims.

Policy provisions

Insurers should pay closer attention to **cyber policy terms** in order to help limit their exposure to only the risks they intend to cover—for example, by having sub-limits and policy exclusions for specific cyber hazards. Co-insurance, too, can have a significant impact on loss ratios and better policyholder behaviour. Policy limits for different types of cyber risk should also be examined and adjusted, as needed, to encourage proactive cybersecurity behaviour.

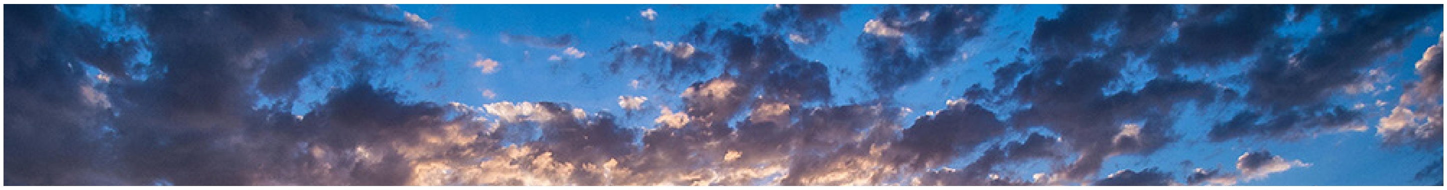
Future direction

Claims reduction for small to midsize businesses

During a panel discussion at the 2023 Insurance Brokers Association of British Columbia (IBABC) annual general meeting and leaders' conference in Whistler, BC, cyber experts shared that insurers who act as incident response services for their small to midsize business clients help lower overall claims. Experts encourage cyber insurers to open the lines of communication with clients so that clients know they can come to them for advice. Cyber insurance may still be unknown or misunderstood by some smaller clients, hence there are opportunities for insurers to contact those smaller clients and pass the message that cyber insurance exists and is important.

Data

Unless it is a legal requirement, companies may not always report and disclose cyber events. Even when events are reported, key information such as cause, and size of loss is often missing.



There are, however, existing frameworks to improve the quality of recorded/gathered cyber-related data. For example, US-based Verizon's VERIS (an acronym for *vocabulary for event recording and incident sharing*) uses four event descriptors: actor—an agent or entity that causes or contributes to a cyber event; action—what an actor did to cause or contribute to the event; asset—the person or thing affected or compromised by an action; and attribute—how the asset is affected or compromised by the event. The VERIS Community Database then aims to collect and disseminate gathered data-breach information from publicly disclosed breaches, with sources that include the US Department of Health and Human Services, various US attorneys general websites that provide breach-notification source documents, media reports, and press releases.

However, there is currently no centralized repository for Canadian insured loss data—though Canada can be expected to follow the American example of developing data sources for cyber-event experiences. Here, the Canadian Institute of Actuaries (CIA) may play a role going forward. As more detailed data becomes available, pricing and cyber risk quantification will undoubtedly improve.

Reinsurance

In 2018, Gallagher Re (then Capsicum Re) developed a white paper outlining an expectation that the reinsurance market would soon be redefined as the property, casualty, and cyber (PC&C) sector. This evolution seems well on its way, evidenced by society's increasing technological dependencies and demand for cyber cover, coupled with more cyberattacks and emerging technologies. The company believes that, by 2024, the cyber aspect of this market will be comparable in size to that of either the property or casualty elements—and will have long since exceeded them in terms of annual reinsurance premiums.

Conclusion

With cybercrime growing at a worrying rate across the globe and organizations habitually increasing their use of IT and remote solutions, we find that now, more than ever, cyber insurance is becoming critical—both as an opportunity for insurers to improve their business outcomes and as a risk-mitigation strategy for insured parties.

Cyber insurance is a fast-growing market segment. Insurers need to keep pace with new developments in this market by offering competitive and relevant insurance policies, while also ensuring they use accurate and up-to-date rate-making models. Insured parties, on the other hand, need to define their cyber risk appetites and risk-mitigation strategies to proactively build up their cyber resilience. Upgrading their cybersecurity infrastructures and purchasing cyber insurance (or updating current coverages) can help them avoid the potentially devastating financial and reputational damage that can result from cyber incidents.

Antonio Ferreiro, Partner, Deloitte
Karl Meissner-Roloff, Partner, Actuarial & Insurance Solutions, Deloitte

PACICC Priority Issues: Updates

Managing Systemic Risk

Back in 2013, PACICC published its first Systemic Risk study which found that there is a potential threshold ("Tipping Point") in total insured losses above which the entire Canadian P&C system would fail in its mission to protect Canadian policyholders. This threshold is very high, as the industry is highly capitalized and well reinsured. The study also noted that there were very few perils which could cause such large insured losses (e.g. asteroid strike, space weather, or a mega-earthquake in British Columbia or the Quebec City/Montreal/Ottawa corridor). We published an updated version of our Systemic Risk Model in 2016 and again in 2021. That most recent study pegged the "Tipping Point" at approximately $35B in insured losses.

The Federal Government made an explicit commitment in its 2017 Budget to address the systemic risks associated with a major quake. Since then, there has been substantial "dialogue" among key stakeholders at Finance Canada, IBC, ICLR, Public Safety Canada and PACICC – but limited tangible progress made. Our Board established "Mitigating Systemic Risk" as a Permanent Priority Issue for PACICC, until such time as some form of backstop mechanism is finally put in place.

In the most recent Federal Budget, the Minister of Finance affirmed the Federal Government's commitment to addressing this issue. The industry is closely engaged in discussions around how to implement public-private partnerships to address multiple perils including quake. We recognize that more time is needed for ongoing dialogue with Finance Canada to reach a successful conclusion. We are continuing with our direct engagement with Finance Canada, OSFI, Bank of Canada, CMHC, FCAC and CDIC, as appropriate. We will also liaise with IBC and ICLR to ensure an efficient and effective alignment of our approaches.

Coverage and Benefits Review

Our first order of business this year has been the completion of our Coverage and Benefits Review Action Plan. In 2020, we committed to the Canadian Council of Insurance Regulators (CCIR) that we would review our coverage and benefits at least once every five years, with the next review occurring within three years (in 2023). This review was the Corporation's Priority Issue last year and was again based on three guiding principles – Fairness; Transparency/Clarity; and Modernization. We reviewed: extent of coverage, claim limits, return of unearned premiums, hardship claims, threshold for commercial coverage eligibility and benefit limits at the provincial level (i.e. Would it be appropriate to have higher limits in certain provinces to reflect higher average claim costs?).

The resulting analysis provided compelling evidence that PACICC offers Canadian policyholders a very high level of protection. Should a PACICC Member fail, roughly 98 percent of all Personal lines policyholders would be protected (on average) to the full value of their claim (with the remaining two percent partially protected). While the review did find that PACICC limits are equally robust across all provinces, it became clear that inflation had eroded PACICC benefit limits, even in the brief three-year period between 2020 and 2023.

Our Board recommended to CCIR that an annual inflation adjustment could be included in our benefit limits for Automobile and Personal Property coverages. Having secured the approval of regulators for these proposed changes in March 2024, the first inflation adjustments were submitted to our Board for approval in April. Any approved changes would then take effect on July 1, 2024. We have also committed to a comprehensive review of our hardship policy and work on this initiative has been added to our 2024 Operating Plan.

Enhancing Resolution Capabilities – PACICC General Insurance

One of our Priority Issues for 2024 is engagement with OSFI and PACICC Members to establish the appropriate governance model, optimal approach to capitalization and detailed approach to operationalization of a federally-chartered "Bridge Insurer" for the Corporation – *PACICC General Insurance*.

During the comprehensive industry consultation that we conducted in 2020 around "Expanding PACICC's Resolution Toolkit," the idea of PACICC incorporating an OSFI-chartered "Bridge Insurer" piqued participants' interest. After more comprehensive discussions with key stakeholders during the lead-up to our June 2022 Strategic Planning Conference, the rationale for adding this tool – suited to a range of distress/crisis scenarios – was affirmed. In the strategic discussions with our Board, we noted that our peer organization in the Canadian life insurance sector (Assuris) had long ago incorporated a similar entity (*CompCorp Life*) under OSFI supervision. Assuris shared useful insights with us regarding the relatively/very low operational costs of having this asset in its resolution toolkit.

We believe that such a mechanism, specifically designed for the needs of the P&C sector, could meaningfully enhance our response capabilities. We would be better positioned to serve as an effective resolution partner for supervisors dealing cases of insurer distress, in very specific but credible scenarios. Such situations could include an insurer incurring "toxic liabilities," or circumstances involving any one of our industry's top-17 insurers in financial distress, where sudden liquidation would be very costly for all involved.

At the direction of our Board, we initiated dialogue with OSFI regarding this prospective enhancement to our resolution infrastructure. OSFI responded by providing us with a "streamlined application process." Earlier in 2023, we worked to develop an initial draft application that was submitted to OSFI. OSFI responded with a comprehensive list of topics/questions (around governance, capitalization, legal process, information flow and operationalization) to be addressed in the next stages of its application review process. Work here is ongoing, with monthly "checkpoint" meetings to ensure effective project management of this comprehensive application.

We are placing significant effort into moving this important capability-enhancing initiative forward. Our industry structure has changed over recent decades with a significant trend toward consolidation. This has led to a growing number of Member Insurers whose financial distress could trigger a PACICC Assessment which, of and by itself, would cause financial distress for other Member Insurers. These are the scenarios where "resolution" alternatives to liquidation become imperative.

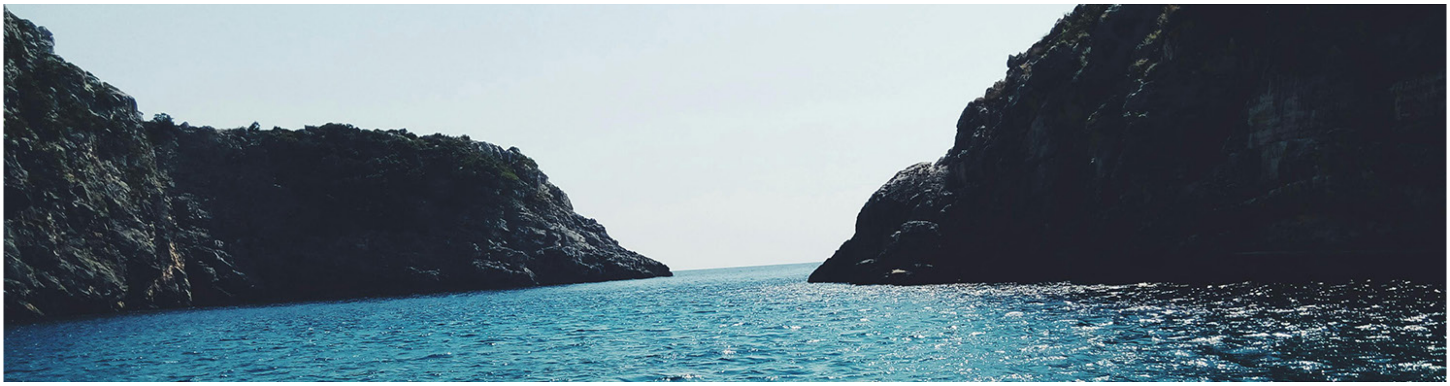
We have already taken significant steps to enhance our capacity, to make effective use of the resolution powers granted to PACICC upon its founding, in order to avert systemic risk to our industry. These steps include: our Board's adoption of a *Resolution Protocol* in 2021; Member-approved changes to our Memorandum of Operation (enabling PACICC to utilize its Compensation Fund and other resources to fund resolution alternatives); and the addition of more instant liquidity via our new Standby Line of Credit facility. The addition of a Bridge Insurer capability will be another important step in this effort.

Member consensus around our approach to launching this bridge mechanism will be essential. To that end, there may be more dialogue required with Members regarding key policy decisions over the course of the year. We are seeking to complete the Bridge Insurer approval process by the end of 2024. We will then seek to initiate the formal mechanisms to establish the new Bridge Insurer entity – subject to all regulator and Member approvals – in the course of 2025.

Expanding our Financial Capacity – Exploring Medium-Term Capacity Options

Our other key Priority Issue in 2024 centres on Expanding PACICC's Financial Capacity. We are exploring whether the potential exists to access capital markets for debt financing in a circumstance where greater liquidity may be required than is otherwise available via PACICC's General Assessment mechanism. This alternative approach to grow financial capacity has been used recently in at least two jurisdictions in the U.S. in recent years – the Louisiana Insurance Guaranty Association (LIGA) and Florida Insurance Guaranty Association (FIGA).

In 2022, LIGA raised $478 million with a bond offering (rated A1 by Moody's) that matures in 2038 with a 5 percent coupon. In the event of hurricane-related insolvencies that exceed FIGA's assessment capacity, or if they desire to spread assessments over a larger time period, it can issue bonds (up to $750 million with a term up to 30 years) to obtain funds to pay covered claims. It did so in 2023.



In the course of this year, we will explore the implications of securing and maintaining a favourable (private) rating for PACICC from a major rating agency (or agencies). Securing and maintaining such a rating would position us to respond in a wider array of crisis scenarios, but could also align well with our "low-cost optionality" model.

While this dialogue continues, we will continue to examine other creative alternatives to address this systemic risk to PACICC, our industry and our country. At the direction of our Board, PACICC staff has begun to explore incremental options to help to mitigate such a colossal risk for the industry, including:

- **An Amendment to PACICC's Memorandum of Operation re: Special Assessment** – Replacing the obligation to establish a "maximum exposure" with a modernized, actuarially established "best estimate" would help to mitigate systemic risk in the case of serial Member Insurer failure. This change has now been approved by regulators with immediate effect.
- **Differential Treatment of PACICC Special Assessments** – We see potential benefit for Members in having OSFI agree to adjust the capital treatment of multi-year PACICC obligations in its Minimum Capital Test formula, in recognition of the systemic risks associated with forcing Member Insurers to reflect 100 percent of their total anticipated Assessments in their accounting liabilities. We will be engaging directly with OSFI on this issue, for consideration in its planned 2025 review of the P&C sector's capital requirement formula.
- **Designation of PACICC as a "Compensation Association" under the Federal Insurance Companies Act** – PACICC has approached the Minister of Finance with a formal request for this designation, and we will be following up on this in the coming months. Regardless of the eventual solution adopted by Ottawa to address systemic risk, it will be easier for PACICC to engage as a trusted counterparty with OSFI and the other federal members of Canada's financial safety net if we are formally recognized in the Act.
- **Further Desktop Insolvency Simulation Exercises** – In July, PACICC will partner with BCFSA (and other stakeholders including OSFI, CCIR, Finance Canada and IBC) to conduct a desktop insolvency simulation exercise, examining the impact of a major earthquake on the financial services industries in B.C. In particular, the scenario will allow all stakeholders to explore how best to manage if and when Canada reaches "the Tipping Point."

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.

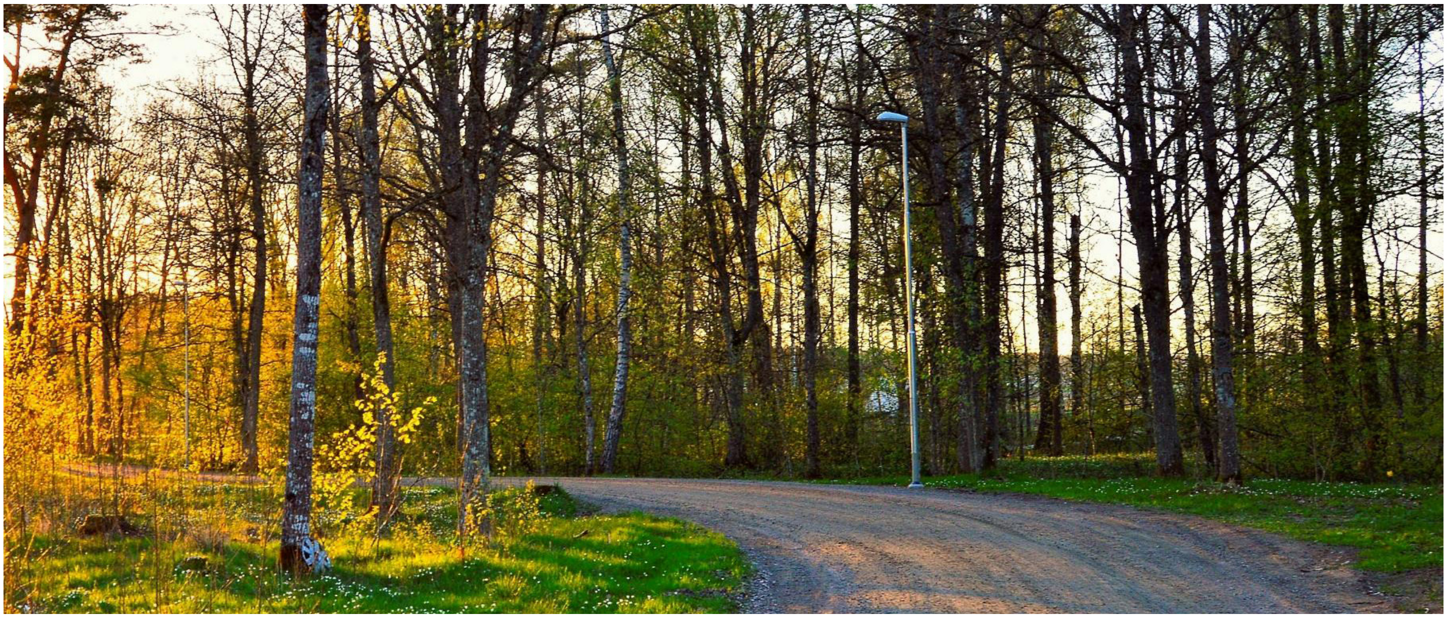
Emerging Risks Webinars

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.

2024 Emerging Risks Webinar Dates/Topics:

Thursday, May 16
Topic: Artificial Intelligence and Claims Processing

Thursday, October 24
Topic: Per- and Polyfluoroalkyl Substances (PFAS)



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.

2024 Forum Meeting Dates/Topics:

Thursday, September 19

Discussion 1 Topic: Third-Party Risk

Discussion 2 Topic: Fair Treatment of Customers

Thursday, November 28

Topic: CEO Perspective on ERM

Keynote Speaker: **Fabian Richenberger** – (Executive Vice-President, Commercial Insurance and Insurance Operations, Definity)

Discussion 1 Topic: Reinsurance Update

Discussion 2 Topic: Climate Change

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 647/264-9709.