Information

Canada's Financial Services Sector

October 2003

Property and Casualty Insurance in Canada

Overview

- The property and casualty (P&C) insurance industry in Canada provides coverage for all risks other than life. In 2001 the industry generated more than $21 billion in net premiums. Automobile insurance continues to be the largest single class of P&C insurance in Canada.
- P&C insurers and their related industries (including independent brokers, adjusters and actuaries) employ approximately 100,000 people in Canada.
- With assets of $66 billion, the P&C insurance industry is an important contributor to the Canadian economy.
- The industry has a wide variety of participants, ranging beyond direct insurers to include reinsurers, government participation in personal auto insurance, and self-insurance arrangements such as reciprocal insurance exchanges and "captive" insurers.
- The private P&C insurance industry in Canada realized a profit of $600 million in 2001, down 50 per cent from 2000.
- Canada's P&C insurance industry comprises about 230 insurers actively competing, with the largest of these having an estimated market share of 9.5 per cent. As such, this is not a highly concentrated industry.
- Foreign participants have a strong position in Canada's P&C market, accounting for 64 per cent of net premiums earned.
- The Property and Casualty Insurance Compensation Corporation is an industry-financed policyholder protection scheme designed to provide a reasonable level of recovery for claims of policyholders under most policies issued by P&C insurers should a P&C insurer become insolvent.
- The federal and provincial governments share jurisdiction over insurance regulation. Although P&C insurers can be incorporated under either level of government, the federal government is responsible for the prudential supervision of three-quarters of the companies, which account for more than 80 per cent of total business. Provincial governments are responsible for the market conduct regulation of all P&C insurers.

Introduction

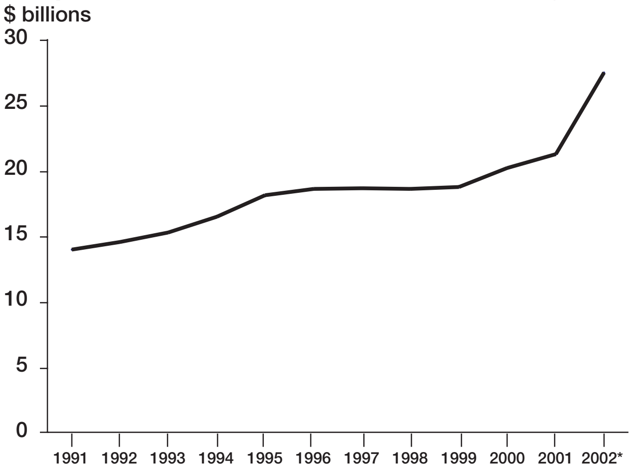
The Canadian property and casualty (P&C) or general insurance industry helps underpin the Canadian economy by assuming the financial risk inherent in many personal and business activities. In other words, the losses of a few are shared among all policyholders, making the lives of individuals and businesses more financially stable and making it easier to plan for the future. The industry is generally defined as including all lines of insurance other than life and health, although there are a few companies that sell a limited amount of sickness and accident insurance.

With assets of $66 billion, the P&C insurance industry is an important contributor to the Canadian economy. In 2001 the P&C insurance industry raised just over $21 billion in net premiums, a slight increase from the previous year (see Chart 1). Preliminary figures for 2002 indicate a substantial increase in net premiums to $27 billion. Of the $21 billion in net premiums in 2001, over $11 billion was for automobile insurance. Most of the remainder came from property (personal and commercial) and liability insurance lines (see Chart 2). Government-owned corporations wrote an additional $4.1 billion in auto insurance premiums in Quebec, Manitoba, Saskatchewan and British Columbia.[1]

Structure of the P&C Insurance Industry in Canada

The diversity of P&C insurance lines available in Canada is reflected in the large number and wide variety of industry participants. There are about 230 P&C insurers active in Canada, including both Canadian-incorporated companies and branches or separately capitalized subsidiaries of foreign companies licensed in Canada. Canada's P&C market has attracted considerable competition from foreign companies: 7 of the 10 largest insurers are foreign-owned, and foreign insurers account for 64 per cent of net premiums earned.

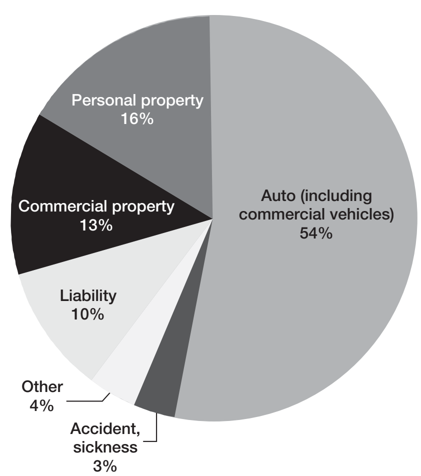
Chart 1
Net premiums in the P&C insurance industry
$ billions



*Preliminary figure.

Sources: Conference Board of Canada, *The Canadian Financial Services Industry, The Year in Review,* 2002 edition; Insurance Bureau of Canada, *Perspective,* Volume 9, Number 1 (March 2003).

Chart 2
Net premiums by line of business in the P&C insurance industry, 2001



Source: Insurance Bureau of Canada, *Facts of the General Insurance Industry in Canada,* 2002.

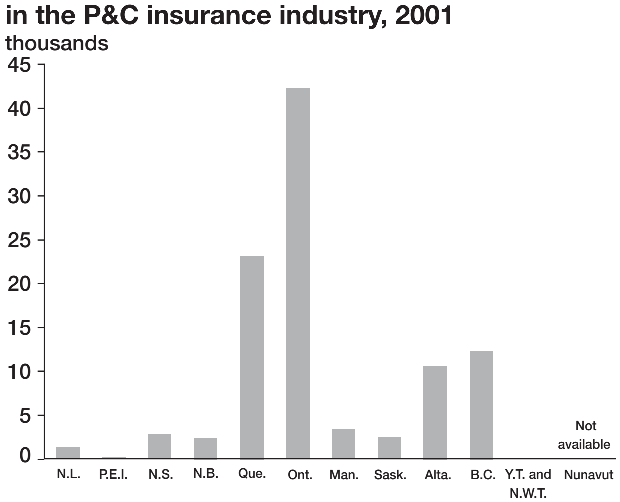
[1] This information sheet deals primarily with insurance provided through private companies. Unless otherwise stated, all descriptions and data exclude insurance provided through public sector entities.

In line with international trends, Canada's P&C insurance industry has been undergoing a period of consolidation. In 1980 the 26 largest insurers wrote 50 per cent of net premiums; in 2001 the 8 largest insurers served just over half of the market (see end of document for a list of the top 10 insurers by net premiums written). However, despite the ongoing consolidation, no single P&C insurer has more than 10 per cent of the Canadian market. In addition, more than 20 new P&C insurers entered the Canadian market in the 1990s.

There were approximately 40,000 employees of primary insurers in 2001. Canada also has an extensive network of stand-alone intermediaries employing 61,000 brokers, independent adjusters and appraisers (adjusters and appraisers participate in the assessment of P&C insurance claims). Employment in the P&C insurance industry is spread throughout the country, but is concentrated in Ontario and Quebec (see Chart 3).

Government-owned corporations also provide some P&C insurance. The area of greatest government participation is in auto insurance, with provincial public companies supplying this type of insurance in British Columbia, Manitoba, Saskatchewan and Quebec. The governments of British Columbia, Manitoba and Saskatchewan supply collision and liability insurance. In Quebec public companies provide only liability insurance, leaving collision insurance to private companies. These provincial government-owned corporations account for 26.6 per cent of the Canadian auto insurance market.

Chart 3
Employment by province and territory in the P&C insurance industry, 2001



Source: Insurance Bureau of Canada, *Facts of the General Insurance Industry in Canada,* 2002.

Reinsurance and Self-Insurance

Direct insurers pay premiums to reinsurers which, in exchange, assume a portion of the risk. The worldwide reinsurance market is an important backstop to Canada's P&C insurers, which ceded business worth about $1.9 billion to reinsurers in 2001. Although this represents only 8 per cent of total industry premiums written, appropriate use of reinsurance is particularly important in managing low probability-high loss events such as natural disasters.

Reinsurers and reinsurance brokers are not required to register with Canadian supervisory authorities but may choose to do so. Canada's direct insurers are subject to regulatory controls in their use of reinsurers. These controls include a focus on the financial health of reinsurance companies as well as a 75-per-cent limit on the percentage of a direct insurer's business that can be reinsured. In addition, there is a 25-per-cent limit on the amount of business that can be ceded by direct insurers to reinsurers that are not regulated in Canada.

For direct insurers, an alternative to reinsurance is the formation of insurance pools under which direct insurers agree to share certain types of risks. Examples of insurance pools in Canada include the Canadian Industrial Risks Insurers and the Canadian Aviation Insurance Group.

Some firms also participate in various self-insurance arrangements. One such mechanism is a reciprocal insurance exchange, whereby a group in a related activity agrees to share certain kinds of risk. In Canada a number of school boards, hospitals and universities have established such reciprocal exchanges.

Another self-insurance mechanism of increasing importance is the ownership by one or more Canadian firms of a "captive" insurer. Captive insurers are firms, typically owned by non-insurers, which undertake some or all of their owners' insurance business. There are many reasons for a parent company to form a captive insurer, such as meeting unique insurance needs, providing a self-funding mechanism, reducing the impact of the insurance industry's underwriting cycle, providing opportunities for the organization to improve risk management and increasing control over funds flowing through the organization. Some captive insurers are established under the terms of British Columbia's Insurance (Captive Company) Act. Under this act, captive insurers can benefit from arrangements such as less onerous licensing requirements, which allow for lower minimum capital. Other captive insurers established by Canadian companies are domiciled in offshore centres, such as Bermuda or the Bahamas, on the condition that captives limit themselves to providing a reinsurance function to the Canadian market.

Profitability and Investment

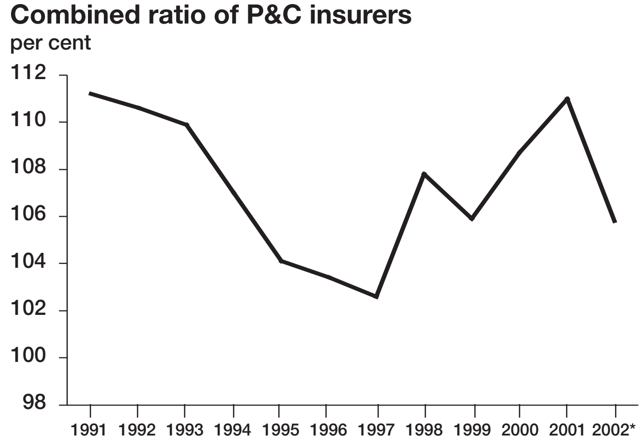
The business of P&C insurers can be divided into two segments: underwriting and investments. As in other countries, including the U.S., P&C insurance activities in Canada normally result in underwriting losses for most major product lines. This means that premiums paid for policies each year do not generate enough revenues to cover outgoing claims and expenses. However, these underwriting losses are normally more than offset by the investment income generated from assets held by the industry.

P&C insurers in Canada invest mainly in domestic government and corporate bonds and in preferred and common stocks. These investments are in secure financial products that have traditionally produced a steady flow of income.

One measurement of underwriting losses is the combined ratio—the ratio of the sum of claims incurred and operating expenses to net premiums earned. A ratio greater than 100 per cent indicates an underwriting loss. The combined ratio for the industry improved from 111.2 per cent in 1991 to 102.6 per cent in 1997, then increased to 110.7 per cent in 2001 (see Chart 4). Preliminary figures for 2002 indicate an improvement in the combined ratio to 106 per cent.

Despite underwriting losses of over $2.1 billion, the industry realized a profit of $600 million in 2001 due in part to its investment income. Given the structure of the business, the profitability of P&C insurers is sensitive to small changes in investment returns. Preliminary financial results for 2002 indicate a further deterioration of results to their worst year on record. Higher premiums over that year were not sufficient to offset the growth in claims costs and the deterioration in investment income. In 2001 the second largest decline in the TSE 300 occurred and, as a

Chart 4
Combined ratio of P&C insurers



*Preliminary figure.

Source: Insurance Bureau of Canada, *Facts of the General Insurance Industry in Canada,* 2002.

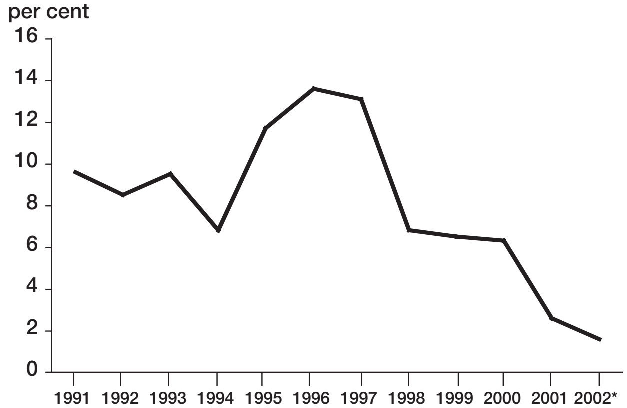
result, investment returns of P&C insurers were negatively affected. Weak markets continue to reduce profitability for the P&C sectors.

Consistent with the experience in other countries, the profitability of the Canadian P&C insurance industry is cyclical. Profitability has fallen over the past four years due in part to higher-than-expected claims growth and significantly lower investment income (see Chart 5).

While the combined ratio is a useful measure for comparing one P&C insurer with another, return on equity allows comparison across industries. Return on equity for P&C insurers fell sharply from 13.1 per cent in 1997 to 7.1 per cent in 1998 due mainly to claims related to the ice storm. Return on equity continued to decline thereafter due to weak financial markets and rising claims costs (see Chart 6). From 1995 to 2001 the return on equity of P&C insurers averaged 8.6 per cent, below the 13.8 per cent for the banks and 10.2 per cent for life insurers but above the 8 per cent for credit unions (see Chart 7).

P&C insurance policies are often subject to renewal every year, and insurance companies generally match their liabilities by investing in short-term highly liquid investments, such as government and corporate bonds, which tend to be highly sensitive to interest rate fluctuations. P&C insurers' assets can be divided in two categories: about 44 per cent are non-investment assets (real and fixed assets, investments in affiliates, accounts receivable, less than one-year term deposits, cash and miscellaneous assets) and the remaining portion is invested "prudently," as required by federal legislation (see Chart 8).

Chart 6
P&C insurers' return on equity



*Preliminary figure.

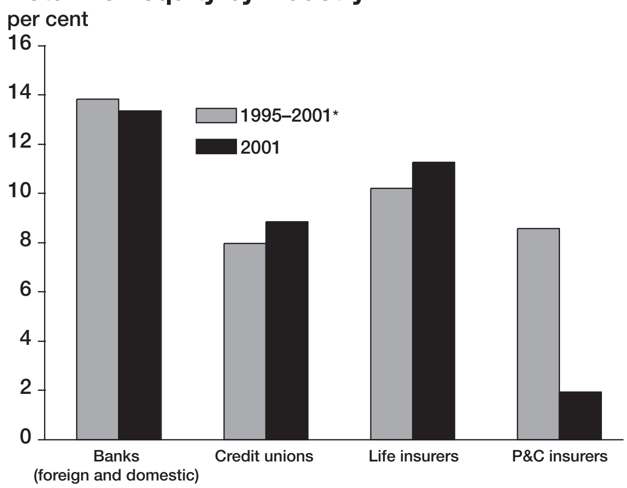
Sources: Conference Board of Canada, *The Canadian Financial Services Industry, The Year in Review,* 2002 edition; Insurance Bureau of Canada, *Perspective,* Volume 9, Number 1 (March 2003).

Chart 5
P&C insurers' net income

*Preliminary figure.

Source: Insurance Bureau of Canada, *Facts of the General Insurance Industry in Canada,* 2002.

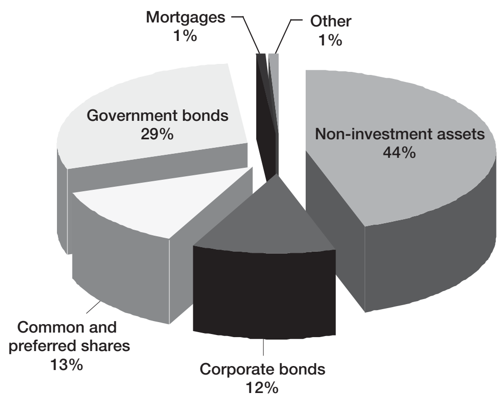
Chart 7
Return on equity by industry



*Average of annual rates.

Source: Conference Board of Canada, *The Canadian Financial Services Industry, The Year in Review*, 2002 edition.

Chart 8
P&C insurers' assets, 2001



Source: Insurance Bureau of Canada, *Facts of the General Insurance Industry in Canada*, 2002.

Regulatory and Legal Environment

The federal and provincial governments share jurisdiction over insurance matters in Canada, and both are involved in the regulation and supervision of participants in Canada's P&C insurance industry.

Federal authorities look after the solvency and stability of the majority of P&C insurers—those incorporated federally and Canadian branch operations incorporated outside Canada. Provincial authorities are responsible for the solvency of provincially incorporated insurers. In addition, they review the terms and conditions of insurance contracts, licence companies, agents, brokers and adjusters, and regulate insurance rates. Overall, automobile insurance remains the only line of insurance where rates are regulated in Canada.

Approximately three-quarters of the P&C insurers in Canada are supervised by the federal government through the Office of the Superintendent of Financial Institutions, as they operate in more than one province or are branches of foreign companies. These federally regulated insurers make up more than 80 per cent of the total business of the P&C insurance industry in Canada. Federally regulated companies must, however, also be licensed in each province and territory in which they undertake insurance activities.

P&C insurers in Canada are required to satisfy regulatory authorities that their policy reserves are sufficient to meet the anticipated requirements of their policyholders. In addition, they must satisfy capital requirements, which changed January 1, 2003. For federally regulated insurers, the new Minimum Capital Test is used to measure the capital adequacy of Canadian reinsurers. This replaces the Minimum Asset Test. The new solvency test is not expected to have an impact on the amount of capital held by the industry.

Insurers are required to maintain at least one dollar in capital for every three dollars in premium revenue. However, industry practice is considerably more conservative, with insurers maintaining one dollar in capital for every $1.23 in premium revenue. The equity/premium ratio for the industry has increased in the recent decades in Canada, the United States, Europe and the other major insurance markets around the world.

Canadian financial institutions in other areas of the financial services sector are subject to legislative and regulatory restrictions on their participation in Canada's P&C insurance industry. For example, banks and other federally chartered deposit-taking institutions may own insurance underwriting subsidiaries, but they are not permitted to issue insurance policies through their branches. Banks are generally not permitted to become directly involved in the retailing of insurance through their branches, but they are allowed limited participation in some lines related to their banking activities, such as credit card and travel insurance.

Canadians are also permitted to purchase insurance from insurers not licensed in Canada. However, the extent to which these unlicensed insurers can solicit business in Canada from Canadians is strictly limited and monitored by the regulatory authorities.

Policyholder Protection

Additional protection for many Canadian policyholders is provided by the industry-run Property and Casualty Insurance Compensation Corporation (PACICC), which has guaranteed most P&C insurance policies in Canada, up to certain limits, since 1988. PACICC membership is required in all Canadian jurisdictions for the licensing of P&C insurers in PACICC-covered lines. PACICC has established a reserve fund of approximately $30 million. In addition, it has the power to levy assessments on its members should an insolvency occur. It can also access a $10-million line of credit with a major bank. For claims for direct loss or damage, PACICC will pay a maximum of $250,000 for all claims arising out of a single occurrence. PACICC does not respond if coverage is available under any other policy. Foreign insurers with branches in Canada must vest assets in Canada to ensure policyholder protection. Both domestic and foreign firms may issue P&C insurance directly to business and personal clients.

Key Industry Issues

Financial Services Regulatory Reform

Government regulation is an integral part of maintaining public confidence in the financial system and safeguarding the interests of insurance policyholders. On October 24, 2001, federal legislation reforming the regulatory framework governing the financial services sector (Bill C-8) came into force. The legislation created the Financial Consumer Agency of Canada to enforce consumer-related provisions of the federal financial institutions statutes. It also requires P&C insurers to be members of a third-party dispute resolution system to handle complaints that have not been resolved to the satisfaction of consumers and small businesses.

Federal financial institutions legislation recognizes the important role of good governance practices by setting out key requirements expected of financial institutions in this area. Included among these requirements are rules relating to the rights of shareholders and policyholders, the role of directors, auditors and other advisers, and rules relating to the preparation, review and disclosure of information. The federal government is currently in the process of reviewing the corporate governance framework as it applies to federally incorporated insurance companies.

Canadian Strategy for Disaster Prevention

Emergency preparedness remains a priority for P&C insurers. Created in 2001, the Office of Critical Infrastructure Protection and Emergency Preparedness is the federal government's primary agency tasked with achieving an appropriate level of national civil emergency preparedness by building partnerships with the private sector, provinces, territories and municipalities. Several provinces are now increasing their disaster prevention initiatives, including earthquake preparedness programs in British Columbia and flood management efforts in Manitoba. Recent unprecedented losses due to the Saguenay flood, the Red River flood and the eastern Ontario/Quebec ice storm further increased the pressure for action.

Acts of Terrorism

The events of September 11, 2001, had a significant impact on the global P&C insurance and reinsurance markets. Changes to premium levels and the type and level of risk that reinsurers are willing to assume have had an impact on insurance companies worldwide, including Canadian P&C insurance companies. Combined with low investment earnings resulting from low interest rates and weak equity markets, this has pushed premiums significantly in the last few years and has resulted in changes to insurance coverage. One outcome of the events of September 11 is that "acts of terrorism" are no longer automatically included in all P&C insurance contracts.

Top 10 P&C Insurers in Canada by Net Premiums Written, 2001

Name	Country of origin	Net premiums written
		(thousands of dollars)
CGU Group Canada Ltd.	UK	1,957,128
ING Canada	Netherlands	1,890,195
Co-operators Group	Canada	1,379,024
Royal & Sunalliance	UK	1,342,777
Economical Insurance Group	Canada	1,101,628
Lloyd's Underwriters	UK	918,196
Groupe Desjardins	Canada	915,284
AXA Canada Inc.	France	903,639
State Farm Insurance Companies	USA	885,250
Zurich North America Canada	Switzerland	841,258
Total of all P&C insurers		20,557,336
Share of top 10		59.0%
Share of top 5		37.3%

Source: *Canadian Insurance*, 2001 Annual Statistical Review.

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