



RESPONSE TO THE SECOND CONSULTATION PAPER ON THE
REVIEW OF THE FEDERAL FINANCIAL SECTOR FRAMEWORK

RECOMMENDATIONS BY THE
CANADIAN ASSOCIATION OF MUTUAL INSURANCE COMPANIES (CAMIC)

September 21, 2017

RECOMMENDATIONS RELATED TO THE SECOND CONSULTATION PAPER ON THE REVIEW OF THE FEDERAL FINANCIAL SECTOR FRAMEWORK

Executive Summary

The Canadian Association of Mutual Insurance Companies (CAMIC) commends the Federal Government for initiating a process that will lead to an in-depth review of the Federal Financial Services Legislation.

In the first consultation document leading to this review, it is mentioned (page 32) that *“A legislative framework was established in 2014 for the demutualization of federally regulated property and casualty insurers. Regulations were introduced in 2015 that outline the terms and conditions for an orderly and transparent demutualization process, providing for a fair and equitable treatment of all policyholders.”*

Ever since a request was made to establish a demutualization framework for federally supervised property & casualty (p&c) mutual insurance companies, CAMIC made representations opposing that such demutualization framework be set up. However, CAMIC added that if a demutualization framework was nevertheless to be put in place, the demutualization process and outcome should not constitute an incentive to demutualize companies and should be fair for all policyholders, past and present, as they all contributed to the financial strength of the p&c mutual insurance company.

CAMIC is of the view that the legislative and regulatory demutualization framework put in place fail to reach these goals. As a consequence:

CAMIC recommends that the p&c insurance companies demutualization framework found in the Insurance Companies Act and the regulations to the Act be repealed as they are “designed” to encourage demutualization and make it too easy to demutualize a company with only mutual policyholders.

If the government nevertheless decides to offer a demutualization framework for p&c mutual insurers, this should be done in a way that recognizes that mutual insurers have been built by many generations of policyholders. To eliminate creating an environment that encourages or makes it too easy to demutualize insurers, CAMIC recommends that the Insurance Companies Act requires the following:

- all insurance policies underwritten by mutual p&c insurers be mutual (voting) policies;
- p&c mutual insurers be allowed to demutualize only if more than 50% of all policyholders vote in favour of demutualization;
- all benefits of demutualization (essentially the surplus of the demutualizing company) be distributed to other Canadian p&c mutual insurers and/or to charitable organizations, not to the current cohort of policyholders, management and board members.

CAMIC also supports the separation between banking and insurance activities. Finally, CAMIC supports that the Department is considering how to limit the system-wide risks an extreme earthquake could pose to p&c insurers.

Canadian Association of Mutual Insurance Companies (CAMIC)

The Canadian Association of Mutual Insurance Companies (CAMIC) is a voluntary national trade association for property and casualty (p&c) mutual insurers in Canada. CAMIC members include 79 mutual insurers from coast to coast: 9 federally supervised Canadian companies, and 70 provincially supervised Canadian companies. In 2016, CAMIC member companies served 6.2 million policyholders; employed in excess of 16,000 managers, employees and agents and underwrote \$7.5 billion in premiums (16.5% of the non-government Canadian market).

The mutual insurance industry

Most mutual insurers were set up by farmers 100-175 years ago, at a time when it was very difficult for them to find insurance at a reasonable cost. They were created without share capital. Basically, each policyholder was also a member and had a right to vote at the company's annual general meeting. Mutual insurers are therefore insurance entities created by their policyholders to provide insurance products to these policyholders. This close relationship between the policyholder and the insurer allows for a better alignment between the products offered and the needs of the policyholders. A case in point, CAMIC members were among the first to offer flooding insurance to their policyholders.

The premium paid by policyholders serves to pay claims and the operating costs of the company. Any profit is either transferred to the surplus account of the company, is refunded to the members or is used for the betterment of the community. The surplus of a mutual insurer is essentially the accumulation over the years of these profits transferred to surplus. When a member stops being insured with the mutual insurer, he/she leaves behind the portion of the surplus he/she contributed. As mutual insurers are more than a century old, their surpluses have been built by many generations of policyholders.

While all policyholders of provincially supervised Canadian companies have the right to vote at their company's annual meeting, federally supervised Canadian mutual insurance companies have two policyholder structures: 1) companies where all policyholders are voting members; and 2) companies where a smaller group of policyholders are voting members. Historically, the difference in policyholder structure was the result of provincial restrictions on the types of coverage and related conditions that could be applicable in every province. Over time, these restrictions and conditions have been eliminated. Further, for the last 70-80 years, the effective elimination of the need/possibility to call on the premium notes has made it archaic to maintain a dual policyholder structure.

In response to a request by one (two classes of policyholder) federally supervised mutual property & casualty insurance company to put in place a demutualization process, the Federal Government adopted two separate demutualization regulations:

- the *Mutual Property and Casualty Insurance Company Having Only Mutual Policyholders Conversion Regulations*; and
- the *Mutual Property and Casualty Insurance Company with Non-mutual Policyholders Conversion Regulations*.

Under the *Mutual Property and Casualty Insurance Company with Non-mutual Policyholders Conversion Regulations*, the mutual and non-mutual policyholders are called upon to negotiate the sharing of the company's value.

CAMIC is of the view that the *Mutual Property and Casualty Insurance Company with Non-mutual Policyholders Conversion Regulations* do not meet the criteria of *promoting the fair and equitable treatment of policyholders* as:

- it fails to recognize the contribution to surplus made by past generations of policyholders; and
- it is utopic to believe that the two classes of policyholders negotiating the sharing of the company's value have the same negotiating powers/skills and are supported equally by the demutualizing insurer who has created and maintained these two classes of policyholders

In the *Mutual Property and Casualty Insurance Company Having Only Mutual Policyholders Conversion Regulations*, the government unintentionally makes it possible for a small group of self-interested individuals to initiate and complete the process of demutualizing a company.

The policyholder is not a shareholder

Mutual insurers have no stockholders. The company succeeds over time to build a healthy surplus by constantly charging an appropriate premium in relation to the risk transferred to the company. In particular, profits, if any, are used to build a level of surplus that allows the company to accept more risks. When a policyholder stops doing business with a mutual insurance company, he/she leaves without cashing its share of the surplus it has built. The surplus of the company is indivisible and is therefore kept by the company for the benefit of future generations of policyholders.

One could argue that, if policyholders of Permanent Life Insurance policies offered by mutual life insurance companies were determined to be the rightful and deserving recipients of their company's surplus upon demutualization, so should the policyholders of p&c mutual insurance companies. However, CAMIC contends that there are major differences between the two types of policyholders. A whole life insurance policy is most often renewed year after year by the policyholder for the duration of his life; it is a form of financial investment that is expected to generate a return on investment dependent on the duration of the life of the policyholder with the final payment being predetermined. The policy incorporates an accumulation in value (the cash surrender value) - the policyholder's contributions are accumulated and recorded and can be considered as that policyholder's assets.

By contrast, a p&c insurance policy lasts one year and is a form of risk management; not an investment. There are no continuing rights for a p&c mutual policyholder once a policy has expired. Therefore, while a

policyholder of a life insurance company has accumulated value in the company, the policyholder of a p&c insurance company, be it a stock company or a mutual company, does not build an accumulated value in the company. The premium income from the entire policyholder base serves to pay the losses of the few.

The absence of shareholders means that policyholders own, as a group, the company while they are mutual policyholders. The surplus of the company is indivisible. The policyholders' "individual ownership" in the company is not tradable or exchangeable and cannot be transferred from generation to generation. The ownership expires at the time the insurance policy expires. CAMIC believes that a particular generation of policyholders, management and board members should not be allowed to access the surplus that has been built unselfishly by many successive generations of policyholders.

Recommendation: Stop the circle of self interest

Arguments in favour of demutualizing a company brought up by a company's board of directors/management often mirror the fact that policyholders stand to gain substantial sums of money if they concur to demutualize their company. CAMIC contends that for policyholders, it is this cash receipt that makes it so attractive to demutualize. For management and Board members, we believe that it is the much higher compensation, the prospect of stock options and/or the significant pay-outs at the time the company is taken-over that make demutualization so attractive. If demutualization was only for the good for the company itself, all the entities involved should agree not to receive a personal financial benefit upon demutualization, especially not a small minority of policyholders sharing the value of the whole mutual insurance company accumulated over many generations of policyholders.

What CAMIC asks for is consistent with demutualization legislation in-force in Quebec. Indeed, in Quebec the dissolution of a cooperative is taken care of by section 185 of the Quebec Cooperative Act which prescribes that: "... *After these payments and remittances, the balance of the assets is vested by the Assembly of members in a cooperative, a Federation, a Confederation or the Conseil de la cooperation du Quebec by a resolution adopted by a majority of the votes cast.*" In other words, the reserve of the cooperative cannot be distributed amongst members of the cooperative nor be reduced through refunds to members. It is not by chance that Quebec has a strong cooperative, credit union and mutual insurance sector. Quebec government legislation, regulation, policies and financial support towards the cooperative, credit union and mutual insurance sector ensure that this form of ownership flourishes in an environment that concentrates on the success of stock companies.

Again, CAMIC recommends that the p&c insurance companies demutualization framework found in the Insurance Companies Act and the regulations to the Act be repealed as they are "designed" to encourage demutualization.

If the government nevertheless decides to offer a demutualization framework for p&c mutual insurers, this should be done in a way that recognizes that mutual insurers have been built by many generations of policyholders. To eliminate creating an environment that encourages/or makes it too

easy to demutualize p&c insurers, CAMIC recommends that the Insurance Companies Act requires the following:

- all insurance policies underwritten by mutual p&c insurers be mutual (voting) policies;
- p&c mutual insurers be allowed to demutualize only if more than 50% of all policyholders vote in favour of demutualization;
- all benefits of demutualization (essentially the surplus of the demutualizing company) be distributed to other Canadian p&c mutual insurers and/or to charitable organizations, not to the current cohort of policyholders, management and board members.

CAMIC supports a principles-based approach to regulation, a size-based ownership regime for financial institutions, and a separation between banking and insurance activities.

CAMIC supports that studies be done on how to limit the system-wide risks an extreme earthquake could pose to p&c insurers. CAMIC also supports that the FCAC be asked to improve consumer education products related to catastrophic risk and insurance to develop consumer awareness of insurance products and consumer rights and responsibilities.