SECTION IV

Facility, Facility Association ("FA"), FA Risk Sharing Pool ("FARSP") and the "Plan de répartition des risques" ("P.R.R.")

Facility, FA, FARSP and the P.R.R. of the "Groupement des assureurs automobiles" are distinct organizations with similar functions.

Premiums, commissions and losses relating to automobile insurance policies transferred to Facility or to the P.R.R. are to be treated in the insurer's books as negative direct business. Premiums and commissions that have not been actually accepted by Facility or the P.R.R. at its closing date must be entered into each insurer's books as direct premiums and commissions.

Premiums, commissions and losses transferred to the insurer, according to the allocation made by Facility or the P.R.R., must be entered as direct business in the insurer's books.

Similarly, premiums and losses received from the FA must also be reported as direct business.

Moreover, the following adjustments should be made in the books of each participating insurer:

(i) Set up a provision concerning the insurer's portion of the total unearned premiums as at year-end regarding automobile insurance policies transferred to the P.R.R. and accepted as at November 30.

(ii) Set up a provision concerning the insurer's portion of the total losses reported or unreported, incurred in the last month of the statement year and concerning the policies transferred to the P.R.R. as at year-end.

(iii) Set up, as receivable from the P.R.R., losses paid on policies that the insurer has transferred to the P.R.R. whether they have been accepted or not as at year-end.

(iv) Insurers participating in the Facility, FA and the FARSP should enter into their books an estimate of the premiums written and losses paid after the organizations' closing date.

Facility, FA, FARSP and the P.R.R. (cont'd)

The following table outlines the details for each entity:

ORGANIZATION	YEAR-END	# MONTHS ACCRUAL
Facility	Nov.30	1
Facility Association	Oct.31	2
FA Risk Sharing Pool	Nov.30	1
"Plan de répartition des risques"	Nov.30	None Required
Unsatisfied Judgement Recovery Fund	Cash Basis	None Required

Calculations of various provisions and estimates needed to make the above noted adjustments are provided by the respective organizations.

Facility, FA, FARSP, the P.R.R. and the Unsatisfied Judgement Recovery Fund amounts must be included under automobile statistics. At the end of each year the Fund Managers will provide insurers with the automobile liability figures representing:

(i) the unpaid assessments for claims paid by Unsatisfied Judgement Recovery Fund in the year of account; and

(ii) an estimate of the claims awaiting settlement by the funds.

These figures must be included in a worksheet supporting line 20 of page 60.30 for the examiner's review. The Unsatisfied Judgement Recovery Fund has been replaced in Quebec by the "Régie de l'assurance automobile du Québec".

Letters of Credit/Deposits of Reinsurers

Letters of Credit

To a limited extent, Regulators are prepared to recognize approved letters of credit as security maintained in Canada for purposes of reducing the capital otherwise required for unregistered reinsurance. General guidelines concerning letters of credit are set out below:

(i) Letters of credit must be in Canadian dollars and payable in Canada. Letters of credit must be issued by Canadian banks or confirmed by Canadian banks if issued by foreign banks;

(ii) They must be for a fixed term, at least one year;

(iii) They must be for a stipulated dollar amount;

(iv) They must be irrevocable except with at least three months notice to the Regulator. This condition can be satisfied either by a provision in letter of credit or by a letter of confirmation from the issuing bank; and

(v) The issuing bank and the confirming bank must not have any claim on the assets of the Canadian insurance company as security for the letters of credit.

Please refer to Section V, *Jurisdictional Requirements*: Quebec (V-8); Ontario (V-9); Federal (V-33).

Deposits of Reinsurers

Where the deposits provided by an unregistered reinsurer are placed in “trust”, the “trust” account must be in a Canadian trust company and the primary Regulator must be party to the “trust” agreement. The “trust” agreement must be in the standard wording prescribed by the primary Regulator.

Deposits of reinsurers that are “not owned” by an insurer, including deposits held in “trust” accounts on behalf of reinsurers, are not to be reported on the insurer's balance sheet. Details of these deposits must be reported on Page 70.40 of the P&C-1.

For additional information, refer to the Instructions for Page 70.38.

Records in Canada

Complete and accurate records in Canada are necessary to permit the identification of Canadian business and to provide a means by which Regulators can readily verify an insurer's Annual Return and determine its financial condition at any time during the year.

Accounting records must be located at one Office in Canada from which the examiners can make a complete review of the insurer's affairs. This does not preclude the maintenance of certain detailed records such as loss files and copies of policies at branch offices or with general agents in Canada. Nevertheless, all necessary information for the completion and verification of the Annual Return must flow to the central office.

Regulators believe that an insurer's operation cannot be properly controlled without at least the following general accounting books or ledgers:

- *General Ledger*
- *Cash receipts and disbursements books*
- *General Journal*
- *Subsidiary Ledgers such as:*
  - *Agents' balances or premiums receivable*
  - *Reinsurance Register (when applicable)*
  - *Securities Ledger*

For reinsurance ceded, the Regulator's main objective is to be able to verify that no reinsurance transaction has the effect of reducing the amount of assets that must properly be available in Canada for the protection of Canadian policyholders. Reinsurance transactions between federally and provincially incorporated insurers generally do not present any particular problem since the liability of the ceding insurer is picked up by the assuming insurer, and recorded in its P&C-1 and covered by assets as required.

However, in the case of cessions to foreign insurers where reinsurance of Canadian business is sometimes reported directly to the head office, it often happens that the Canadian return of the reinsurer is not adjusted to reflect the Canadian business assumed. Therefore, in order to ensure that all liabilities are properly covered by assets in Canada, the deposit requirement of the ceding insurer may not be reduced unless the Regulator can verify, not only that the transaction has been recorded by the ceding insurer, but also that it has been duly reported in the Canadian Annual Return of the assuming reinsurer. This can best be accomplished if

Records in Canada (cont'd)

reinsurance transactions are arranged directly between the Canadian offices of the insurers concerned, on the assumption that all business will be recorded in their respective Canadian Annual Returns. If the reinsurance has not been arranged in this way, Regulators will still give the ceding insurer credit for the reinsurance if the ceding insurer is able to provide evidence that the business ceded to the non-Canadian reinsurer is actually being reported in the Canadian return of the assuming reinsurer. Normally, such evidence would take the form of a letter from the Canadian chief agent of the assuming reinsurer, attesting to the fact that the reinsurer is reporting the assumed liability in its Canadian Annual Return.

Regulators have become increasingly aware and concerned about the difficulty faced by examiners when attempting to trace computer generated information in respect of premiums and losses back to the detail and source documents.

The areas that have caused the most problems in this regard are as follows:

(i) Premiums written by provincial location of property or risk insured;

(ii) Losses paid and unpaid by provincial location;

(iii) Losses by year-of-loss to provide a means of verifying the adequacy of the reserve for unpaid claims;

(iv) Premiums in-force by term and date of expiry to provide a means of verifying the unearned premiums.

Insurers are requested to ensure that computer based information systems are designed to provide not only the summary data necessary for management decision making, but also to produce and maintain an audit trail which can be used to reconcile the source documents with the output.

For examination purposes, every insurer must keep all documents, books and records and, in particular, the working papers used in determining the balance for each item in the Annual Return.

Self-Insured Retention

Self-Insured Retention (SIR) represents the portion of a loss that is payable by the policyholder. In some cases, SIRs may be included in the policy declaration or in an endorsement to the policy, stipulating that the policy limit applies in excess of the SIR. When policy wordings are controlled by provincial statute, the SIR arrangement is usually the subject of a separate agreement between the insurer and the policyholder.

Where the insurer has to pay the entire claim to a third party (whether in accordance with the terms of the policy or the separate agreement), the amount of the SIR portion of the unpaid claim must be reported on Page 20.20, line 28 as "Other liabilities" with the equivalent amount recoverable reported as an "other recoverable" on Page 20.10, line 37. Any SIRs included in "Other liabilities" must be reported on page 50.50, line 50.

To admit SIR recoverables for statutory test purposes, Regulators must be satisfied with the collectibility of the recoverables. Regulators may request collateral, acceptable to them, to ensure the collectibility of the recoverables.

Appropriate reserves, including a reasonable IBNR provision, must be maintained with respect to SIR accounts. The adequacy of these reserves should be addressed in the insurer's actuarial report.

Structured Settlements

A structured settlement refers to a contractual arrangement whereby a third party makes periodic payments to a claimant of a P&C insurer (insurer).

The periodic payments are normally funded through purchase by the insurer of an annuity from a life insurance enterprise and are usually arranged so that the payments are tax free in the hands of the claimant.

The insurer may have to report a financial liability and a financial asset on its balance sheet, depending on the type of contractual arrangement, and must disclose the information required in its notes to the financial statements.

There are essentially two types of structured settlements:

Type 1

Type 1 structured settlements have the following characteristics:

a) An annuity is purchased by a insurer who is named as the owner. There is an irrevocable direction from the insurer to the annuity underwriter to make all payments directly to the claimant.

b) Since the annuity is non-commutable, non-assignable and non-transferable, the insurer is not entitled to any annuity payments and there are no rights under the contractual arrangement that would provide any current or future benefit to the insurer.

c) The insurer is released by the claimant to evidence settlement of the claim amount.

d) The insurer remains liable to make payments to the claimant in the event and to the extent the annuity underwriter fails to make payments under the terms and conditions of the annuity and the irrevocable direction given.

Under this type of structured settlement arrangement, the insurer does not have to recognize a liability to the claimant, nor does it have to recognize the annuity as a financial asset. However, the insurer is exposed to credit risk by guaranteeing the obligation of the annuity underwriter to the claimant.

Structured Settlements (cont'd)

According to the CICA Handbook, Section 3861, the insurer should disclose in its notes to the financial statements the terms and conditions, the credit risk and the fair value of this financial guarantee.

Any gain or loss should be recorded as an adjustment of incurred claims expense.

The insurer also should not recognize a financial asset at time of purchase where the terms of the annuity make it commutable in the event the liability to the claimant becomes fully settled or otherwise discharged. In these circumstances, a gain could subsequently arise to the extent there is a residual value after the liability is fully settled.

The existence of a contingent gain in this case should be assessed for disclosure in the notes. The disclosure should be based on Sections 3290 and 3861 of the CICA Handbook with respect to the amount, the nature, the terms and conditions of the contingent gain.

Type 2

Type 2 structured settlements differ from Type 1 in that:

a) The annuity is commutable or assignable or transferable; that is, there is some form of reversionary interest or continuing right to a benefit for the insurer.

b) A legal release is not necessarily obtained from the claimant.

The commutation rights of the insurer have the potential for terminating the claimant's right to future payments in advance of the annuity being exhausted.

The extent of the rights held by the insurer sometimes indicates the insurer has contracted with the annuity underwriter to provide only administrative services with respect to the periodic payments.

Under this type of arrangement, the financial liability must be recognized on the insurer's balance sheet, and the annuity must be recognized as a financial asset.

The annuity should be carried initially at its cost to the insurer and the liability should be measured in the same manner as other outstanding claim liabilities of similar type.

Structured Settlements (cont'd)

According to the CICA Handbook, Section 3861, the insurer should disclose in its notes to the financial statements the terms and conditions, the credit risk and the fair value of the annuities recognized as financial assets on the balance sheet.

Please refer to Section V, *Jurisdictional Requirements*: Federal Guidelines and Bulletins (V-30).