PACICC

November 15, 2016

Mr. Glenn Campbell
Financial Institutions Division
Financial Sector Policy Branch
Department of Finance Canada
James Michael Flaherty Building
90 Elgin Street
Ottawa, Ontario, K1A 0G5

Re: Consultations to Review the Federal Financial Sector Framework

Dear Mr. Campbell:

Thank you for the opportunity to participate in consultations regarding the Federal Financial Sector Framework. We share the view that it is important for the Government of Canada to regularly review the legislation guiding the activities of the financial sector. We welcome this opportunity to identify two issues that PACICC believes should be included in the current review – preparedness for a catastrophic earthquake and modernization of the *Winding-Up and Restructuring Act (WURA)*.

PACICC recommends that the Financial Sector Review include an examination of the ability of Canada's financial sector to manage the risk of loss and damage due to a catastrophic shock, like a major urban earthquake. This examination should include a review of *WURA* to remove some critical shortcomings in Canada's resolution framework.

Research by PACICC finds that Canada's insurers are ready to respond (with no impact expected on the solvency of well-run healthy insurance companies) to a disaster resulting in insurance claims of up to $25 billion. This is five-times larger than any event ever experienced in Canada. This level of preparedness is the result of the responsible approach taken by insurers to manage the risk of loss from disasters, and the most stringent regulatory system in the world for the management of earthquake exposure by insurers.

While the insurance industry would be severely distressed, it appears ready to play its role in paying claims from a larger event with insured losses between $25 and $35 billion. This indicates a level of preparedness that exceeds regulatory requirements. However, an earthquake of this magnitude would likely cause some insurers to become insolvent. At this level of disaster, Canada's insurance industry would experience significant problems with timely payments of all claims made by eligible policyholders.

An earthquake resulting in insurance claims exceeding $35 billion is very unlikely, but possible. We believe that it has the potential to overwhelm the capacity of Canada's insurance industry. Multiple insurers would be distressed and could fail, including smaller regional insurers and large national insurers. Following a catastrophic earthquake, many insurers could have a significant liquidity problem. PACICC was not designed to protect insurance consumers from this level of catastrophic loss, and if it was to apply regular procedures, there could be contagion.

PACICC is eager to partner with Finance Canada and other stakeholders, like the Insurance Bureau of Canada, to develop a plan setting out how Canada will respond to a catastrophic event.

WURA provides the resolution framework for insurers experiencing financial distress and insolvency. This legislation has been largely unchanged for more than 100 years. It does not, for example, anticipate a catastrophic event like a large urban earthquake. Moreover, this federal legislation does not presently facilitate the desire of many provinces to use a common national resolution framework. In addition, *WURA* has not been modernized to include changes made in the legislation governing bankruptcy resolution in other sectors.

PACICC believes that *WURA* should be included in the ongoing regular review of the financial sector framework. Since PACICC was established in 1989, we have successfully protected the interests of thousands of insurance consumers whose insurers have failed based on direction provided by *WURA*. The process of liquidating a failed insurer can take 15 to 20 years to complete, and is expensive to administer. These costs are borne by the insurance industry, and ultimately added to the cost of insurance.

PACICC has identified a number of minor reforms that would lessen the time required to liquidate a failed insurance company and reduce the administrative costs. In addition to these changes, PACICC believes that *WURA* should be reformed so it can be applied to federal and provincial financial institutions that fail in Canada.

Moreover, PACICC would like to liaise with Finance Canada about the potential role it could play in the management of the response to a catastrophic event. Modifications of powers given to PACICC in 1989, perhaps reinforced by changes in *WURA*, could establish a framework that would enable the Government of Canada to create a mechanism to support distressed insurers. For example, research has shown that there could be dozens of otherwise healthy insurers that would struggle with severe capital and liquidity problems if an earthquake strikes in Canada that is more severe than anticipated by current regulations. In this scenario, systemic financial contagion could kick in, triggering a chain of insolvencies within the P&C insurance industry and across the financial services sector.

PACICC believes that a federal emergency last-resort backstop for catastrophic risk is urgently needed in order to prevent the risk of contagion and ensure the stability of the insurance and financial sector. Similar to the banking industry, a mechanism could be designed that would enable the federal government to flow funds through an industry guarantee fund (PACICC) to prevent the scale of insurer failures from becoming “too big”, hence addressing contagion risk and protecting insurance consumers.

Best regards,

Paul Kovacs
President & CEO

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