Lessons learned from insolvency in the Canadian P&C insurance industry

Paul Kovacs
President & CEO, PACICC

Canadian Institute for Actuaries
Toronto, June 21, 2012
Agenda

- Why insurers fail
- Protecting consumers
- Lessons learned
Survey

How many life and health insurance companies have been closed by Canada’s solvency regulators since 1979?

a) 1
b) 4
c) 13
d) 32
Survey

How many life and health insurance companies have been closed by Canada’s solvency regulators since 1979?

answer: b) 4
Survey

1992 – Les Coopérants, Société mutuelle d'assurance-vie

1993 – Sovereign Life Insurance Company

1994 – Confederation Life Insurance Company

2012 – Union of Canada Life
Survey

How many P&C insurance companies have been closed by Canada’s solvency regulators since 1979?

a) 1
b) 4
c) 13
d) 32
Survey

How many P&C insurance companies have been closed by Canada’s solvency regulators since 1979?

answer  d)  32
## Survey

<table>
<thead>
<tr>
<th>Company Name</th>
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<td>Abstainers Insurance Company</td>
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<tr>
<td>Alta Surety Company</td>
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<tr>
<td>American Reserve Insurance Company</td>
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<tr>
<td>Canadian Great Lakes &amp; Surety Company Ltd</td>
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<td>Canadian Universal Insurance Company</td>
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<td>Century Insurance Company of Canada</td>
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<td>Hiland Insurance Company</td>
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<td>Ideal Mutual Insurance Company</td>
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<td>Maplex General Insurance Company</td>
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<td>Mennonite Mutual Hail Insurance Company</td>
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<td>National Employers Mutual General Insurance</td>
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<td>Northumberland Insurance Company</td>
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<td>Orion Insurance Company plc</td>
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<td>American Mutual Liability Insurance</td>
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<td>Beothic General Insurance Company</td>
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<td>Canadian Millers Mutual Insurance Company</td>
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<td>Eaton Bay Insurance Company</td>
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<td>GISCO la compagnie d’assurance</td>
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<td>Kansa General International Insurance Co</td>
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<td>Markham General Insurance Company</td>
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<td>Midland Insurance Company</td>
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<td>Northern Union Insurance Company</td>
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<td>Ontario General Insurance Company</td>
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<td>United Canada Insurance Company</td>
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- Why insurers fail
  - Protecting consumers
  - Lessons learned
Why insurers fail

PACICC evaluated every P&C insurer forced into closure by federal or provincial solvency regulators since the 1960s.

The primary reasons why insurers failed in Canada:

* inadequate pricing / reserves
* parent fails
Why insurers fail

Number of insurers

Insolvent

Parent Failed

Source: PACICC, with data from liquidations and General Insurance Statistical Agency
Cause of failure

- reserves/pricing
- failure of foreign parent
- rapid growth
- alleged fraud
- overstated assets
- reinsurance
- catastrophes
- affiliate problems

32 Canadian P&C failures, 1979 - 2012

Source: PACICC,
Contributing factors

- reserves/pricing
- rapid growth
- failure of foreign parent
- reinsurance
- overstated assets
- alleged fraud
- affiliate problems
- catastrophes

32 Canadian P&C failures, 1979 - 2012
Why insurers fail

The primary reason why 871 insurers failed in United States:
* inadequate pricing / reserves

The primary reason why 140 insurers failed in Europe:
* inadequate pricing / reserves

The primary reason why 159 insurers failed in Asia:
* inadequate pricing / reserves
Risk of insurer failure

Insolvencies as a share of operating insurers, 1990 - 2005

Source: PACICC, with data from FSCS, Superintendent Annual Reports, A.M. Best
Why prices are inadequate

Most costs are unknown when prices are set

Pricing under duress – gambling the company

Rate regulation delinks prices and claims

Data deficiency – poor information systems

Challenge of pricing for new markets
Markham General

average auto insurance premium by period leading up to liquidation

$1,000
$750
$500
$250
$0

1 year  6 months  2 months  1 month  2 weeks  1 week

Source: PACICC
Selling discounted policies

premium growth in two years prior to liquidation

**growth in year prior to liquidation, as a new company, two year growth was 118,090%

Source: PACICC, with data from Superintendent annual reports
Gambling for survival

proportion of inadequately priced failed insurers exhibiting behaviours

- Selling discounted policies
- Reserve manipulation
- Increased management control of data
- Change in business direction

Source: PACICC
The price-claim relationship

No rate regulation

Rate regulated

Source: PACICC, with data from GISA, Private Passenger Automobile Economic Trends Exhibit
New entrants are vulnerable

Age distribution of insolvent insurance companies (Canada & U.S.)

Source: PACICC, with data from provincial & state superintendent annual reports, A.M. Best
Selling discounted policies

pricing as a proportion of the industry average

Industry Average

Markham General

Source: PACICC, with data from liquidations and General Insurance Statistical Agency
Operational risk

Decisions to enter new or unrelated business lines often lacked appropriate underwriting expertise and loss experience data.

Inadequate information and reporting processes and systems were found in 71 percent of Canadian involuntary exits linked to inadequate pricing.
Most failures follow poor earnings

Number of insolvencies

ROE (1 year lag)

Source: PACICC, with data IBC & the General Register
Catastrophe losses

points on the industry combined ratio

United States

Canada

Source: PACICC, with data from IBC & III.
Catastrophe losses

Insured losses ($ billions)

ROE

Source: PACICC, with data IBC & the General Register
Interest rate volatility

Number of insolvencies

Interest rate volatility

(standard deviation of Government of Canada 3-5 year bonds - lagged one year)

Source: PACICC, with data from Statistics Canada
Why insurers fail

- reserves/pricing
- rapid growth
- failure of foreign parent
- reinsurance
- overstated assets
- alleged fraud
- affiliate problems
- catastrophes

32 Canadian P&C failures, 1979 - 2012
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Protecting consumers

Regulation and the presence of a guarantee fund (PACICC for insurance) are the primary reasons consumers identify for maintaining high confidence in their financial institutions.

Regulation is the primary means of protecting insurance consumers for active insurance companies.

PACICC protects consumers if their insurer fails.
Protecting consumers

If the regulator loses confidence in the solvency of a Canadian insurer they will seek a court order under the Winding Up and Restructuring Act to close the company.

The court will appoint a liquidator, like Deloitte or KPMG, to manage the liquidation or restructuring of the insurer.

Insurers, through PACICC, share the cost of resolving a failure.
PACICC

PACICC protects eligible policyholders from undue financial loss in the event that a member insurer becomes insolvent.

PACICC works to minimize the cost of insurer insolvencies and seeks to maintain a high level of consumer and business confidence in Canada’s property and casualty insurance industry through the financial protection it provides to policyholders.
National protection

PACICC has about 200 member insurers
70 percent are supervised by OSFI
9 provinces supervise the other 30 percent
Lines covered by PACICC

PACICC covers consumers of the major lines of insurance:
- accident and sickness
- automobile
- boiler and machinery
- credit protection
- legal expenses
- liability
- property

But not some specialty lines like aircraft, credit, fidelity, hail, marine, surety, title …
PACICC’s coverage

PACICC pays 100% of approved claims up to:
- $300,000 for personal property
- $250,000 for all other covered lines

We also refund 70% of unearned premiums to a maximum refund of $700 per policy.

The courts determine if any funds are available to pay claims beyond PACICC limits.
Consumer confidence

Extensive adverse publicity in the 1980s

P&C failures eroded consumer confidence

PACICC was formed in 1989

Insolvencies continued but adverse publicity is gone
More fail but less media exposure

insolvency media exposure per million DWP

pre-PACICC: 6

PACICC: 0

Source: PACICC, with data from FACTIVA & ProQuest
Insurance industry in crisis as firms collapse, losses mount

By LAWRENCE WELSH

Bankrupted insurance firm leaves policy holders in air

by EUGENE MOREN

The Gazette

Montréal Thursday, July 17, 1986

Bankrupted insurance firm leaves policy holders in air

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The Gazette

montreal

Thursday, July 17, 1986

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The Globe and Mail

Monday, February 8, 1982

Reputational risk — before PACICC

Source: PACICC, with data from FACTIVA & ProQuest

The Globe and Mail

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Source: PACICC, with data from Globe & Mail, Toronto Star
Reputational risk – after PACICC

The Globe and Mail, Friday, March 10, 1995

Commission to seize Maplex

Insolvent insurer fails to raise enough money to carry on business

BY ALLAN HODGSON

The Commission to Protect Insurance Consumers (PACICC) is seeking a court order to seize the assets of Maplex Insurance Co. of Canada Ltd., which is in receivership.

The commission alleged that the company, which has been in receivership since 1994, has failed to protect the rights of policyholders.

Maplex is one of several companies that were ordered to cease operations in 1994, following a series of failed insurance companies.

The commission said it will seek a court order to liquidate the company's assets and pay policyholders.

Failing Canadian insurer shut down

A 123-year-old farm insurance company based in southwestern Ontario was ordered to close Friday by the Financial Services Commission of Ontario.

Canadian Millers’ Mutual Insurance Co. of Cambridge, was forced to cease operations after its assets dipped dramatically below $3 million.

The farmer-owned company provided insurance to feed mills and farm properties across Canada. Two-thirds of its 3,200 policyholders were in Ontario. Officers have 15 days to appeal the order.

Policyholders will be protected for policies worth up to $250,000 through the insurance industry-funded Property and Casualty Insurance Compensation Corp. Appeals can be filed to protect larger policies.

The provincial superintendent of financial services first intervened in June when the company’s monthly reports indicated assets were dropping. The company was likely hit by a combination of a large number of claims and slumping financial markets which reduced investment income, said Brian Donlevy, a Financial Services Commission spokesman.

Four employees will assist KPMG to liquidate remaining assets. The company had employed 16 workers.

The Globe and Mail

Tuesday, December 4, 2001

Failed U.S. insurer’s Canadian unit liquidated

The small Canadian branch of a failed U.S. property and casualty insurer has run into financial trouble, OSFI froze its director. At June 30, the Canadian operation in Toronto, had assets of $71 million, liabilities of $5 million and 16 employees, an

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WEDNESDAY, AUGUST 23, 1989

Advocate General claims to be paid shortly

BY ANGELA BARNES

The Globe and Mail

The 4,000 or more consumers with valid claims against failed insurer Advocate General Insurance Co. of Canada will be able to receive the money from the property and casualty insurance compensation fund.

Advocate, a small company that specialized in providing car insurance to Ontario motorists, was ordered wound up by the Manitoba Court of Queen’s Bench on July 6. It is the ninth general insurer to fail this decade, but the first to be ordered into receivership.

The Property and Casualty Insurance Compensation Corp. was named receiver in February, just around the time when rumors about problems at Advocate started circulating in the industry.

Since the winding-up order was issued, liquidity Deloitte Haskins & Sells has been going through Advocate’s books trying to determine how many claims are outstanding. Advocate filed by individuals insured by the company, it is assumed that the compensation plan will provide full and fast compensation for lost policies.

Only if the claim exceeded the amount available on the uninsured motorist coverage — at least $200,000 in Ontario — would a claim against Advocate be covered, and then the compensation plan, be possible.

Before the compensation plan was put in place, those with claims against a failed insurer had to wait for months to get their money back, frequently years, and payments were often less than the full amount.

Mr. Bethell said he has talked to a lot of Advocate policyholders who were worried that their claims would not be paid at all, but was able to reassure them that they would be paid quickly and in full, up to the $200,000 limit.

Millers’ Insurance shut to protect policyholders

8 December 2001

Guelph Mercury

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Source: PACICC, with data from Globe & Mail, Toronto Star
The role of PACICC

Oversee the liquidation of insolvent member companies (pay claims, supports liquidator in the realization of assets etc).

Monitor industry solvency trends:
- financial analysis of member insurers
- stress testing (earthquake, interest rate risk etc)

Dialogue with regulators on solvency issues:
- policy issues (insolvency clause, capital modeling)
- supervision (support identification of solvency risks)
- licensing (new entrants, market exits)
The role of PACICC

Guarantee funds are the final safety net (the supervisory system being the primary protection mechanism) for consumers in the event a financial institution fails.

Rationale for a guarantee fund system:
- protection of individual & small business policyholders
- maintenance of public confidence in the industry
- protects the reputation of surviving insurers
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Lessons learned

Inadequate pricing and reserves are the primary reason insurers fail.

Pricing is difficult due to unknown costs, rate regulation…

Insurers are most vulnerable during first 5 or 10 years.

Failure of a parent, fraud, volatile interest rates, reinsurance, and catastrophes can be contributing factors.

PACICC will protect consumers when failures occur.