RECOMMENDATIONS WITH RESPECT TO THE REVIEW OF THE FEDERAL FINANCIAL SECTOR FRAMEWORK

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311 McArthur, Suite 205, Ottawa ON K1L 6P1, Tel : 613.789.6851, Fax : 613.789.7665, www.camic.ca

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FEDERAL FINANCIAL SECTOR FRAMEWORK

Executive Summary

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

In the 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 the issue of establishing a demutualization framework for property & casualty (p&c) mutual insurance companies has surfaced, CAMIC has made representations to indicate that it is against setting up a demutualization framework. However, CAMIC added that if a demutualization framework was to be adopted anyway, then would ask that such demutualization rules not constitute an incentive to demutualize companies and be fair for all stakeholders, including past generations of policyholders.

CAMIC is of the view that the two sets of demutualization regulations subsequently put in place (2015) fail to reach these goals.

CAMIC recommends that the p&c insurance companies demutualization framework found in the Insurance Companies Act and the regulations to the Act be repealed. While CAMIC is against putting in place a demutualization framework for p&c insurance companies, if the government nevertheless adopt such measures, CAMIC then recommends that the Insurance Companies Act incorporates the following measures:

- **all insurance policies sold by a mutual p&c insurer be mutual (voting) policies**;
- **a company be demutualized only if more than 50% of all policyholders vote in favour of demutualization**;
- **benefits of demutualization (the surplus of the demutualizing company) should be distributed to other Canadian mutual insurers and/or be distributed to charitable organizations, not to policyholders, management and board members.**

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 83 mutual insurers from coast to coast: 8 federally supervised Canadian companies, and 75 provincially supervised Canadian companies. In 2015, CAMIC member companies served 5.8 million policyholders; employed in excess of 16,000 managers, employees and agents and underwrote $6.0 billion in premiums (13.8% of the non-government Canadian market).

There are 94 mutual insurers operating in Canada, basically a third of the about 276 property & casualty (p&c) insurers competing on the Canadian market - 87 federally supervised Canadian companies, 74 federally supervised foreign companies and about 115 provincially supervised Canadian companies.

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, or simply difficult to find insurance. The mutual insurance companies they created are almost exclusively governed under the "one person, one vote" principle where all policyholders have a right to vote. Since their origin, policyholders have been electing their company's Board of Directors and have been adopting the major strategic orientations of their company. Having no shareholder to take care of, mutual insurers have been instructed by their policyholders to develop products and levels of services adapted to their own needs. Further, consistent with their origin, most mutual insurers are still today headquartered in rural and semi-rural Canada, creating jobs locally and playing a significant role in the development of their communities and in the support provided to local charities.

Canadian-owned insurance companies now represent 57% of the Canadian insurance market. For its part, the mutual insurance sector is almost exclusively comprised of Canadian-owned companies. The insurance provided by mutual insurers has been recognized over the years as being very stable and as forming an essential component of the Canadian insurance market outside large urban centres. Mutual insurers provide competitively priced products at cost and effectively contribute to economic growth. Having no stockholder to serve, mutual insurers can better demonstrate their commitment to protecting the interest of consumers (their members).

While 100% of policyholders of provincially supervised Canadian companies have the right to vote at the annual meeting of their company, federally supervised Canadian mutual insurance companies have two policyholder structures: 1) companies where all policyholders are voting members – 6 companies; and 2) companies where a smaller group of policyholders are voting members – 3 companies. 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 collect on premium notes has made it archaic to maintain a dual policyholder structure where a very small proportion of the policyholders are voting members.

In response to a request by one federally incorporated mutual insurance company to demutualize, the Federal Government adopted the following regulations:

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

According to federal government documentation, *"The stated objectives of this regulatory framework are to provide p&c mutuals with the ability to demutualize into a stock company through a process that is orderly and transparent, while promoting the fair and equitable treatment of policyholders".*

In the Mutual Property and Casualty Insurance Company with Non-mutual Policyholders Conversion Regulations, the government seems to have recognized that giving a very small number of voting policyholders the right to be the only recipients of their mutual insurance companies surplus or sales proceeds would be scandalous and would likely offend the non-voting members who were never offered the right or given the opportunity to have a voting policy and were not even made aware of the existence of two classes of policy (voting and non-voting) and the differences between the two types of policies.

However, the government did not go as far as eliminating the non-mutual policies and therefore decided to put in place two sets of demutualization regulations, including a demutualization regulation whereby non-mutual policyholders would negotiate with the mutual policyholders what portion of the company's surplus (or sales proceeds) they would respectively be getting.

The risk incurred by a participating policyholder

It may be argued that "participating policyholders" or voting members of the small voting base mutual insurers have, many years ago, signed a promissory or premium note to provide additional funds to the company if called upon by the company's Board of directors and that there is a financial risk associated with these participating policies, risk that deserves to be compensated. However, the risk was minimal considering the value at stake. Further, considering that the last time a Board of Directors called on a promissory note was in the 1930s, these notes should have been eliminated many decades ago. Further, federally regulated insurers have for many decades been closely supervised by the Office of the Superintendent of Financial Institutions (OSFI) and are members of the Property and Casualty Insurance Compensation Corporation (PACICC). In effect, "participating policyholders/mutual policyholders/voting policyholders" of small voting base mutual insurers take no additional financial risk than non-voting members but nevertheless share the right to direct the destiny of their company. No mutual insurer has ever failed since PACICC has been put in place. Therefore, the only effective difference between a participating/voting/mutual policyholder and a non-participating/non-voting/non-mutual policyholder of a small voting base insurer is that the former has the right to vote and not the latter.

The policyholder is not a shareholder

Over the last 175 years, insureds joined mutual insurance companies with the objective of having access to insurance, of participating in the decision-making process with respect to the types of products and the level of service to be offered to policyholders and also with the objective of contributing to the betterment of their community; not with the objective of demutualizing their company. When a policyholder stops doing business with a mutual insurance company, he or she does not leave with a portion of the company's surplus, even though he or she contributed to creating it; 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 whole life 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 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.

While mutual policyholders in a p&c company vote at annual meetings and are allowed to refunds when a distribution is declared by the board of directors, the insurance policy does not provide the mutual policyholder with an ownership of the underlying equity of the company or a right to demand distribution of a portion, or of the entire, surplus of the company. The absence of shareholders in the case of mutual p&c insurance companies should not be interpreted as giving mutual policyholders an ownership interest in the company.

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. A particular generation of policyholders should not be allowed to access the surplus that has been built unselfishly by many successive generations.

Recommendation: Stop the circle of self interest

Arguments in favour of demutualizing a company brought up by a board of directors/management of a company that contemplates demutualization mirror the fact that policyholders stand to gain substantial sums of money if they concur to demutualization. For policyholders, it is this cash receipt that makes it so attractive to demutualize. For management and Board members, 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. If demutualization is portrayed to be good for the company itself, all the entities involved should not receive a personal financial benefit for demutualizing their company, especially not a small minority of policyholders sharing the value of the whole mutual insurance company accumulated over many generations of policyholders.

CAMIC is strongly opposed to advisors, board of directors, management and policyholders withdrawing substantial financial benefits from the demutualization of mutual insurance companies, as we believe that the distribution of the current value of the mutual entity creates a "circle of self interest" amongst stakeholders that is one of the most significant drivers of the process.

What CAMIC asks for is consistent with legislation on the demutualization of co-operatives 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.

CAMIC recommends that the p&c insurance companies demutualization framework found in the Insurance Companies Act and the regulations to the Act be repealed. While CAMIC is against putting in place a demutualization framework for p&c insurance companies, if the government nevertheless adopt such measures, CAMIC then recommends that the Insurance Companies Act incorporates the following measures:

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