Solvency Matters

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

PACICC

Insolvency protection for home, automobile and business insurance customers

Issue 26 - July 2024

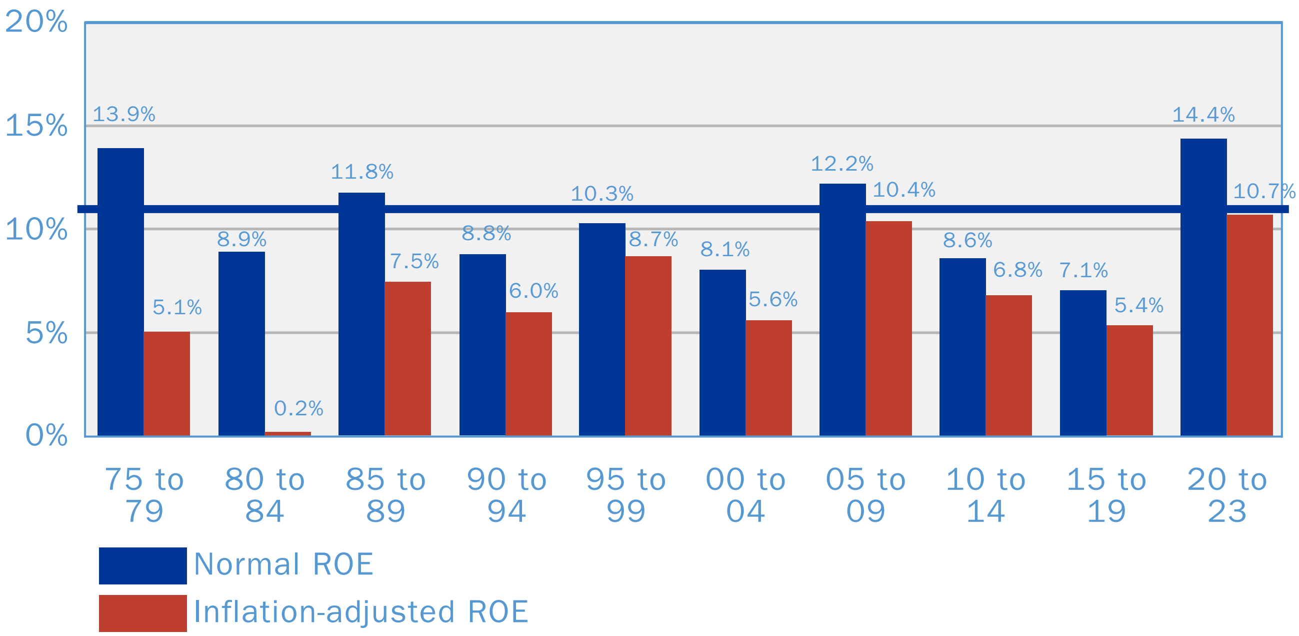
NEXT

From the Desk of the President

When the Audio Doesn’t Match the Video - by Alister Campbell

PACICC’s Chief Economist Grant Kelly recently published an analysis of the Canadian P&C industry’s results (see chart below) and described the results that he was seeing as representing “a golden era” in industry financial performance. And indeed, the results are remarkable. The average Return on Equity of our industry for the last three-year period is the highest of any such period since at least the 1970s. This is true even on an inflation-adjusted basis. So, why doesn’t it feel like it?

Inflation-adjusted P&C return on equity



Source: PACICC based on data from MSA Research

Each summer, I conduct what we call our “Top-20 CEO Tour” (in the new hybrid era, this means chats over coffee with some, but mostly 45-minute Teams calls) where I check in with the senior executives at each of Canada’s largest insurers. I have found it a tremendously useful way to ensure that our industry leaders are kept up to speed with the next proposed steps in PACICC’s modernization agenda. But the calls also give me deep insight into the challenges facing our industry, as seen through the lens of those with the best view – leaders whose roles require them to look down from “30,000 feet” while simultaneously duking it out “in the trenches.” And what I am hearing from these leaders this year simply doesn’t align with the financial results that they are reporting. In fact, I have rarely encountered senior leaders feeling under greater stress.

This misalignment brings to mind old movies shot in a pre-digital era – where the audio simply didn't match the video, and left the viewer frustrated as dialogue and action seemed somehow disconnected from speaker and actor. Sometimes the viewer would have to piece together what was being said and by whom, while still following the next developments in a fast-paced scene. It made for confusing viewing. In the same way, the mismatch between excellent results and deep stress in the industry producing those results is hard to explain. On my "Tour," I have been keeping a list and have identified a series of "stressors" which are making it particularly challenging to be a CEO of any Canadian insurer in 2024.

> **"The average Return on Equity of our industry for the last three-year period is the highest of any such period since at least the 1970s. This is true even on an inflation-adjusted basis. So, why doesn't it feel like it?"**

Stressor #1 – Rapid shift in inflation and interest rates

Much has been written on the post-COVID-era spasm of inflation and the resulting upward spike in interest rates, as the central banks of the developed world responded (after perhaps waiting a bit too long?). For P&C insurance, inflation can be cancerous to previously profitable lines of business, unless immediate rate action is taken to cover off rapid upward movements in replacement and reconstruction costs. But one extraordinary additional result of this latest bout of inflation was the largest single investment loss in the history of our industry, as our huge portfolios of (mostly government-backed) fixed-income securities were severely marked down. In fact, 2022 saw the first-ever investment loss for our industry as a whole! Insurers have always been able to rely on investment income, even when underwriting income is weak. But CEOs know just how lucky we were that underwriting results were strong enough that year to offset these ahistorical investment results. If that year had also seen poor underwriting results overall, or a major natural catastrophe, the forced sale of securities at (thankfully temporary) marked-down prices would have been simply disastrous.

Stressor #2 – Natural Catastrophe Losses Continue to Climb

I am antique enough to remember how unique was the Quebec Ice Storm, which stood as a Nat-Cat outlier for industry losses for several decades. But the Calgary/Toronto floods of 2013 kicked off a decade of steadily increasing Nat-Cat losses for Canada. And all above a new and higher bar. The losses from the Slave Lake and Fort McMurray wildfires, the Ontario derecho and a steady cloudbeat of Calgary hail events have all brought home the reality that a shifting climate is driving consistently higher natural catastrophe claims. If $3B in annual losses – even in years with no particularly severe single event – is the new normal, our industry needs to fundamentally recalibrate property insurance rates that have already been climbing in high single digits (or more) for a decade. Which leads to Stressor #3…

Stressor #3 – We Are Having to Buy Way More Reinsurance…That Costs Way More

Every few years when we update our Systemic Risk Model at PACICC, we ask the major reinsurance brokers of Canada to privately share with us their estimate of total natural catastrophe reinsurance purchased in this country. When we first asked in 2013, the number was estimated to be $17.6B. A decade later that estimated upper end is $36.5B – more than double! But the challenge doesn't stop there. The 2022 renewal season saw dramatic upward pressure on reinsurance pricing for natural catastrophe – even for profitable portfolios. PACICC Members were forced to absorb higher net retentions and the withdrawal of aggregate covers – meaning increased volatility in earnings and higher risk of adverse balance sheet impacts in the event of a series of non-large severity catastrophes. The index of pricing (based on rate online) shows that the doubled reinsurance purchases of the Canadian market over the last decade are also coming with a compounding doubling of reinsurance prices. A true "double whammy."

Stressor #4 – Incomprehensible Financials

The mandated implementation of the new accounting standard (known as IFRS 17) was a massive undertaking, with huge added costs in consulting and Information Technology. Think of Y2K…with half the value and twice the costs. The result of all that value-neutral (at best) spend is financials that are utterly incomprehensible to the vast majority of market participants. When All Other Comprehensive Income (AOCI) was introduced into modern financial statements, they became unreadable by those other than financial professionals. But the new IFRS 17 financial statements are completely opaque even to senior executives and regulators in our insurance sector. Work is still being done to define the "key metrics" to study in order to quickly gauge trends in financial performance. From a PACICC perspective, an accounting standard that makes it impossible for key players to understand their own financial performance means increased solvency risk and represents an unfortunate step backwards.

Stressor #5 – Increased Regulatory Burden

It is entirely normal for senior executives in financial services to begrudge any increased effort required to ensure compliance with a growing regulatory burden. And given the adverse impacts of the Global Financial Crisis just 15 years ago, it is also entirely reasonable that regulators are seeking to enhance the effectiveness of their oversight of the sector – to ensure that society does not need to experience that type of strain again. But, over the last several years, regulators have dramatically expanded their remit in the area of "non-financial risk." In Canada, OSFI and other prudential authorities have initiated oversight of whole new areas of risk including climate, culture, cyber, third-party/outsourcing, operational, as well as integrity and security. And this list is not exhaustive. Each area of focus of and by itself can be seen as a legitimate target for regulatory scrutiny. But taken in combination, the associated wave of consultations, data calls and new guidelines has proven to be almost overwhelming and has imposed substantial added pressure on risk departments and senior leadership of insurers, both large and small.

Stressor #6 – Living at War

The growing threat of cyber breach has forced a dramatic upward spike in IT security costs and dramatically increased the risk for all insurers seeking to securely guard their huge databases of confidential/proprietary customer information. The CNA breach in the US showed how expensive a ransomware attack could be (both in treasure and in reputation). And the data breach at Desjardins revealed the risks that insurers can also face from internal rogue actors. Some of our other Members have experienced significant breach events – not all of which have been made public. Suffice it to say that the threats that Canadian insurers face in this area are continuous and still rising.

Stressor #7 – The "Channel" is Changing

After the list above, it is almost a relief to identify a stressor that is actually directly related to the activities in the core business of insurance. But the continued consolidation of the insurance brokerage channel is leading to a shift in the traditional "balance of power" between underwriters and originators. The battle for "shelf space" is much more challenging for small- and mid-sized players in this evolving environment. And that battle means upward pressures on distribution expense (or, at a minimum, no room for efficiencies) and/or downward pressures on pricing. That this is happening at a time of upward trends in both operating and underwriting costs – driven by all of the stressors described above – makes this yet another source of industry leadership stress.

Stressor #8 – All the Others Left Off this List

Conscious of the risk of exhausting my reader's patience, I have chosen to keep this list (relatively) short. But in doing so, I am actually understating the pressure that Canada's Top-20 CEOs are feeling from a diverse range of other risks, including impacts from geopolitics, populist provincial governments engaging directly in setting of automobile insurance prices, supply chain pressures, hybrid working models, the war for talent, artificial intelligence and PFAS. And even that list only covers off the "known unknowns" (to borrow from Donald Rumsfeld). CEOs have to own accountability for ensuring the resilience of their business in the face of all these stressors, as well as the potential adverse impacts of the "unknown unknowns" that they cannot even identify but can be sure will come.

I have now been active in this industry for roughly 39 years (gulp). It has never been more interesting to be an engaged observer and participant. But, it has also never been so stressful. All the more reason that I hope you find enough family time to enjoy all the blessings of a great Canadian Summer. It won't get any easier this Fall…talk to you all again then!

Alister Campbell, President and Chief Executive Officer at PACICC

Diving beneath the surface - by Grant Kelly and Zhe (Judy) Peng

Beneath the surface of the strong overall industry-level results, there is considerable variation in the level of profitability of PACICC's 166 Member Insurers. The driving force behind the differences in profitability across insurers is underwriting performance. The first metric to look at in this regard is the new, IFRS 17 Net Insurance Service Ratio (NISR). This new metric is similar to the old, IFRS 4 Loss Ratio, but the new measure will generally produce higher numbers, as it now includes acquisition expenses, including commissions and reinsurance as well as the impact of onerous contracts (if any). Generally speaking (i.e. for most lines of business), PACICC would expect that this ratio would be below 75 percent to 85 percent.

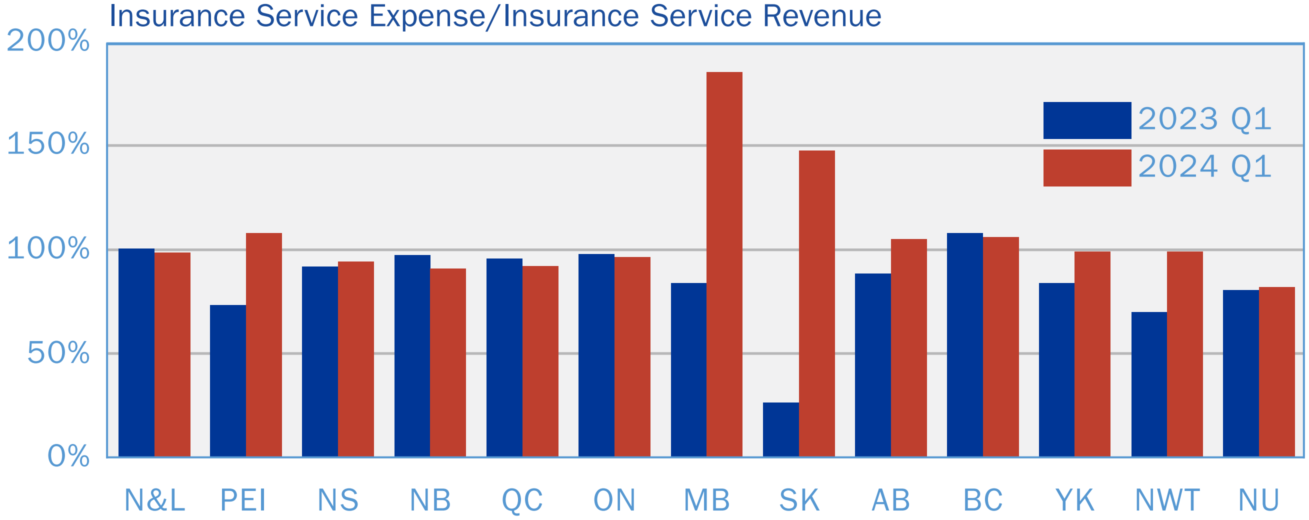
For a line of insurance to be stable over time, insurers providing that coverage must be profitable. Let's now take a look at the major classes of business using this new NISR metric.

Auto insurance

Auto insurance remains the largest line of insurance sold by Canada's P&C insurers. In the first quarter of 2024, there was clear reason for concern about the stability of this line. A NISR for Auto insurance above 80 percent to 85 percent indicates that the line of insurance is not profitable, and is likely draining the capital base of the underwriter. In the first quarter of 2024, 12 of Canada's 13 provinces and territories reported an Auto NISR above this threshold. Nunavut is the only Auto insurance market in Canada that is seeing insurers actually increase their capital base. In fact, five markets (Alberta, Prince Edward Island, Manitoba, Saskatchewan and British Columbia) reported ratios greater than 100 percent. The seven other markets reported a NISR for Auto insurance greater than 90 percent. Auto NISRs at these levels are not sustainable and indicate likely instability in this market. Insurers will be forced to increase the price that policyholders pay (if regulators will allow it), or reduce their exposure by selling less coverage...or both.

Insurance Service Ratio, Total Auto

Insurance Service Expense/Insurance Service Revenue



Source: PACICC based on data from MSA Research

Personal Property

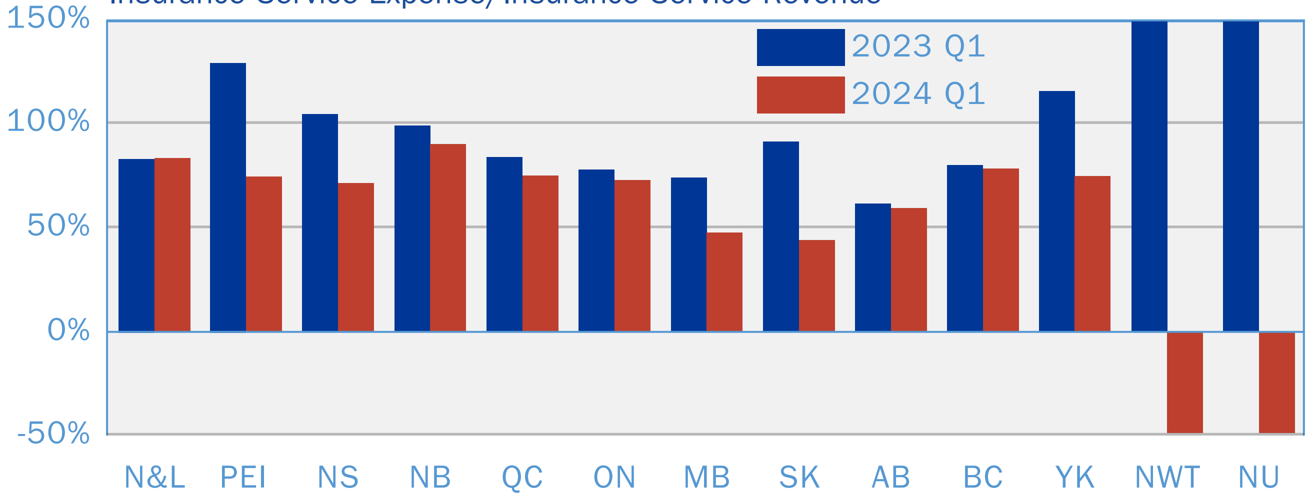
The second largest line of insurance offered by PACICC Member Insurers is Personal Property (also called Homeowners) insurance. A NISR for Personal Property insurance above an 80 percent to 85 percent threshold indicates to PACICC that the line of insurance is not profitable for insurers, and is likely draining the capital base of the company. Happily, in the first quarter of 2024, 11 of 13 Canada's provincial and territorial insurance markets appear profitable. The outliers are Newfoundland and Labrador with a ratio of 83.7 percent and New Brunswick with a NISR of 90.6 percent.

There are two significant reasons for the current stability of Personal Property markets. One, the first quarter was free of any major catastrophic losses. And second, many insurers have been consistently raising rates charged to policyholders over the past few years.

Given the long-term trend of increasingly frequent and increasingly severe catastrophic losses, it remains unclear if the rate adjustments so far are adequate. According to the Institute for Catastrophic Loss Reduction, the total direct damage to homes, businesses and public infrastructure from extreme weather events has been $6 billion per year over the last five years. And the upward trend remains of deep concern.

Insurance Service Ratio, Personal Property

Insurance Service Expense/Insurance Service Revenue

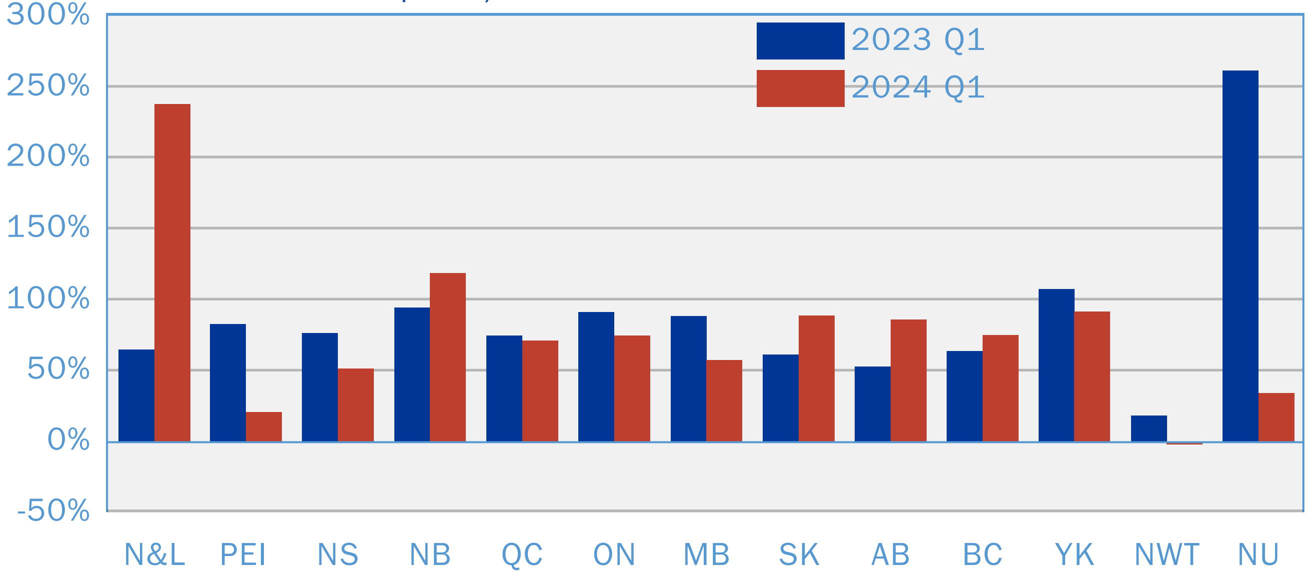


Source: PACICC based on data from MSA Research

Commercial Property

To be profitable, Canada's Commercial Property markets require a NISR in the range of 75 percent to 80 percent. In the first quarter of 2024, eight of 13 Canada's provincial and territorial insurance markets appear profitable. The five outliers are Newfoundland and Labrador (237.3 percent), New Brunswick (118.1 percent), Saskatchewan (88.4 percent), Alberta (85.4 percent) and the Yukon (91.1 percent).

Insurance Service Ratio, Commercial Property
Insurance Service Expense/Insurance Service Revenue

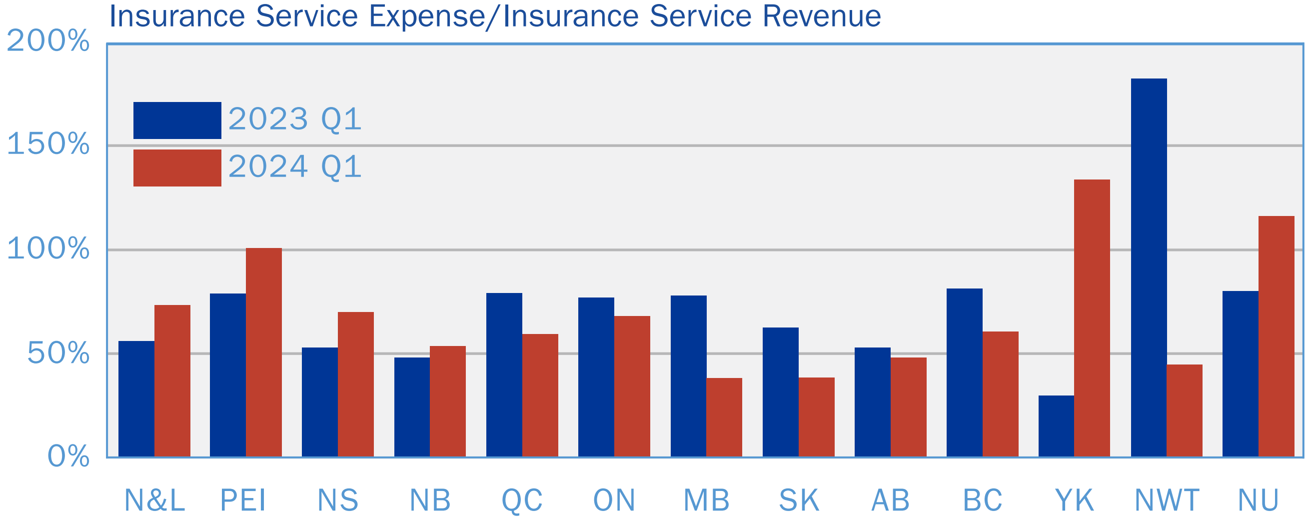


Source: PACICC based on data from MSA Research

Commercial Liability

PACICC is aware of growing rumbles of a "softening" in Commercial Liability markets, but there is limited evidence of softening in the first quarter results of insurers. PACICC estimates that Canada's Commercial Liability markets require a NISR in the range of 75 percent to 80 percent in order to ensure profitability and contribute to growing the capital base of insurers. In the first quarter of 2024, 10 of Canada's 13 Commercial Liability insurance marketplaces reported NISRs better than that threshold. It is difficult not to assume that these results will encourage more competition and attract more capital in the next few quarters. And if this indeed takes place, these good results will not last long.

Insurance Service Ratio, Commercial Liability
Insurance Service Expense/Insurance Service Revenue



Source: PACICC based on data from MSA Research

Summary

There will still be some uncertainty in evaluating industry performance over the next few quarters, as all observers learn to evaluate this performance using new IFRS 17 metrics. But close evaluation of results by line of business will ensure that we can quickly see what is happening…beneath the surface.

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

Zhe (Judy) Peng, Research Associate, PACICC

The good news continues for most P&C insurers
- by Grant Kelly and Zhe (Judy) Peng

Canada's P&C insurers have implemented the IFRS 17 accounting standard, beginning in 2023. As a result, the first quarter of 2024 marks the first time that PACICC can truly begin comparing industry-level IFRS 17 quarterly results on an "apples-to-apples basis." A quick review can confirm that the first quarter of 2024 continues the trend of profitable results for Canada's P&C insurers.

Under IFRS 17, the old "Gross Premiums Earned" under IFRS 4 has been replaced by "Total Insurance Revenue," defined as the amount earned for providing insurance coverage. In the first quarter of 2024, Total Insurance Revenue increased by $1.36 billion (6.5%). This growth was broadly based. However, among the 142 non-mortgage P&C insurers that reported both 2024 and 2023 financials, 27 companies (19 percent) – all of which are small-or medium-sized – reported negative growth. In the first quarter of 2024, larger insurers grew at the expense of smaller insurers.

"Insurance Service Results" – defined as "Total Insurance Revenue" minus "Insurance Service Expenses" and "Net Expenses from Reinsurance" – also increased, by $845 million (40.9 percent). Overall though, annualized ROI decreased to 4.1 percent in 2024Q1, compared to 6.5 percent in the previous year.

"Net Investment Results" remained largely the same, declining from $1,004 million in 2023Q1 to $983 million in 2024Q1, a mild 2 percent decrease. This is the joint result of lower mark-to-market valuations of invested assets in a high-interest rate environment, as well as the reduction of the finance expenses from insurance contracts issued and reinsurance contracts held.

The net impact of these changes was a 25.8 percent increase in Net Income. This increase came despite the fact that "General and Operating Expenses" increased by $309 million, a more than 50 percent increase (presumably due to inflation). The increase in the Insurance Service Result enabled insurers to fully absorb this surge in their operating costs. It is also worth noting that the overall increase in General and Operating Expenses seems to be driven by a few large insurers, with three of the largest 20 P&C insurers reporting a more than 300 percent increase. This variance is hard to grasp and will require further analysis.

All in all, the first quarter of 2024 adds to the string of quite positive results for Canada's P&C insurers.

1st Quarter 2024 Financial Results

All values are from MSA as of June 11, 2024

Values exclude mortgage insurers* and are in $millions, except where noted.

	2024 Q1	2023 Q1	Percentage Change
Total Insurance Revenue	22,327	20,969	6.48%
Insurance Services Expenses	-18,047	-17,566	2.74%
Net Expenses from Reinsurance Contracts Held	-1,370	-1,338	2.44%
INSURANCE SERVICES RESULT	2,910	2,065	40.94%
Investment Return	1,495	2,095	-28.67 %
Net Finance Income/Expenses from Insurance Contracts Issued and Reinsurance Contracts Held	-512	-1,090	-53.04%
NET INVESTMENT RESULT	983	1,004	-2.08%
General and Operating Expenses	-1,323	-851	55.52%
Other Income and Expenses	467	303	68.81%
Income Taxes	513	515	0.4%
NET INCOME	2,523	2,006	25.80%
TOTAL COMPREHENSIVE INCOME	2,650	2,441	9.90%

Select Solvency Indicator Ratios

	2024 Q1	2023 Q1	Percentage Change
Return on Investment (ROI)*	4.1%	6.5%	-37.08%
Return on Equity (ROE)*	15.5%	14.1%	10.26%
MCT Ratio (Capital Available / Capital Required)	256.3%	258.7%	-0.95%
BAAT Ratio *(Applicable to Branches)* (Net Assets Available / Capital Required)	339.8%	316.9%	7.23%

* Values exclude two mortgage insurers, i.e., Canada Guaranty Mortgage Insurance Company and Sagen Mortgage Insurance Company Canada, and are in millions of CAD, except where noted.

Emerging Issues

With climate change, the federal government needs to do more

by Mary Kelly

As climate change increases the frequency and severity of natural disasters globally, the resilience of private insurance markets is increasingly tested. Although Canada has navigated these challenges relatively well, the global landscape shows a pressing need for more robust government intervention. Financing losses from catastrophic perils and supporting the resilience of private insurance markets are significant challenges that require proactive measures. This article explores why the Canadian federal government needs to support the private insurance market in providing coverage to properties at high risk of flood or wildfire losses, drawing lessons from international experiences and highlighting the need for a strong public-private partnership.

Canada has been fortunate in managing the growing climate risk while maintaining adequate coverage for property owners and the financial health of insurers. Even the record-breaking 2023 wildfire season, which burned an estimated 18.4 million hectares (over seven times the historical average), had little impact on the availability of reinsurance for 2024, and insurers are still willing to provide coverage across the country. However, this fortunate position might not last, as climate change poses significant challenges, including increased risk of loss for high-risk properties and heightened tail risks for insurers.

Experiences from around the world highlight the need for governments to support the private insurance sector in the face of growing weather-induced losses.

In Belgium, primary insurers offer mandatory coverage for a comprehensive range of perils including fire, storms, floods, and earthquakes to simple risks–properties defined by usage and value. A risk-sharing pool provides coverages to high-risk properties and to manage excessive losses from a single event, the payout by insurers is capped, and regional governments cover excess losses up to a predetermined limit. This model was effective until July 2021, when Belgium experienced unprecedented flooding, with parts of the country receiving three times the average monthly rainfall in just two days. The flooding led to evacuations, loss of water and electricity, and extensive damage, resulting in 73,802 flood claims with a total cost of €2,440.6 million (in contrast, the average annual flood claims over the previous two years was €15.3 million). The private-public coinsurance model faced significant stress, with total flood losses breaching the maximum payable by insurers and regional governments.

After lengthy negotiations, insurers paid an additional €305 million above their obligations, while the government nearly doubled its loss payments. This experience underscores the need for a more robust public-private partnership to ensure sustainability: Given the expected impacts of climate change, the maximum obligations payable by both the industry and the regional government may not be sufficient, compromising adequate compensation for future large-scale disasters.

Australia faces a growing crisis, with estimates suggesting that by 2030 approximately [4% of properties will be uninsurable, and a further 9% will face significant annual damage costs]. In response, the government expanded the Australian Reinsurance Pool Corporation's mandate to cover cyclone losses in addition to providing coverage for terrorism losses. This cyclone pool, effective from July 2022, aims to reduce insurance premiums for households and small businesses with the highest cyclone and related flood damage losses by creating a cross-subsidy between lower risk and high-risk customers, without increasing costs to lower risk consumers. The federal government has further agreed to backstop the pool with a $10 billion AUD guaranty, highlighting the need for decisive government intervention.

Closer to home, Florida and California present stark examples of the challenges faced by high-risk areas. Hurricane Ian, in 2022, caused over $65 billion USD in insured damages, leading to insurer withdrawals and increased reliance on the state-backed Citizens Property Insurance Corporation. Fourteen private insurers are in receivership in Florida, and other companies have voluntarily left the state resulting in Citizens becoming (once again) the state's largest property insurer. The Senate Budget Committee's investigation into Citizens underscores concerns about its solvency and the potential need for federal intervention in the event of a major hurricane. The situation is expected to deteriorate, as it is likely that many of the lowest-lying coastal areas of the southeastern U.S., stretching from Miami Beach north to Charleston, SC, will be subject to more frequent flood events by 2050. For Florida property owners, the increased frequency and severity of natural disasters cannot be solved by the current government interventions.

> **“In California, between 1.3 and 2 million homes are at extreme risk due to wildfire. Seven of the top twelve U.S. insurers, including Allstate and State Farm, have stopped writing new policies, and many insurers have stopped renewing existing policies, leaving consumers reliant on the state's insurer of last resort, the FAIR Plan.”**

In California, between 1.3 and 2 million homes are at extreme risk due to wildfire. Seven of the top twelve U.S. insurers, including Allstate and State Farm, have stopped writing new policies, and many insurers have stopped renewing existing policies, leaving consumers reliant on the state's insurer of last resort, the FAIR Plan. The FAIR Plan is more expensive and less comprehensive than private insurance, illustrating the inadequacy of current solutions in high-risk areas. The California Department of Insurance launched a Sustainable Insurance Strategy in 2023 (to be completed by December 2024) to allow insurers to use catastrophe models when pricing wildfire risk in an attempt to stabilize the private insurance market.

Canada can learn valuable lessons from other countries that have implemented similar programs. Belgium's experience highlights the need for a robust public-private partnership to handle large-scale disasters. Australia's cyclone pool demonstrates the importance of mandatory participation and government guarantees to stabilize the market and make insurance affordable for high-risk properties. Florida and California show the challenges of relying primarily on private markets and the necessity of a government-backed solution to ensure coverage for high-risk areas.

Flooding is Canada's biggest weather-related risk, and significant events in recent years have highlighted the urgent need for a national solution. Approximately 10% of Canadian households are highly exposed to flooding but lack access to flood insurance. The financial and emotional consequences of flooding are dire, as seen in central Canada in 2017 and 2019, southern British Columbia in 2021, Newfoundland and Labrador in 2022, and Nova Scotia in 2023. Canada's property and casualty insurance industry has been working with federal and provincial emergency management officials for over six years to develop a solution to provide residential flood protection for high-risk properties.

The federal government has recognized the need for a public-private solution, as evidenced by its Task Force on Flood Insurance and Relocation report. In 2023, Finance Canada committed seed funding to set up Canada's first National Flood Insurance Program. However, the program requires operational funding and a clear implementation strategy.

Given that the development of the program is in its infancy, consideration should be given to expanding the program's scope to protect properties at risk from other perils, such as wildfires. The Canadian insurance industry has been resilient to date partly due to high solvency standards and effective risk management practices. However, as climate change intensifies, the possibility that catastrophic events could overwhelm the private insurance market increases (especially when considering the increased likelihood of multiple events in one year). In a global examination of insurer failures, PACICC identified catastrophic risk as growing contributor of P&C insurer failures, and the primary cause of 30% of failures in 2021 and 2022. This underscores the need for a robust public-private partnership to manage such risks effectively.

> **"Federal government intervention can help reduce the protection gap and support the availability of private insurance markets in high-risk areas."**

Federal government intervention can help reduce the protection gap and support the availability of private insurance markets in high-risk areas. By sharing risks and leveraging private market capacity, the government can enhance the resilience of the Canadian insurance industry. Canadians would benefit from improved affordability and availability, enhanced market stability, protection against catastrophic losses, and encouraging risk mitigation. Government-backed programs can make insurance more affordable for high-risk properties by reducing the cost of reinsurance and spreading risks across a larger pool. Public-private partnerships can stabilize the insurance market, supporting insurers' financial health and claims paying ability. Government guarantees can provide a safety net for catastrophic losses, preventing insurer insolvency and encouraging private market participation.

As climate change intensifies, the need for more robust government intervention in catastrophe insurance markets becomes increasingly evident. Canada has been fortunate so far, but the experiences of other countries highlight the vulnerabilities and risks that lie ahead. By acting now and implementing these solutions, the federal government can safeguard the future of Canadian households against the growing threats posed by climate change. The establishment of a National Flood Insurance Program is a crucial step, but it is only the beginning. Expanding this program to cover other climate-related perils, ensuring adequate funding, and fostering strong public-private partnerships will be essential to protecting Canadian communities from the escalating impacts of climate change.

Mary Kelly, Professor, Finance and Chair in Insurance
Assurance of Learning Co-ordinator, Wilfrid Laurier University

PACICC Priority Issues: Updates

Managing Systemic Risk

PACICC has published a series of Systemic Risk studies to identify the potential threshold in total insured losses (“Tipping Point”) above which the entire Canadian P&C system would fail in its mission to protect Canadian policyholders. The first was published back in 2013. An updated version of our Systemic Risk Model was prepared in 2016, and the most recent in 2021. The 2021 study pegged the “Tipping Point” at approximately $35B in insured losses. The 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 extensive insured losses (e.g., asteroid strike, space weather, or a mega-earthquake in British Columbia or the Quebec City/Montreal/Ottawa corridor).

In its 2017 Budget, the Federal Government made an explicit commitment to address the systemic risks associated with a major quake. Since then, PACICC has participated in substantial dialogue with key stakeholders, including: Finance Canada, IBC, ICLR and Public Safety Canada. Tangible progress has unfortunately been quite limited. PACICC’s Board consequently established “Mitigating Systemic Risk” as a Permanent Priority Issue, until such time as some form of backstop mechanism is finally put in place.

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

We are also moving forward with a series of incremental measures designed to mitigate systemic risk. We recently secured regulator approval for an amendment to PACICC’s Memorandum of Operation to remove the obligation for PACICC to establish a “maximum exposure” when calculating any Special Assessment. This has been replaced with a requirement for a modernized, actuary-established “best estimate” that will help to mitigate systemic risk in the case of serial Member Insurer failure. At the direction of our Board, PACICC staff is also exploring other incremental options to address risk for the industry, including:

- **Differential Treatment of PACICC Special Assessments –** PACICC sees great Member benefit in having OSFI agree to adjust the capital treatment of multi-year PACICC obligations in its Minimum Capital Test formula. This recognizes the systemic risks of forcing Member Insurers to reflect 100 percent of their total anticipated Assessments in their accounting liabilities. We are engaging directly with OSFI on this matter. This initiative is well timed, as OSFI will be undertaking a review of the P&C sector's capital requirement formula in 2025.
- **Designation of PACICC as a "Compensation Association" under the *Federal Insurance Companies Act* –** PACICC is following up on a formal request to Finance Canada for this designation, which will make it easier for PACICC to share information and engage as a trusted counterparty, if we are formally recognized in the Act.
- **Desktop Insolvency Simulation Exercise –** In early July, PACICC will be partnering with BCFSA and other stakeholders (including OSFI, CCIR, Finance Canada, IBC and the PACICC Board) to conduct a desktop insolvency simulation exercise, examining the impact of a major earthquake and subsequent aftershock on the financial services sector in B.C., and the efficiency and effectiveness of response protocols.

Coverage and Benefits Review

Our first order of business in 2024 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 undertake a review of our coverage and benefits at least once every five years, with the next review occurring within three years (in 2023). This review was PACICC's Priority Issue in 2023 and was again shaped by 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. the appropriateness of possibly having higher limits in certain provinces to reflect higher average claim costs).

The resulting analysis provided compelling evidence that PACICC currently offers a very high level of protection to Canadian policyholders. In the event of a PACICC Member failure, roughly 98 percent of all Personal lines policyholders are protected (on average) to the full value of their claim (with the remaining two percent partially protected). The review found that PACICC limits are equally robust across all provinces. It became clear, however, that inflation had eroded PACICC benefit limits in this brief three-year period between 2020 and 2023.

Our Board recommended to CCIR that an annual inflation adjustment be included in PACICC's benefit limits for Automobile and Personal Property coverages. We committed to developing options for an alternative "hardship" claims adjudication model to address potentially significant volumes of such claims, in the event of a natural catastrophe-induced Member Insurer failure. Having secured the approval of regulators, the first inflation adjustment is scheduled for implementation on July 1. Claims limits will increase – from $500,000 to $520,000 for Personal Property policies; and from $400,000 to $415,000 for Auto policies. Claims limits for Commercial policies will be reviewed every five years.

Expanding Resolution Capabilities – PACICC General Insurance

With work on the Coverage and Benefits Review largely concluded, PACICC's focus is on a list of Board-established Key Priorities, including: engaging with OSFI and PACICC Members to establish an appropriate governance model, optimal method for capitalization and detailed approach to launching a federally-chartered "Bridge Insurer" for the Corporation (*PACICC General Insurance*).

In our comprehensive industry consultations in 2020 regarding "Expanding PACICC's Resolution Toolkit," it was proposed that PACICC consider incorporation of an OSFI-chartered "Bridge Insurer." Comprehensive follow-up discussions were held with key stakeholders in 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. It was noted that our peer organization in the Canadian life insurance sector (Assuris) had already incorporated a similar entity (*CompCorp Life*) under OSFI supervision. Assuris shared useful insights with PACICC regarding the relatively low operational costs of having this valuable asset in its resolution toolkit.

A Bridge Insurer that is specifically designed for the needs of the P&C sector could meaningfully enhance PACICC's response capabilities. The Corporation would be better positioned to serve as an effective resolution partner for regulators dealing with insurer distress, in specific but credible scenarios. This includes an insurer incurring "toxic liabilities," or situations involving any one of our industry's top-17 insurers in financial distress, where immediate liquidation would be very costly for all involved.

At the direction of our Board, we approached OSFI to discuss this possible enhancement to our resolution infrastructure. OSFI was receptive to the proposal and provided us with a "streamlined" application process. We worked last year to prepare and submit an initial draft application. Not surprisingly, OSFI responded with a comprehensive list of topics/questions (regarding governance, capitalization, legal process, information flow and operationalization) to be addressed in the following stages of its application review process. Work here is ongoing. PACICC has monthly "checkpoint" meetings with key OSFI staff to ensure timely and effective management of this comprehensive application.

This is an important initiative for PACICC, with strong capability-enhancing potential. It is clear that our industry structure is changing, with a significant trend toward consolidation. This has led to an increase in the number of Member Insurers whose financial distress could trigger a PACICC General

Assessment which, of and by itself, would cause financial distress for other Member Insurers. Rather than simple liquidation, there are scenarios now where “resolution” alternatives have become imperative.

PACICC has taken great strides to enhance its financial capacity, to make effective use of resolution powers granted to the Corporation upon its founding and to avert systemic risk to the industry. The initiatives have included: adoption of a *Resolution Protocol* in 2021; Member-approved changes to PACICC’s Memorandum of Operation (enabling us to use the Compensation Fund and other resources to fund resolution alternatives); and the addition of instant liquidity via a Standby Line of Credit facility. The addition of a Bridge Insurer mechanism represents another important step in this effort.

We will be seeking to complete the Bridge Insurer approval process by the end of the year, and undertake the necessary steps to establish this Bridge Insurer entity (subject to all regulator and Member approvals) in the course of 2025.

Enhancing our Financial Capacity – Exploring Medium-Term Capacity Options

Another Key Priority Issue for 2024 centres on Expanding PACICC’s financial capacity. We are exploring the potential for PACICC access to capital markets, for debt financing in circumstances where additional liquidity may be required beyond what is available via PACICC’s General Assessment mechanism. Both the Louisiana Insurance Guaranty Association (LIGA) and the Florida Insurance Guaranty Association (FIGA) have taken this alternative approach to secure immediate funding to address large numbers of claims caused by a cluster of devastating hurricanes.

In 2022, LIGA raised $478 million through a bond offering (rated A1 by Moody’s) that matures in 2038 with a 5 percent coupon. In the event of hurricane-related insolvencies exceeding FIGA’s assessment capacity, or the 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.

PACICC is also actively exploring the implications of securing and maintaining a favourable credit rating for the Corporation from a major rating agency (or agencies). Securing and maintaining such a rating is another low-cost option that would enable PACICC to respond to a larger number of crisis scenarios. Dialogue here is continuing with rating agencies.

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.

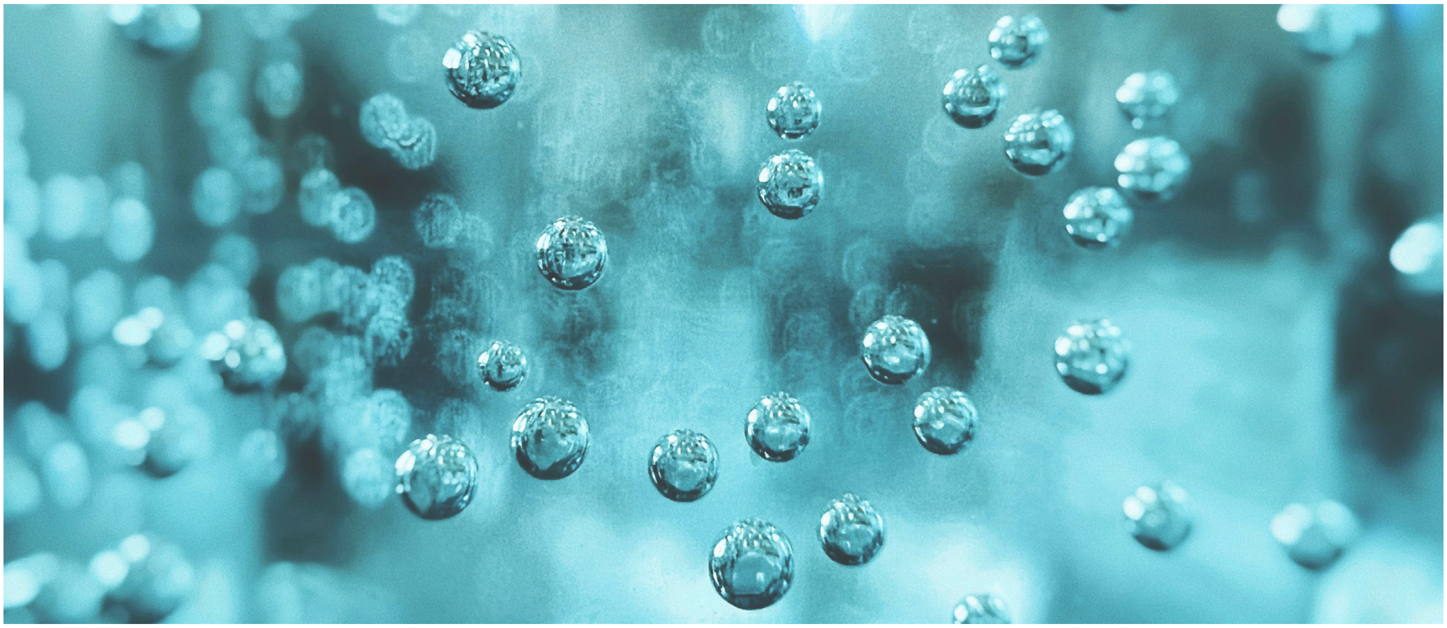
Emerging Risks Webinars

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 Date/Topic:

Thursday, October 31*
Topic: Per-and Polyfluoroalkyl Substances (PFAS)

*Please note the new date here.



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

Keynote:	**Michael George** Chief Executive Officer, Tokio Marine Canada
Discussion 1 Topic:	Third-Party Risk
Discussion 2 Topic:	Fair Treatment

Thursday, November 28

Keynote:	**Fabian Richenberger** Executive Vice-President, Commercial Insurance & Insurance Operations Definity Financial Corporation
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.

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PACICC

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