Property and Casualty Insurance Compensation Corporation
Société d'indemnisation en matière d'assurances IARD

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M^e^ Anne-Marie Beaudoin
Director, Secretariat
Autorité des marchés financiers
800, square Victoria, 22nd floor
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Montréal (Québec) H4Z 1G3

Dear M^e^ Beaudoin,

PACICC is pleased to comment on l'Autorité des marchés financiers proposed reinsurance risk management guideline.

As Canada's national guarantee fund, PACICC brings a unique perspective to the discussion on reinsurance – that of role of reinsurance in the winding-up and liquidation of P&C insurance companies. The observations and positions outlined in this letter reflect PACICC's experience with reinsurance in liquidation.

Reinsurance is an important risk management tool for the insurance industry and its policyholders. This 'insurance for insurers' diversifies the risks assumed and permits a more efficient use of capital. Reinsurance can be a valuable mechanism to lower an insurers' risk of insolvency by stabilizing loss experience and enhancing a company's resilience to shocks.

In Canada, reinsurance has been instrumental in supporting the solvency of insurance companies. For example, the 1998 ice storm – Québec's most expensive natural disaster – was a major financial and operational challenge for the insurance industry yet there were no insurers that experienced financial distress. In large part this was due to the significant role of reinsurance in the insurance industry's response to this event.

The experience of significant benefits from reinsurance can also bring risk and dependency for insurance companies. Canadian insurers actively use affiliated, unaffiliated, registered and unregistered reinsurance. The risk that expected arrangements are not realized must be managed. Moreover, it is natural that solvency supervisors and other parties, like PACICC, are keenly interested in reinsurance arrangements.

PACICC is responsible for protecting policyholders from undue financial hardship in the event that a member insurer becomes insolvent. We support actions that reduce the risk that a member insurer may fail, and that improve the liquidation process.

Universal to PACICC's views on reinsurance, are the following considerations.

- reinsurance is a large asset for most insurers and the largest asset for some insurers. L'Autorité's mandate to monitor the financial health of insurance companies and protect policyholders should include supervising the use of major risk management tools.

- reinsurance represents a material credit risk for most insurers, a risk that must be managed and supervised. Reinsurance credit risk is low in the majority of cases, but there are important differences among reinsurers, and in some cases the risk of default is material.
- uncollectible reinsurance, in the rare circumstances of an insurance company failure, is a cost of providing protection of policyholders that will be passed on to the insurance industry if it is not recovered from the appropriate reinsurers. Insolvency clauses and other actions to ensure clarity in reinsurance arrangements in liquidation benefit policyholders, liquidators and insurers.

In November 2008, PACICC released an issue paper reviewing the role of reinsurance in relation to insurer insolvency and liquidation. This research demonstrates that credit risk challenges related to reinsurance programs were one of the factors that contributed to 26 percent of Canadian insurance company failures over the past 50 years. Moreover, securing reinsurance recoverables was an issue for 100 percent of the insurance wind-ups over this period. As a result, a key theme that arose out of PACICC's research was the importance of insurer risk management and the inclusion of an insolvency clause to minimize the risk of difficulties associated with the collectability of reinsurance recoverables when an insurer is involuntarily wound-up in liquidation.

Overall, PACICC believes that this guideline embraces best international supervisory practices and we strongly support Québec's leadership in outlining expectations for managing reinsurance risk and in particular, that insurers should:

- consider the conditions to be included in reinsurance agreements, such as the insolvency clause (page 11, fourth bullet)
- establish a contingency plan in the event reinsurance coverage is lost due to new market conditions or a reinsurer's insolvency (page 11, sixth bullet)
- carry out a proper legal review of the agreement clauses, particularly the insolvency clause (Page 12, fifth bullet).

Further, while PACICC understands that this guideline focuses on the risk management framework, we recognize that the capital framework is an important consideration when considering contract clauses such as the insolvency clause. Given both international and Canadian insolvency experience, PACICC recommends that only reinsurance arrangements with an appropriate insolvency clause should be recognized as allowable assets in the capital tests monitored by insurance solvency supervisors.

I remain available to discuss with you and your colleagues these comments and the findings from our ongoing insolvency research program.

Best regards,

Paul Kovacs
President & CEO