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BUILDING A BRIDGE FOR THE INDUSTRY

Building a Bridge for Canada's P&C industry

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PACICC



Problem Statement

- The types of insurer failure PACICC has successfully managed in the past are less and less likely in future...
- The next failure will likely be:
 - a much larger insurer and...
 - require substantially larger industry funding to resolve
- Insurance industry failure in Canada always managed under the federal *Winding-up and Restructuring Act (WURA)* meaning liquidation is both costly and slow
- There are now 15+ PACICC Member Insurers whose failure would require PACICC Assessments large enough to cause systemic stress

The PACICC Approach

- Invest in “low-cost optionality”:
 - failure is very rare so logic for capital-heavy pre-fund or large, fixed cost infrastructure simply not compelling...but...
 - Regulatory partners need to know we have capacity and capability to respond effectively in a crisis scenario
- Steps taken so far...
 - Board-approved “*Resolution protocol*” (enabling us to engage before failure and perhaps help avert it)
 - Pre-negotiated terms for key third-party vendors (actuarial, accounting, claims management, legal, insolvency management)
 - Tabletop simulation exercises (with OSFI and AMF)
 - Successful placement of \$250M Standby LoC (subscribed to by all six major banks)
- OSFI Superintendent challenged our Board to ensure “resolution infrastructure” properly in place...what else (if anything) have we missed?

Going back a step – What is Resolution?

“**Resolution** refers to an action taken by a resolution authority(ies) towards an insurer that is no longer viable and has no reasonable prospect of returning to viability. Resolution actions include portfolio transfer, run-off, restructuring and liquidation.” – IAIS

At our founding (in 1989) PACICC was granted these substantial resolution powers

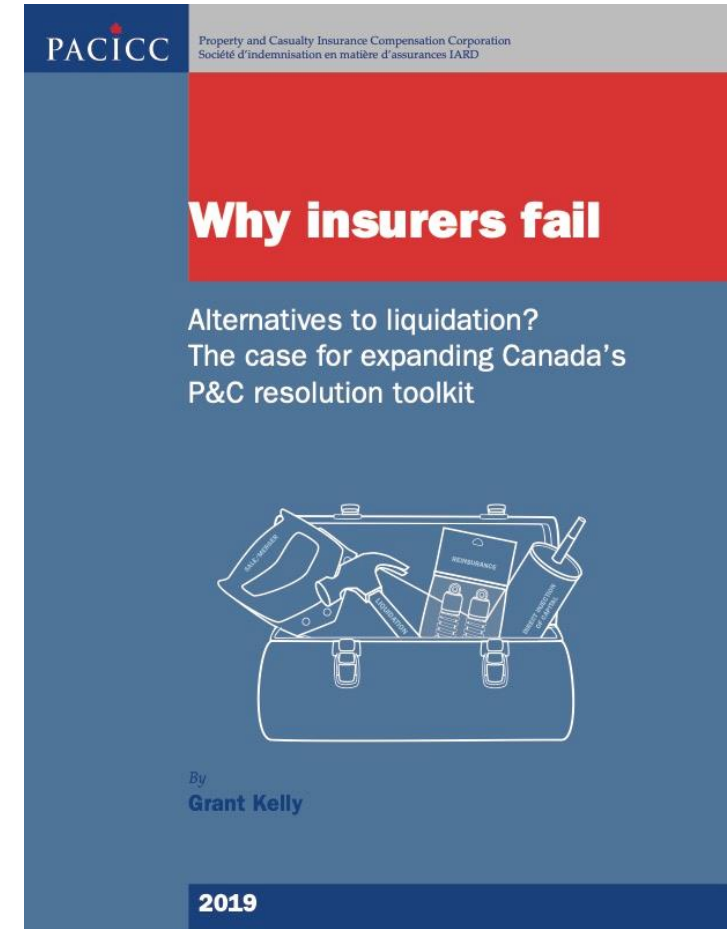
PACICC Memorandum of Operation – PART XI

The Corporation may take reasonable steps with respect to a Member in financial distress, prior to such Member becoming a Controlled Insurer or an Insolvent Insurer, **to facilitate the achievement of the Corporation's objects** with respect to such Member, **including, without limitation, the following:**

- a) assist in the sale, transfer or reinsurance of a book of business** written by such Member which is covered by the Corporation on such terms and conditions as may be approved by the board of directors of the Corporation
- b) issue guarantees or otherwise provide financial support in respect of a book of business** written by such Member which is covered by the Corporation on such terms and conditions as may be approved by the board of directors of the Corporation

In 2020, we explored use of these powers in dialogue with industry

- In 2020, PACICC's Member Insurers confirmed that they would be comfortable if PACICC pursued alternatives to liquidation under defined circumstances
- The Board approved a formal *Resolution Protocol* to clarify when the Corporation could use industry funds to avert failure of a Member Insurer
- The Protocol was successfully tested in an OSFI desktop simulation exercise in 2022



PACICC Resolution Protocol

Resolution Protocol Criteria	PIRL Committee Evaluation
STEP ONE: Is PACICC's mission at risk?	
STEP TWO: The Supervisor has determined that recovery is unlikely	
"Runway" exists	
Appropriate resources are available	
Any potential resolution action(s) can be conclusively demonstrated to be materially less expensive than liquidation	
STEP THREE: Supervisor and PACICC can both be satisfied with the governance of the troubled insurer during any transition period	
Capital providers of the troubled insurer will not benefit	

So...what, if anything, have we left out?

Assessing Canada's resolution infrastructure

- In 2020, the Financial Stability Board released a paper detailing the “Key Attributes Assessment Methodology for the Insurance Sector”
- Many of the suggested powers of a Resolution Authority are current or potential powers of Canada's regulators
- Some of those powers are within PACICC's mandate (**bolded in the following table**)

According to the FSB, a Resolution Authority should have the power to.....

FSB Power	Who in Canada has this power
Override rights of shareholders of the firm in resolution, including requirements for approval by shareholders of particular transactions, in order to permit a merger, acquisition, sale of substantial business operations, recapitalization or other measures to restructure and dispose of the firm's business or its liabilities and assets	OSFI does not have this power outside of <i>WURA</i> . As part of the 2022 simulation, OSFI communicated to PACICC that they could not force a sale
Transfer or sell assets and liabilities, legal rights and obligations, including deposit liabilities and ownership in shares, to a solvent third party, notwithstanding any requirements for consent or novation that would otherwise apply	OSFI does not have this power outside of <i>WURA</i>
Establish a temporary bridge institution to take over and continue operating certain critical functions and viable operations of a failed firm	Assuris has a bridge insurer to support resolution of a life insurer. <u>PACICC does not have a bridge insurer to support resolution of a P&C insurer</u>

According to the FSB, a Resolution Authority should have the power to.....

FSB Power	Who in Canada has this power
Establish a separate asset management vehicle (for example, as a subsidiary of the distressed firm, an entity with a separate charter, or as a trust or asset management company) and transfer to the vehicle for management and run-down non-performing loans or difficult-to-value assets	Assuris has used their bridge insurer to achieve this result for Canadian life insurance policyholders. <u>PACICC does not currently have this capability</u>
Carry out bail-in within resolution as a means to achieve or help achieve continuity of essential functions either (i) by recapitalizing the entity hitherto providing these functions that is no longer viable, or, alternatively, (ii) by capitalizing a newly established entity or bridge institution to which these functions have been transferred following closure of the non-viable firm (the residual business of which would then be wound up and the firm liquidated)	(i) Both Assuris and PACICC have the ability to provide capital, loans or guarantees to recapitalize a distressed insurer in Canada. Neither would allow industry funds to recapitalize a distressed insurer in a way that benefits capital providers or enables a distressed insurer to permanently resume activities (ii) Assuris has a bridge insurer. <u>PACICC does not</u>

The Assuris Bridge Entity – CompCorp Life

- Assuris already has a Bridge Insurer regulated by OSFI – CompCorp Life (successfully used in one of their 4 insolvencies)
- CompCorp Life has no capital at this time. OSFI has allowed the “shell” insurer to use a pledge against the Assuris Liquidity Fund (\$10M) as capital. This would quickly change if there was a failure
- CompCorp Life does minimum filings based on the *Insurance Companies Act* and supervisory monitoring requirements, including:
 - Quarterly and annual financial returns: these are sparsely populated, given that it has no ongoing business activities, effectively reflecting just administrative transactions and the balance sheet position
 - An Appointed Actuary’s Report which highlights that it has no actuarial liabilities
- Senior Assuris staff members, as well as some Board members, serve on the Board of CompCorp Life

Current “Resolution Infrastructure” – Summary

- Canada does not have a single Resolution Authority for insurers
- For P&C insurers, the powers of a Resolution Authority are shared by regulators and PACICC
- For Life insurers, the powers of a Resolution Authority are shared by regulators and Assuris
- There is only one significant gap on the P&C side...the absence of a bridge insurer capability

Filling the gap – the logic for building PACICC's Bridge Insurer capability

- Of the FSB Key Attributes, the one missing piece in PACICC's contribution to Canada's "Resolution Infrastructure" is the existence of such a "Bridge Insurer"
- Good support for PACICC Bridge Insurer in 2020 consultations on resolution – when first broached
- Strong support for PACICC Bridge Insurer in 2022/2023 Stakeholder Surveys and "Top-Twenty CEO" tours

Feedback from Stakeholder Survey (2022)

- Strong (majority) positive support for addition of Bridge Insurer to PACICC “toolkit”
 - “Makes sense”
 - “Started out hating it...but the more I think about it, the better I like the idea”
 - “Strong support for this idea”
 - “Do what you need to do to honour your mandate”
- But not unanimous...
 - “Remain open...but unconvinced it is necessary”
- One Big Idea...
 - Have Bridge Insurer Board be made up exclusively of our independent directors...and use this as vehicle for interactions with regulators
- Our Board approved an approach to OSFI regarding this topic in November 2022

Steps taken since then...

- Board approval to formally broach with OSFI (November 2022)
- OSFI responded favourably and provided “simplified application process”
- Internal work on how best to operationalize a “bridge entity” – including deep dive into other Canadian “bridge” models:
 - CDIC
 - Assuris
- Counsel retained to support our application work (Torys – including Partner who initially assisted Assuris in formation of CompCorp Life)
- Initial draft application submission submitted in early July of 2023
- OSFI response now in hand with initial round of follow-up questions
- Monthly checkpoint meetings with OSFI Approvals team to be established

Key Issues Surfaced...so far

1. Need to provide clarity on most “probable use” cases to ensure:
 - Industry alignment on the need/value of a PACICC bridge insurer
 - OSFI comfort regarding potential utilization of a charter for PACICC General Insurance (PGI)
2. Capitalization
 - Our going-in proposal is to have same terms/conditions as Assuris
 - Unclear that OSFI will grant same terms/conditions at this point
 - If activated, how would OSFI view required capital (“gone concern” vs. “going concern”)?
3. Governance
 - Our going-in proposal is to make PACICC non-Industry Directors (PIRL Committee members) the Board of PACICC General Insurance (with addition of recently retired senior industry executives)
4. Legal steps required for activation
 - How exactly can transfer/assumption be legally executed (OSFI/Provinces/PACICC/Courts)?
5. Operationalization
 - If Bridge entity actually called into service...who would manage it and how?

PACICC General Insurance Company (PGIC) – the “use cases”

- All five identified scenarios begin from the same starting point...

An insurer is in financial distress...and there is no buyer on the immediate horizon ready to assume all the assets and liabilities...even at a discount

- PGIC would:
 - Allow transfer of certain distressed assets and or liabilities to PGIC and enable continuation of policyholder coverage – and with potential to offer compensation at least to minimum of defined PACICC benefit limits
 - Provide time to manage uncertainty regarding valuation of asset/liabilities
 - Provide time to find buyer(s)
 - Enable PACICC to legally provide reinsurance (as per our By-Law) to support a transaction (e.g. adverse development cover)

1. Five Use Cases

Scenario #1

- Elements of a distressed insurer's portfolio of liabilities are “toxic” and make the sale of the total business to any outside bidder impossible, because a potential bidder interested in some/most components will be unwilling to assume these particular, and currently unquantifiable or unaffordable liabilities
- In this case, the segregation of these liabilities – via a transfer and assumption of a portion of the distressed insurer's liabilities and claims outstanding – to PGIC would enable the appropriate authorities and/or Court-appointed Liquidator to successfully negotiate for the sale of the remainder of the distressed insurer's business (similar to the concept of a “good bank/bad bank” split)

1. Five Use Cases (cont.)

Scenario #2

- Components of a distressed insurer's asset portfolio are impaired and prevent it from honouring policy obligations, but the immediate sale of these assets would be impossible or imprudent. Transferring this portion of the assets to a bridge entity would provide time to properly ascertain and secure accurate market value for these assets, to the benefit of the ultimate resolution of the entity.

Scenario #3

- A distressed insurer would be a desirable acquisition for one or more bidders, but is temporarily "unsellable" due to market-timing issues which make transactions impossible for all market players (e.g. global financial crisis). As a result, the optimal outcome for all stakeholders is the transfer of all liabilities and assets of the distressed insurer to a bridge entity temporarily, to enable more timely disposal of the business when market conditions have stabilized.

1. Five Use Cases (cont.)

Scenario #4

- The distressed insurer has accumulated policy exposures (covered by PACICC) which no other bidder is willing to acquire, and which are unlikely to find acquiritor interest even in the medium-term. Managing the portfolio in run-off through the bridge entity may prove to be the best solution in these circumstances.

Scenario #5

- Any bidder/bidders for some/all of a distressed insurer's business demand protection against downside risk, and it is determined to be appropriate for the provision of some form of financial guarantee or reinsurance (permitted under PACICC's resolution authority). The bridge entity would be the vehicle for the provision of this reinsurance protection.

2. Capitalization

- We have proposed to OSFI that PGIC be capitalized in a similar fashion to Assuris' CompCorp Life (no current capital, but formal pledge of \$10M as soon as requested)
- IF OSFI required that the new PACICC General Insurance entity needed start-up capital, where would it come from?
 - First and best option likely to be that we would transfer capital from our Compensation Fund
 - Would require change to our By-Law to avert requirement for automatic replenishment via Assessment
- Second source of capital if/as PACICC General Insurance called into action, would be our new Standby Line of Credit facility
 - Subscribers to the facility are aware of this possibility and have not ruled it out...but flexibility for PACICC to call on the LoC and transfer it to a subsidiary was not embedded in current Credit Agreement (added unnecessary complexity, delay and legal cost as facility was first initiated)
- Third source of capital would be a PACICC Special Assessment (only if Bridge entity made active to deal with actual case of distress)

3. Governance

- Going-in proposal is to populate the Board of PACICC General Insurance with members of our PIRL Committee...
 - This would enable PIRL and PGI to engage with regulators in cases of distress without engaging full PACICC Board (to ensure confidentiality)
 - PGI Board would be guided by PACICC *Resolution Protocol* in determining if appropriate to engage
 - PACICC Board would only be engaged if/when additional capital was required
- In addition, we have proposed to add a select group of retired senior industry Execs (with no conflicts)

4. Legal Steps for Activation

- All scenarios would foresee activation under the *Winding-Up and Restructuring Act (WURA)*
 - Legal analysis by Torys confirms that there is no effective scenario for utilization of PGIC outside *WURA*
 - Successful implementation will require a negotiated outcome with Courts and Liquidator under WURA – there is a special section of the Act (Sec. 162 – rarely (if ever) used) which would be employed to enable beneficial outcomes for policyholders...as long as “other creditors no worse off”
- We anticipate that rigorous evaluation of the legal implications of each scenario will be an important focus in OSFI review

5. Operationalization

- Going-in assumption is that PACICC General Insurance would be able to rely on services (IT, Finance, Claims) via Liquidator of distressed insurer – who would have access to their systems and personnel
 - This would keep run-rate costs for inactive PGIC shell to a minimum
 - Consistent with Assuris model
 - Largely consistent with CDIC model
- Important issues around how to co-ordinate with provincial/territorial supervisors when utilizing PGIC
 - Likely minor issue in case of federally supervised insurer
 - Potentially more challenging/problematic in case of provincially-supervised insurer

6. Timing/Next Steps

- Engage with OSFI through full application process...aspiration would be to complete all required steps in course of 2024... with legal activation in 2025
- Will need to secure appropriate By-Law changes (if/as required). Approval needed from Member Insurers and from provincial/territorial supervisors (must be unanimous)
- Once/if OSFI charter is granted, will then need to secure licenses in all provinces and territories

Questions/Comments/Advice

All welcome!