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Financial Services Regulatory Authority of Ontario
25 Sheppard Avenue West, Suite 100
Toronto, ON
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Dear FSRA Officials;

Re: ***2022-008 PC0045APP – Insurance Prudential Supervisory Framework***

Thank you for the opportunity to provide input on the Insurance Prudential Supervisory Framework recently published by FSRA.

We are responding on behalf of the provincially incorporated farm mutuals that are supervised under statute and regulation by FSRA.

We are making the response jointly as an association group, as well as on behalf of the Fire Mutuals Guarantee Fund (FMGF) Trustees whose signatory members are all voting members of our trade association.

Background

The Fire Mutuals Guarantee Fund was established in the 1970s through the Insurance Act. Since that time, the companies that are signatory to this agreement have worked together to provide a guarantee for mutual policyholders in the event of an insolvency by any signatory company.

This has involved developing resources and structures, including the use of a Financial Review Committee/Financial Examination Committee that monitors mutual solvency and reports on an as needed basis to the regulator. This Committee also reports to the members on an aggregate basis to provide insight on solvency and solvency regulation requirements.

The Financial Review Committee's role in monitoring the solvency of the FMGF mutuals and reporting to the mutuals as a group was established in the early 1990s. This Committee proved so effective and diligent in its monitoring that, at the regulator's request in the early 2000s, the Committee took on a formal examination and reporting role to the regulator. At this point the regulator also formalized OMIA's role in collecting and aggregating P&C 1's from the FMGF for the regulator's use.

Context on our Comments

We recognize that the Approach published in FSRA's *2022-008 PC0045APP* applies to all insurers incorporated under the Act. As a result, we acknowledge that, by necessity, the Approach does not specifically address the unique role of the Fire Mutuals Guarantee Fund, the Financial Review Committee/Financial Examination Committee, and OMIA. This creates a gap in our ability to determine how this approach would change the existing, highly effective, policyholder centric, solvency monitoring methods used by the FMGF mutuals.

In addition, we note that the Approach cannot address other specific features of the mutual system that support solvency, including the existence of the Farm Mutual Reinsurance Plan as a provincially incorporated and supervised reinsurer and the role of OMIA as a resource for mutuals to facilitate compliance and reporting.

We will provide comments on the published "Approach" but believe that the practical considerations of implementation will be of significant concern to mutual insurers. The practical considerations arising from the "Approach" will need to be set out and documented for more insightful feedback from mutual insurers. We believe this is particularly important given the mutuals proactive approach in building the Financial Review Committee/Financial Examination Committee to protect policyholders and their demonstrated engagement and investment in the existing process.

Our comments on the "Approach," are subject to the above noted caveat.

Proportionality and Burden

The "Approach", as we understand it, is consistent with supervisory approaches from other jurisdictions, but we believe that the critical issue for small, localized insurers is the degree to which the regulator is able to demonstrate a willingness to ensure there is proportionality. While proportionality is referenced in the document, we believe this is of little value without a clear shared understanding of where proportionality will provide an actual reduction in administrative effort and cost for smaller insurers with well-established and consistent business models.

As written, the "Approach" provides an impression that significant cost will be added to smaller insurers as related to hiring additional staff or working with external consultants and vendors to satisfy the framework, without necessarily improving risk management and safety. The additional expense to comply with this framework would be significant and of an order of magnitude that would result directly in increased premium costs to policyholders.

In addition, the mutual governance system directly involves policyholder participation. Boards of Directors are elected by policyholders and the underlying corporate structure of the mutuals places policyholders firmly in a position to influence governance oversight.

We often refer to this informally as “grassroots” governance and we believe that this adds significant consumer protection and value to the policyholder. As a corporation without share capital, the mutual model provides a long-term view to corporate stewardship and removes many of the conflicting priorities that can arise in non-member owned corporate structures.

The relatively small scale of mutual insurers also provides both boards and senior management with much more insight into the inherent risks as encountered by insurers on a day-to-day basis. Both boards and senior management are deeply immersed in the mutuals’ activities and risk appetite.

In the same sense, the small size of a mutual must be considered when assessing the need for some of the roles set out in the framework, including internal audit and compliance. These are accomplished on a simplified basis with transparency, straightforward governance and compliance checklists, and accountability to policyholders and other stakeholders at the governance level.

The Relationship Management Process

The Approach imposes many obligations on the insurer to manage risk. At the same time, the insurer will be heavily reliant on the regulator’s Relationship Manager and the capabilities of the regulator’s examination staff, to maintain a fair minded and proportionate mindset. In our view, the ability of these individuals to apply experience and insight that allows for proportionality, efficiency, and cost effectiveness is a critical factor.

We believe this is particularly important as, while the Approach is principles based, it will also be very directive. As an example, the framework does not appear to include an appeal process or an ability to take issue with a regulator’s recommendations or assessment of an insurer’s risk rating. This would appear to provide the regulator with discretionary opportunities to impose their will on the regulated entity. We recognize that situations where solvency is at direct risk require an ability to intervene and act, however the risk and staging framework places opportunities to exert control and direction over the activities and processes of the regulated entity at what we believe is an earlier stage than necessary. An opportunity to better understand the anticipated “normal” use of this framework is necessary as we see the potential for significant disagreements on the steps that may be set out by the regulator. This is particularly important given the lack of a formal appeal or dispute process.

As an example, we note, of the 5 Intervention Levels, an insurer may be required to consider merger opportunities as early as Level 3 under FSRA’s oversight. This is an example of relatively drastic action which would appear to be solely at the discretion of the regulator.

Principles-Based vs Rules-Based

A principles-based approach is held out in direct contrast to a rules-based approach. Even in a principles-based environment there is a concern that “rules” are still manifested through the discretionary decisions by the regulator. In a sense, this provides regulatory staff with the ability to create “rules” through discretionary decisions, without the necessity of publishing or setting out their rationale. Our experience is that while frameworks may be principles-based, day to day regulatory decisions and activities can be more reflective of the inflexibility associated with a rules-based environment.

A further concern about the discretionary powers of the regulator within the framework relates to the transparency in how regulators are arriving at their risk assessments. We acknowledge that supervisory letters and specific risk matrixes provide some transparency, but we believe the framework needs to be more explicit as related to how FSRA will share its own decision-making matrix and deliberations with an insurer that is subject to some of the interventions set out in the intervention guide.

The framework also refers to a reliance on early warning tests, and the ability of insurers to consistently be above average as related to industry performance. The use of an average approach can be problematic. By its nature, an average does not necessarily truly reflect the degree of safety from a solvency standpoint, whether it be overstated or understated.

The Need for Practicality

Some of this feedback may seem speculative in nature, given that this framework incorporates some structures which will be new to our business environment. Our concern is that after decades of experience in the mutual system on solvency monitoring, intervention in some cases, and policyholder protection, the benefit of that experience will not necessarily be accessed or given credence by this regulatory structure.

Of particular concern to us is that assessing this framework is virtually impossible without specific examples as to how it will work, or has worked, in practice, for smaller insurers.

We believe the role of self-monitoring and examination also needs to be explicitly addressed from a practical standpoint to understand the impact this new framework will have on the expense ratios, workload, and ability to deliver value to policyholders.

The Value of Mutual Insurers

As a final point, we wish to reiterate that mutual insurers operate solely for the benefit of mutual policyholders and our paramount guiding consideration has always been a cautious and conservative approach to solvency protection and long-term decision making.

To assess the degree to which this framework will enhance or detract from the major contribution mutuals make to local economies and communities to the benefit of policyholders, the more practical elements of how this framework will operate need to be reviewed.

We circulated the “Approach” framework to all FMGF mutuals and we received the following direct comment. While we hesitate to provide this comment on a second-hand basis, we feel that the spirit of service and stewardship to mutual policyholders is important, aside from any of the technical elements of frameworks and prudential theory:

> *“The burden the framework will place internally on the mutual insurance system and at the individual company level will be more than a challenge. The focus at the company level currently is on serving the policyholder in all areas and departments. This new approach will shift the organization’s focus or direction from the policyholder to one of formalities and official procedures.”*

Given the short timeline provided for written response we hope that some extension may be provided for our member mutuals who may also wish to provide comment.

Thank you for the opportunity to respond to this consultation.

Yours truly,

JL C Taylor

John L. Taylor BBA, FCIP, FCLA, CHRL
President

Cc:
Fire Mutuals Guarantee Fund Trustees
OMIA Member Companies
Fire Mutuals Guarantee Fund Signatory Mutuals:
Algoma Mutual Insurance Company
Amherst Island Mutual Insurance Company
Axiom Mutual Insurance Company
Ayr Farmers Mutual Insurance Company
Bay of Quinte Mutual Insurance Company
BCM Insurance Company
Brant Mutual Insurance Company
Caradoc Townsend Mutual Insurance Company
Cayuga Mutual Insurance Company
Dufferin Mutual Insurance Company
Dumfries Mutual Insurance Company
Edge Mutual Insurance Company
Erie Mutual Fire Insurance Company
Germania Mutual Insurance Company
Grenville Mutual Insurance Company
Halwell Mutual Insurance Company
Hamilton Township Mutual Insurance Company

Howard Mutual Insurance Company
Howick Mutual Insurance Company
Kent & Essex Mutual Insurance Company
L&A Mutual Insurance Company
Lambton Mutual Insurance Company
Maple Mutual Insurance Company
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