



June 17, 2024

[submitted via FSRA website]

**Financial Services Regulatory Authority of
Ontario 25 Sheppard Avenue West, Suite 100
Toronto, ON M2N 6S6**

RE:

Identifier: No. PC0050INT: Proposed Guidance: Operational Risk and Resilience for Ontario-incorporated Insurance Companies and Reciprocal Insurance Exchanges (“Risk Guidance”)

Identifier: No. PC0051INT: Proposed Guidance: Corporate Governance for Ontario-incorporated Insurance Companies and Reciprocal Insurance Exchanges (“Governance Guideline”)

CURIE has reviewed the comment letter from CAIR (Canadian Association of Insurance Reciprocals) regarding the newly proposed insurance Guidelines: (1) Operational Risk and Resilience and (2) Corporate Governance, and we support their comments provided in the letter.

Sincerely,

A handwritten signature in black ink, appearing to read "P. Lundy", with a long horizontal flourish extending to the right.

Patrick D. Lundy

CEO & Attorney-In-Fact



CANADIAN ASSOCIATION OF
INSURANCE RECIPROCAL

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collectively known as the Proposed Frameworks.

We are pleased to provide the Financial Services Regulatory Authority of Ontario (“FSRA”) with our comments in connection with the above-noted Proposed Frameworks.

CAIR and General Commentary on Reciproals and Regulatory Oversight

The Canadian Association of Insurance Reciproals (“CAIR”) is an industry association for Canada’s insurance reciprocals. CAIR is providing comments on behalf of its Ontario members, which include municipal governments, hospitals, educational institutions and local electrical distribution companies.

Our submissions on recent other FSRA Guidance asserted and we assert again our concern that the regulatory burden, administrative cost and reduced flexibility associated with this guidance outweighs, in our opinion, the benefits to be achieved. While CAIR Ontario members appreciate FSRA’s objectives in relation to effective risk management and governance for all FSRA licensees, given the distinct nature of Reciproals and the absence of an obvious need for additional regulatory oversight for this sector, it is not, in our submission, necessary to treat Reciproals in the same way as other licensees. As explored more fully below, Reciproals are and were intended to be treated differently from other insurers. This provided a mechanism to and flexibility for insureds, who are all Subscribers and not members of the public, to create vehicles for insurance in situations where other insurers abandoned the space and where insurance was not otherwise available. We would ask that this information be considered again as an aspect of your consideration of these two Proposed Frameworks.

Reciprocal Exchanges Background & Commentary Related to Both Documents

As defined in the *Insurance Act* (Ontario) (the “Act”), a Reciprocal Insurance Exchange (“reciprocal exchanges”) is a group of subscribers exchanging reciprocal contracts of indemnity or insurance with each other through the same attorney. Subscribers are the persons exchanging with each other reciprocal contracts of indemnity or insurance as provided in section 378 of the Act. In general, Section 283 of the *Corporations Act* (Ontario) is not applicable to reciprocals.

Due to their nature, reciprocal exchanges are not-for-profits. Reciprocal exchanges are often created in sectors where traditional insurance has not met the needs of an industry from a cost and/or coverage perspective. Reciprocal exchanges permit subscribers to mutually protect themselves with appropriate coverage in a more cost-efficient manner than they can with traditional insurance, with each subscriber contributing its share of claims and operational costs. Importantly, reciprocal exchanges may undertake insurance only on behalf of their subscribers.

Reciprocal exchanges are regulated separately under the *Insurance Act* to recognize their unique structure and Member risk profile (e.g., self-contained, no risk to individual consumers, specialized demographic). Although the Proposed Frameworks acknowledge this, they also concurrently state that FSRA will still assess reciprocals under the primary Guidance rules, which is, in our view, an inherent conflict or at least a potential for such conflict.

In general, we appreciate that Reciprocal Insurance Exchanges were explicitly identified in both documents. The guidance documents are well structured, and they appear to represent the highest standards for effective, efficient, and agile governance and operational risk resilience for standard insurers. However, insurance reciprocals are uniquely different and, to be effective vehicles to address their needs, are required to be treated differently. While reciprocal exchanges are *licensed* under the Act, they are not *incorporated* under the Act.

While Reciprocal Insurance Exchanges were identified in the above-mentioned documents and we appreciate the reassurances provided in our meeting with FSRA’s representatives, we continue to be concerned that the Frameworks do not highlight any differences in approach or expectations and reciprocals were simply grouped under the same umbrella. As indicated above, reciprocal exchanges have inherent differences in corporate structure, which are based on our individual Subscribers’ Agreements.

As reciprocal exchanges, we are fully committed to strong, modern governance and risk resilience practices which align with our member subscriber’s agreements. We believe this has been both clearly stated and demonstrated in our interactions with FSRA, however, the Proposed Frameworks simply don’t apply to or work well for reciprocal exchanges. Historically, regulators have recognized the unique aspects of reciprocal exchanges. Specific acknowledgement of the differences of reciprocal exchanges and modifications to address these differences within the Proposed Frameworks would be appreciated by our membership.

Need for Continued Consultation

In our experience, the concept of reciprocal exchanges is not well understood. The Proposed Frameworks do not properly apply to reciprocal exchanges. We strongly suggest that further direct consultation by FSRA be conducted with reciprocal exchanges. In this way, FSRA will have enhanced understanding of the operational and other challenges inherent with the Proposed Frameworks, but it may be possible to collaboratively develop a way to create a framework in connection with reciprocal exchanges that would be meaningful.

In our view, the Proposed Frameworks propose a theoretical way to supervise insurers, generally but Ontario's insurers are not a homogenous group – reciprocal exchanges are not traditional insurers, they are the result of a group of subscribers exchanging reciprocal exchange contracts of indemnity or insurance with each other.

In the event that FSRA is considering amending the Proposed Frameworks to include differing expectations of reciprocal exchanges, we have set out below some of our high-level concerns and/or feedback. We note that given the interaction between and in some instances overlap between the two Frameworks and anticipating that you may need to separate the commentary, we have, in some instances, repeated our comments.

Corporate Governance Requirements

The Governance Guidance lays out common expectations for an organization's Corporate Governance Process. However, given reciprocals limited risk profile, strict Governance under the Subscribers' Agreement and capital protections (e.g., retro-assessment), we would comment that these attributes should be taken into account when applying the principles outlined in the Governance Guidance.

Principle 1: Defined roles and responsibilities

Given the size and resource constraints of a reciprocal, some responsibilities set forth would not be practical for some and in some instances All reciprocals. Examples of this include:

- Audit plans: Internal Audit plan and related execution with internal/external resources
- Other Oversight Functions: In addition to Internal Audit, these would create unnecessary strain on lean reciprocal exchange resources.

Principle 2: Board independence and composition

Each reciprocal exchange is governed by a subscriber's agreement. A reciprocal exchange's subscriber agreement, among other things:

1. establishes an advisory board to be responsible for the supervision of the exchange,
2. sets out the powers and duties of the advisory board, and
3. describes how the exchange will establish standards and procedures in connection with investments.

Any change to the agreement must be approved by the regulator and reciprocal

Members/Subscribers.

Unlike a traditional insurer, through the subscribers' agreement, the reciprocal exchange has a contract with its subscribers/policyholders regarding the governance of the reciprocal exchange, including its management and oversight.

Through the mandated advisory board, subscribers/policyholders are given a voice in the governance of the exchange - the advisory board is made up of the reciprocal exchange's policyholders. As such, the interests of subscribers and reciprocal exchanges are aligned, significantly reducing market conduct risk. The very structure of the reciprocal lowers the likelihood of imprudent or unsafe business practices and misconduct impacting policyholders, which is the rationale for the Proposed Framework.

The principles related to Independence and Composition have to take into account what is prescribed under the Act vs. Subscribers' Agreement, which does not permit Directors outside of the Member base.

e.g. The Board is appropriately structured to allow it to act independently – "...no more than two-thirds of the directors of an incorporated Insurer can be affiliated with the Insurer..." Examples such as these statements are inconsistent with the legislation of reciprocals.

I. Board Independence: "An "independent" director is a director who is not an affiliated individual of the insurer." Again, this does not align with a reciprocal, and we would interpret this statement to mean that the Board is independent of management.

II. Board Composition: "...identify areas for enhancement in the composition of the Board, its committees, and skillsets..." Again, this may be difficult for a reciprocal to achieve, given our Board members are restricted to our member base.

III. Assurance and effectiveness: "...the Board, must review, the adequacy and effectiveness of the insurer's risk management and internal control systems and provide commentary in annual report". We would interpret this to mean that the Reciprocal should have the risk management and internal control framework and the Board must review the adequacy and effectiveness of these frameworks on a continuous basis (as opposed to all and every internal control being tested on an annual basis).

Principle 3: Effectiveness of oversight structures

The Three Lines of Defense further creates another layer of oversight and complexity that will be difficult within the lean resource structure of a reciprocal. How can this be practically achieved for reciprocal exchanges with a lean resource base?

This section also acknowledges that reciprocal exchanges are not subject to the MCT Guideline. However, it also states that "not meeting the intended outcomes of the principles may result in elevated level of supervisory support." This statement does not acknowledge and recognize the exclusion from the MCT Guidance which is appropriately afforded to reciprocal exchanges.

With respect to expectation on the Risk Management Requirement, the Corporate Guidance infers that execution and management of the Oversight Functions must be handled internally with assistance of external resources. This has a significant potential to place an undue strain on reciprocal exchanges' human and financial resources.

Principle 4: Integrity in reporting and disclosure

The requirements under this section are unclear and if they are to have continued application to reciprocals more definition is needed (e.g., The annual statement of the condition of the affairs of the Insurer).

Reciprocal exchanges are required to make up any deficiency

Section 386 of the Act requires the reciprocal exchange to maintain reserves and surplus in amounts set out in the legislation. The subscriber agreement allows premium reassessment in the unlikely event that additional premium is needed (i.e., the subscribers are required to make up any deficiency), thus improving the stability of the reciprocal exchange itself. This is different than in traditional insurance, where an insurer cannot go back to the insured to request additional premium.

The structure of the reciprocal means that, for the most part, only subscribers are affected by its failure. Subscribers are aware of this risk because subscriber agreements outline the financial impacts to subscribers.

The guidance documents reference the MCT Guideline, issued in January 2023, and other sections of the Insurance Act, which are not applicable to reciprocal exchanges.

Risk Guidance Requirements

The Risk Guidance lays out common expectations for an organization's Risk Management Process. As with the Governance Guidance comments above, we ask the unique structure and mandate of a reciprocal exchange be considered.

1. (Principle 1) where *"Ultimate accountability and responsibility of operational risk oversight rests with the Insurer's Board and Senior Management"*.

As indicated, reciprocals are governed by Subscriber Agreements. Accordingly, it is necessary to acknowledge the different application of these principles. Section 380.1 (a) of the Act – Exchange Agreement requires that the agreement between subscribers of a reciprocal insurance exchange provide for the establishment of an advisory board to supervise the exchange (the "Oversight Provisions"). Such Subscriber Agreements identify the governance responsibilities of Reciprocals and identify the importance of the Attorney-in-fact (Principal) role. For inclusion and accuracy of governance accountability, the principles should reflect the applicable governance structure and responsibilities for reciprocal exchanges.

2. Reciprocal exchanges were created to provide stability in vulnerable sectors and as such have legislated differences which should be acknowledged, where appropriate, within the proposed guidance. Providing clarity and context for Principles 1 to 3 for Reciprocals and

identification of the correct terms/action will support adoption and implementation of any aspects of this guidance which are formalized. As an example, it would be appropriate to incorporate “may”, “should”, or “can” or similar words in reference to reciprocals as noted within the proposed guidelines interpretation section, without further conflicting language as exists in current form.

3. In the section dealing with Identification of risk method (e.g., risk appetite, tolerance and limits), there is an opportunity to take a broader integrated risk management approach and to be more inclusive when referencing principles of risk identification (e.g., risk appetite, tolerance and limits). As an example, not all operational integrated risk management programs align to risk appetite and tolerance statements. Within a healthcare context as an example, risk appetite statements for care dimensions do not follow risk informed practice and are not widely adopted (e.g., reasonableness of zero patient safety incident and escalation limit). Referencing risk appetite, tolerance and limits as examples to operationalize integrated risk management approaches will be prudent for inclusivity or all sector approaches.
4. Providing greater examples to illustrate how the guidance could work in practice would add value. For example, summarizing the requested output expectations of the operational risk and resilience guidance would be helpful. In addition, providing a table of the clear risk activities that are expected with the illustrative examples for Insurers and Reciprocals will provide clarity for implementation. As examples:
 - Providing definition and context for illustration of lines of risk defence (first, second, third) and clarity of independent risk oversight in reference to “FSRA’s view is that compliance with the Risk Management Requirement necessitates that Insurers establish an organizational structure where operational risk management activities are conducted by operational management (first line of defence), are reviewed and challenged by risk management (second line of defence), and independent assurance is then provided by internal audit (third line of defence), facilitating effective governance, oversight and risk management.”
 - Providing clarity for expectation in FSRA’s Resilience assessment of the Insurer (Principle 4: Resilience) would add value. As an example, “during supervisory monitoring, FSRA may direct an inquiry to require that the Insurer present its BCP, DRP, or any relevant report to demonstrate its stress and scenario testing activities, and overall resilience during stress environments.” Providing clarity on the internal stress testing requirements will provide clarity in expectation (e.g., confirmation this does not include Financial Condition Testing, etc.).

This letter has touched on several areas we feel warrant a deeper review. We thank you for the opportunity to provide this feedback and would ask that you please contact me if you have any questions via email at craig@rmainsurance.com.

Sincerely,



Craig Pettigrew
Chair