

Address by

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While I am very proud of both of my hats, for the next few minutes allow me to proudly be la surintendante de l'encadrement de la solvabilité de l'Autorité des Marchés Financiers.

Our last 12 months have been very productive and I would like to take the opportunity to focus on some of our initiatives:

1. Our climate change survey;
2. Our participation in the revision of the B-9 guideline;
3. Our work on a plain language automobile insurance policy;
4. Our commercial practices guideline;
5. Our work with IAIS;

We all know that climate change is one of the most serious environmental problems the world is currently facing.

As mentioned last year, as a responsible regulator desirous of contributing to the various initiatives in this area, l'AMF undertook to survey P&C insurers carrying on business in Québec by means of a 10-item questionnaire. The stated objective was to determine the extent of insurers' understanding, their appreciation of this particular risk and the measures, if any, they were taking in order to manage it.

I am pleased to give you a scoop and share with you a preview of our findings and some of the conclusions we have drawn from the responses received.

Allow me first to take a few minutes to properly establish the context.

The industry in general has always been concerned by meteorological swings and the damage they cause. They have dealt with them in the traditional manner and continue to do so with a variety of tried and tested measures:

- premium increases;
- more restrictive selection and underwriting criteria;

- more limited and better targeted products;
- geographic diversification;
- mapping;
- Reinsurance;

and the like.

I have no doubt that this is old news to you. Nor will you be surprised if I tell you that these extreme meteorological phenomena, once exceptional occurrences, are increasingly frequent and destructive.

Not only do they seem to have become the norm in certain regions of the world, but their increasing incidence appears to be accelerating. Witness the severe flooding that struck the Montérégie region of Québec this past May.

Our task should not be to debate the causes of this acceleration, but rather to ensure that the industry takes this phenomenon into account.

You are in the best position to ascertain the impact of these climatic disturbances on the insureds and on their own financial health. Our objective is to get you to tell us what you see from your privileged vantage point!

In a few days, I will have the pleasure of participating in the upcoming meeting of the United Nations Environment Program Finance Initiative Task Force which did publish a report in 2009 following a wide-ranging investigation that sought to understand and incorporate environmental factors – such as climate change – as well as social and governance factors into the underwriting and creation of insurance products.

I believe this will be a unique opportunity to see where we stand in this regard with respect to the rest of the world.

Let us now turn to our findings, beginning with a word or two about the methodology used and the response rate.

Although we were well aware that a number of insurers might not be directly affected by climate change, we nevertheless chose to send our survey – an optional survey if I may point out – to all insurers authorized to carry on business in Québec.

We opted for this approach as the primary purpose was to establish not only a qualitative profile but also how the industry tackles the issue and the extent of their preoccupation.

Out of all the personal property insurers in Québec, 31% answered the questionnaire. They do cover more than 61% of the market, and if we include responses from reinsurers affected by the issue, we consider that the quality and diversity of responses provide a fairly accurate picture of the situation.

Moreover, had it not been for the lack of response from two major groups of insurers, the rate would have been close to 75%.

Without hypothesizing on the reasons for the lack of participation of these major players, as well as a few other smaller ones, we believe they are indicators of the relative novelty of the issue and the uncertainties that surround the risk it represents.

Although severe bad weather, floods and water damage are now a more common occurrence, it appears, insurers still generally approach them in the traditional manner.

Within the next few weeks, we will be publishing the principal observations and conclusions from our analysis but, as promised, here is a general preview:

- Looking at the answers as a whole, we noted a very broad spectrum of perceptions and approaches with respect to this issue. Climate change risk is generally admitted, whether quite directly or indirectly. Moreover, the attitudes

noted run the gamut from an almost total wait-and-see approach to exemplary proactivity.

- Most insurers have integrated climate change into their risk management plan and have taken it into account when formulating their strategy. From among those at the forefront of this group, the emerging risk of climate change has a formal place within their governance structure. However, and this is the case for a majority of them, climate change is perceived and handled first and foremost in a traditional manner, as an event of a catastrophic and repetitive nature. Within the other group, the matter is quickly shrugged off insofar as the insurers in question rely on reinsurance cover already considered sufficient (for example: earthquakes).
- While certain respondents indicated their reliance on the traditional tool of catastrophe reinsurance to protect themselves against this risk, they admitted, paradoxically, that the risk threatens their profitability rather than their solvency.
- The insurers surveyed did not take into account the impact of climate change on their investment strategy.
- With the occasional exception, insurers seem to be relying on industry associations to initiate measures to manage this risk. Many of them discuss the issue, but few truly involve their partners in order to examine the issue and take concrete action.
- Based on the responses obtained, it is difficult to determine whether the models used by insurers are tailored to deal with the real nature of severe bad weather such as experienced in Québec. For example, certain insurers mentioned the use of existing models in order to estimate the incidence of hurricanes, tornados and windstorms, although their principal risks relating to water damage originate mainly from other sources.

- With respect to the two questions relating to greenhouse gases and sustainable development, we noted that most insurers have made commendable efforts. However, one may question whether, in certain cases, these actions are intended to improve the insurer's image, without having any short or medium term effect on reducing the impact of climate change or on the sustainability of the insurance sector. With a few exceptions, insurers do not seem to be making as much of an effort to adapt or respond to the immediate effects of climatic risks.
- Lastly, when asked to express their level of concern as compared to the previous year, only two respondents indicated they were more concerned. It is interesting (and perhaps alarming!) that the two insurers who indicated a greater concern are among those who are actively monitoring the issue.

The role of insurance companies in the coming years will no longer be limited to covering the damage resulting from disasters; they will also be required to participate in prevention, by more thoroughly monitoring the adequacy of infrastructures in light of the standards in effect, by excluding or penalizing zones with the highest exposures and by calculating appropriate premiums.

Regulators will also have to establish a prudential legal and regulatory framework that takes these risk factors into account. The framework will have to be prudent, efficient and effective and allow for innovation. In this regard, we will continue to cooperate with industry members so as to target the necessary measures to better cope with extraordinary occurrences.

Along the same lines, I would like to take the opportunity to inform you about the latest developments with respect to the guidelines regarding earthquakes.

In May 2009, following a request from the OSFI, the Insurance Bureau of Canada issued a number of recommendations for revising federal Guideline B-9 relating to earthquakes. A year later, the AMF partnered with the OSFI and other industry stakeholders (IBC, ICLR, insurers, reinsurers and brokers) to establish a working group on the subject.

The working group's mandate is three-fold:

- Recommend changes to the OSFI (and AMF) guidelines which, it bears reminding, date back to 1998;
- Consider all other matters relating to this issue, as appropriate;
- Contribute to an IBC study to establish the maximum likely loss that would result if a major earthquake were to occur in an urban setting. However, this last objective has been postponed due to a lack of resources.

The working group's efforts are nonetheless well underway and are continuing in 2011. The OSFI's initial objective is to publish a consultation document in the fall of 2011 and to implement changes as of December 31, 2012. While this date may seem ambitious, it currently remains the target date.

I would now like to move on to a less "hazardous" topic I think...the Quebec Commercial Practices Guideline.

As a consequence of the recent financial scandals that have rattled the business world, regulatory bodies, governments and the public alike are now more keenly interested in an institution's commercial practices, ethical conduct and integrity.

In addition, many international organizations, including the International Association of Insurance Supervisors (IAIS), the Joint Forum and even the Organisation for Economic Co-operation and Development (OECD), are revising or planning to revise or develop key principles that foster sound commercial practices and protect consumers' interests.

As you know, the AMF is the first Canadian regulator (some say the first North American one) to put in place a framework on Market Conduct (or Commercial practices in Québec) which is focussed on Fair Treatment of Customers.

In our view, ensuring adequate consumer protection and information builds confidence in the industry, which in turn leads to greater market discipline and effectiveness.

In the proposed guideline, the fair treatment of consumers is approached from the perspective of the need for institutions to manage their reputational risk with a holistic approach.

A first consultation with the industry took place from November 2009 to March 2010. We received many comments and reactions from various actors, from which we identified the major irritants, but also possible misunderstandings or misconceptions.

We then decided to review the initial draft of the Guideline and a second draft was issued for industry consultation from March 11 to April 22, 2011.

This second version of the guideline also responded to changes in core principles and the sound commercial practices orientations of international bodies (mainly IAIS ICPs 18 (Intermediaries) and 19 (Conduct of Business)).

The major change for the insurances industry is that the new version no longer covers insurer's distribution activities per se (for example, advice), since the very act of advising customers is reserved for representatives, as set out in the Distribution Act.

To avoid confusion, the revised version of the guideline focuses on the responsibilities of insurers in their capacity as **manufacturers**, not **distributors**.

Therefore, it was decided to withdraw the distribution of insurance products from Part A of the guideline.

However, it is very important to note that insurers are not relieved of their responsibilities. They must monitor the risks associated with the distribution of their products, particularly as such monitoring is part of reputational risk management.

As for other changes from the initial version, the AMF set out its expectations regarding information for consumers and product advertising, and added its expectations about the management of overall compensation strategy incentives.

We are still going through the numerous comments received during the second consultation. We expect to finalise our work in the coming weeks and hope to have a final draft by summer's end.

I fully understand that the implementation of such a new and unique framework may cause some worries within the industry. Especially that for many of you, it will be your first "real" experience with the AMF.

But as with our other guidelines, a transition period will be granted after the guideline on commercial practices comes into effect.

This transition period is intended to enable institutions to adopt the expectations set out in the guideline and, in doing so, develop the strategies, policies and procedures necessary to enable them to adequately address the AMF's expectations to ensure full implementation of the guideline.

Since transparency is for us the key for a smooth implementation of such an important framework, if the industry as a whole, or individual insurers, need to have more input or explanations from the AMF during the transition period, my Directors will be available to meet and discuss with you in a forum of your choice.

Remember that every jurisdiction where you do business will have to put in place such a framework after the adoption of the IAIS ICPs 18 (Intermediaries) and 19 (Conduct of Business). See the fact of having the AMF being one of the first regulators to this date to put in place a framework on commercial practices as an opportunity, not a burden

If I may, I would now like to turn to another topic that is I hope of as much interest to you as it will be to consumers: a plain language automobile insurance policy.

Over the past few months, work was begun, in collaboration with the *Groupement des assureurs automobiles* (“GAA”), with a view to revising all automobile insurance policy forms so as to make them more comprehensible to all insureds.

Various committees were created, with members comprised of GAA representatives, industry representatives and AMF representatives, for the purpose of redrafting existing forms in plain language.

Given that automobile insurance coverage protects over five million vehicle owners, there is no doubt that this significant task will satisfy the needs of consumers who will benefit from an insurance policy that is easier to read and understand.

This overhaul was considered necessary because of a number of studies showing that consumers have a very limited understanding of the legal jargon used to draft the existing forms. Indeed, the studies indicated that in order to understand this type of contract, a person needs 16 years of schooling; in Québec, this represents a university degree.

Furthermore, according to Statistics Canada, in 2005 only 15% of the population had attained this level of schooling.

This necessarily begs the question whether a significant percentage of the population is in a position in which it cannot understand the contract to which it is mandatorily required to subscribe.

It would seem that a majority of consumers are not aware of their rights or obligations, because the existing contracts are drawn up from the perspective of the issuer, that is, the insurers, and not from the perspective of the recipients, namely, the insureds.

There is a real need to improve consumer comprehension of these documents.

We believe that the industry itself would also benefit from a plain language redrafting of the automobile insurance policy forms. With insureds having access to a contract written in

plain language that they can understand, they might possibly view the industry in a more favourable light. This change therefore presents an opportunity for the industry to transform the public's perception and thereby earn more of its trust.

To that effect, two qualitative surveys were carried out among consumers, one in December 2010, before the revision of Q.P.F. No. 1, and another in February 2011, based on the proposed Q.P.F. No. 1 prepared by the various working committees. The proposed form deals primarily with the coverages and exclusions in section A, namely, civil liability.

The goal of the surveys was to determine consumers' understanding of the wording of the forms and their ability to find information in the forms. In the December 2010 survey, the average rate of success was 2.5/5, while in the second survey carried out in February 2011, the rate increased to 4.6/5.

Initial impressions of the proposed form were generally very positive, with consumers expressing a more favourable view of the revised document.

Certain consumers commented that they would feel less vulnerable towards their insurer if they were to enter into a contract they were able to understand on their own.

Others perceived the revision work as a sign of respect shown towards them by the insurance industry. The surveys indicated that consumers have a much better understanding and appreciation of the plain language version of the policy.

The work of these committees will continue over the next several months and we hope should allow consumers to better understand not only their rights, but also their obligations.

In addition, we the AMF view this as an opportunity to play a leadership role in Canada and in the rest of the world, given that this type of work is perceived as a social project that ties in perfectly with the numerous efforts to ensure financial literacy among the population.

It is worthwhile to note that the automobile insurance policy is one of the most common contracts in Québec.

And, coming full circle on the topic of automobile insurance, I would now like to present you some of the conclusions from the annual report on automobile insurance rates for the year 2010.

As provided for in Québec's *Automobile Insurance Act*, each year the AMF must analyze the rate manuals and the statistical data concerning the automobile insurance experience of private insurers who write automobile insurance in Québec and we must file a report on automobile insurance rates with the Minister of Finance.

This year's report deals with insurers' claims experience, their practices for the classification and pricing of risks as well as the rates in effect in 2010.

According to the data compiled for 2010, the automobile insurance industry in Québec is composed of the following:

- 48 Québec-chartered insurers with 63% of total direct premiums written;
- 44 federally-chartered insurers with 35% of total direct premiums written;
- 26 foreign-chartered insurers with 2% of total direct premiums written;
- 1 insurer chartered in another province with less than 1% of total direct premiums written.

Based on the distribution method, direct insurers dominate the Québec market, holding a 53% share. More specifically, they control the personal lines insurance sector, with 59% of premiums written.

The automobile insurance market in Québec is considered to be a stable and mature market that provides insurers with good returns.

The automobile insurance industry continues to be very healthy, a situation that can only benefit consumers, because competition is highly present.

In this regard, insurance rates have decreased for an eighth consecutive year – with an average reduction of 2.9% in 2010 – indicating the existence of a competitive market, and it is consumers who benefit as a whole.

For example, the average premium written for cars in the “passenger vehicle” class decreased by 1.8%, settling at \$545. With the all-item consumer price index (CPI) in Québec and Canada for the last 12 months at 3.3%, few sectors can boast a reduction in prices charged to consumers; in our opinion, this reflects sound management by insurers.

Notwithstanding the rate reductions granted by insurers over the past few years, premiums written have continued to increase, reaching \$3.1 billion this year. Furthermore, for a second consecutive year, total losses paid out by insurers decreased by 4.8%, with an amount of \$1.7 billion having been paid out.

Insurers’ technical performance was solid (the claims rate was 66%), giving rise to highly respectable underwriting earnings. These results are all the more remarkable given the prevailing economic conditions and the limited income generated by investment activities.

This year’s results indicate a continuation of the favourable trend observed over the past decade, with historical rates of return exceeding those generally expected by insurers. Consequently, we can say that the year 2010 was an exceptional one for the automobile insurance sector in Québec.

The frequency of claims fell to a record low for the past 25 years, resulting in operating income for the year 2010 – estimated at 17.3% of earned premiums – that was the highest ever during that period. This decrease was heavily influenced by the significant reduction in the frequency of claims during the 1st quarter of 2010 due to the warmer winter and the

lower than normal snowfall we experienced. In this regard, climate change may possibly have a positive impact.

In conclusion, we can expect the performance of the Québec automobile insurance industry to remain above the historical average in 2011, which is very good news for the entire population given the crucial role of insurers as employers, investors and partners in our communities.

Finally, I would like to briefly give you an update on our involvement in the work of the International Association of Insurance Supervisors, more particularly regarding the Market Conduct Subcommittee (MCS).

We joined the MCS at the time of its creation in 2008 and, our active participation was recognized by the election, on January 20th, 2011, of Julien Reid, Director, Standards and Deposit Insurance, as Chair of the Subcommittee.

The MCS is responsible for the review of the Insurance Core Principle (ICP) 18 on Intermediaries and of ICP 19 on Conduct of Business. These ICPs aim at implementing, within the insurers and the intermediaries, a culture of fair treatment of customers (FTC).

To that effect, I would like to again remind you that the AMF is the only Canadian regulator, to date, to put in place a framework on FTC that is inspired by ICP 19 via our Guideline on commercial practices.

As part of its future work plan, the IAIS Market Conduct Subcommittee will be considering risk-based supervisory approaches to (i) examine the commercial practices of each insurer and (ii) evaluate the oversight effectiveness of the insurer's board of directors and senior management in ensuring compliance with the international FTC requirements.

It will also analyse Policyholders Protection Schemes around the globe and identify best practices on the subject.

The whole set of ICPs and related global standards as well as supporting guidance will be submitted to the Technical Committee and Executive Committee of the IAIS for approval in principle at their June 15-17, 2011 meetings in Macau, China. The new framework together with its assessment methodology is scheduled for final adoption on October 1, 2011, at the IAIS General Annual assembly in Seoul, Korea.

The implementation of the new IAIS ICPs will represent a great challenge, not only for regulators, but for insurers alike. Close collaboration with the industry will therefore be necessary.

Thank you very much!