Written Submission for the Pre-Budget Consultations in Advance of the 2019 Federal Budget

By: Craig Stewart, Vice-President, Federal Affairs, Insurance Bureau of Canada (IBC)

Recommendations

1. **Earthquake:** IBC continues to advocate for a liquidity line for the Property and Casualty Insurance Compensation Corporation (PACICC) and for financial backstops for distressed insurers as mechanisms needed to ensure broader financial stability in the case of a severe earthquake.

2. **Flood:** IBC encourages Finance Canada to engage in the policy development process now underway. Department officials can do so constructively while the Department still maintains its challenge function. The federal government should pay particular attention to the role of natural infrastructure such as wetlands, given their relatively high return on investment in providing community resilience to flooding.

3. **Office of the Superintendent of Financial Institutions' (OSFI's) review of the reinsurance framework:** IBC believes that certain items in the reinsurance discussion paper require extensive further study by OSFI and the industry to assess the broader economic impacts and unintended consequences that may be outside the scope of OSFI's mandate.

4. **International Financial Reporting Standard (IFRS) 17 Insurance Contracts:** IBC recommends that the government minimize the tax uncertainty associated with implementing IFRS 17 by engaging property and casualty (P&C) insurance expertise in the review process and ensuring that legislative tax amendments are included in the budget to be tabled in early 2020.

5. **Cannabis legalization:** IBC encourages the government to invest sufficiently in impairment-detection tools, law enforcement and preventive measures, such as a public education campaign that emphasizes the risks associated with cannabis-impaired driving.

Introduction

On behalf of Canada's private P&C insurers, IBC is pleased to present its recommendations for consideration by the Standing Committee on Finance in advance of the 2019 federal budget. The P&C insurance industry is an important contributor to the Canadian economy, and IBC supports the standing committee's focus on economic growth and the need to ensure Canada's competitiveness. We recommend action on a wide range of issues of strategic importance to the industry and the Canadian economy as whole.

1. Earthquake

A catastrophic earthquake poses one of the most significant financial risks to Canada and Canadians. Natural Resources Canada calculates the probability of a large earthquake in the next 50 years in British Columbia at 30% and in Eastern Canada at 10% to 15%. To address this significant exposure, insurers are well capitalized. OSFI requires every insurer to have sufficient financial resources to meet a 1-in-500-year event by 2022 – one of the most stringent prudential standards in the world.

An analysis undertaken by OSFI and PACICC has shown that a greater than 1-in-500-year earthquake would lead to institutional failures and result in PACICC assessing surviving stressed insurers, resulting in more failures. These failures would have consequences throughout the financial sector, creating significant uncertainty in financial markets. An event of this magnitude would leave Canadians financially exposed and unable to rebuild their homes, causing severe macroeconomic consequences across the national economy.

There are institutional solutions that governments can implement relatively easily to avoid this scenario. Most developed economies, including the U.S., the U.K. and Japan, have created public-private solutions for catastrophic risks, including earthquakes, floods, hurricanes and terrorism. Canada's federal government has established such programs for nuclear disasters, oil spills and railway accidents. Canada needs to approach its earthquake risk in a similar way. IBC raised this issue in previous pre-budget consultations and recommended that action be taken to prepare for a large earthquake.

When considering broader issues dealing with systemic risk and institutional failure, it is critical to recognize the structural differences among the different sectors that make up Canada's financial industry. Given that only seven of the more than 200 P&C insurers in Canada are publicly traded, measures like "bail-in capital" that might be applicable to the banking sector are not appropriate for the P&C sector. Furthermore, given the already stringent capital reserves required by OSFI, the insurance industry is not supportive of further measures that might require pre-funding of consumer compensation entities.

The catastrophic risk focus of the Review of the Federal Financial Sector Framework is a positive step. IBC looks forward to further discussions on earthquake-related contagion and systematic insolvency over the course of the review period as we continue to advocate for a liquidity line for PACICC and for a financial backstop for distressed insurers.

2. Flood

Flood is the natural peril affecting the greatest number of Canadians today. Taxpayers currently bear the cost of decades of land-use planning decisions that permitted residential and commercial developments to be built in areas at risk of flooding. Residential overland flood insurance products have been available since 2015 and, while market capacity is increasing, the market is not yet mature. Private insurance will likely continue to be either unavailable or unaffordable for residential properties at the highest risk. These homeowners will continue to rely on government disaster assistance until alternative solutions are found.

Federal payments to provinces to offset provincial financial aid for residential property owners account for a significant percentage of the losses shouldered by taxpayers through the Disaster Financial Assistance Arrangements (DFAA) program. Government spending on disasters has increased over the past 40 years, from an average of $40 million a year in the 1970s to over $600 million a year in the current decade. The Parliamentary Budget Officer estimated that from 2016–17 to 2021–22, the DFAA program can expect claims averaging $902 million per year with flooding the primary driver. Climate change will likely exacerbate these problems if efforts to prioritize risk mitigation and make communities more resilient are not undertaken in the near term.

Following the November 2017 roundtable on flood convened by the Minister of Public Safety Canada, the Honourable Ralph Goodale, IBC has been asked to lead a National Working Group on the Financial Risk of Flood. This Working Group will develop options for the financial management of high-risk properties and for elevating consumer engagement. These options will be presented to a National Advisory Council on Flood Risk before recommendations are presented to Federal/Provincial/Territorial Ministers at their January 2019 meeting.

IBC encourages Finance Canada to engage in the policy development process now underway. Department officials can do so constructively while the Department still maintains its challenge function. To mitigate future risk, IBC continues to assist the federal government in

allocating infrastructure investments to identified areas of greatest risk and ensuring that these investments are captured in models used to price risk. The federal government should pay particular attention to the role of natural infrastructure such as wetlands, given their relatively high return on investment in providing community resilience.

3. OSFI's review of the reinsurance framework

Following a multi-year, broad-based review of the reinsurance framework applicable to federally regulated insurers in Canada, OSFI published a discussion paper on June 8, 2018, that outlines a slate of proposed changes, some with potentially significant impacts on the P&C insurance industry.

IBC appreciates OSFI's collaborative approach and the opportunities for IBC's members to submit comments by Sept 15. But given the serious implications arising from the proposed changes, IBC believes that the proposals in the discussion paper warrant additional review and consideration. Specifically, we strongly believe that some of the proposals require extensive study to assess the potential broader economic impacts and unintended consequences that may be outside the scope of OSFI's mandate.

Some of the proposals may affect the availability and affordability of insurance products and influence companies' decisions on where to deploy their capital given the scope of their global operations. Canadians enjoy the benefits of a vibrant, highly competitive insurance market which provides corporate and individual clients with a diversity of products that address their risk management needs. We also note that as part of insurers' prudent risk management practices, risk is transferred to those who are best able to bear it, which in some cases means that it is transferred to global reinsurers, who have access to vast capital resources otherwise unavailable in Canada. This model has served us well, including in the aftermath of the devastating 2016 Fort McMurray wildfires, which constituted the costliest insured disaster in Canadian history. We believe that policies to limit "reinsurance risk" or minimize it relative to insurance risk are not in the best interest of Canadians.

One of the proposed rules would limit the issuance of high-limit policies, which could have negative implications on affordability and availability of commercial insurance, such as commercial liability, property, business interruption, cyber risk and surety. Commercial insurers issue large policies at the request of large commercial clients who are undertaking large-scale projects and transactions that support economic activity across the country. Prudential rules that limit the issuance of high-limit commercial policies are not in the best interest of Canadian businesses.

IBC greatly appreciates OSFI's collaborative approach to fulfilling its mandate. However, we believe that certain items in the reinsurance discussion paper require extensive further study by OSFI and the industry to assess the broader economic impacts and unintended consequences that may be outside OSFI's mandate.

4. IFRS 17 Insurance Contracts

The P&C insurance industry and its stakeholders identify IFRS 17 as a significant development.

Coming into effect on January 1, 2021, IFRS 17 will change the way insurance contracts are valued and reported for accounting purposes, which could change the way taxable income is computed. For example, under IFRS 17, the calculation of key cash flows that determine a P&C insurer's income will significantly differ from the current accounting standards that are used to calculate income for tax purposes under the Income Tax Act.

Earlier in 2018, IBC's IFRS 17 Tax Working Group held an introductory meeting with Finance Canada to highlight key accounting changes and advocate for a collaborative approach between the industry and policymakers. We are hopeful that the collaboration will increase as the adoption date nears and as the industry works to ensure an efficient, effective implementation of IFRS 17 in Canada. To mitigate the tax uncertainty associated with the adoption of IFRS 17, we recommend that legislative changes related to IFRS 17 adoption be drafted shortly and included in the federal budget to be tabled in early 2020.

IBC recommends that the government minimize the tax uncertainty associated with implementing IFRS 17 by engaging P&C insurance industry expertise in the review process and ensuring that legislative tax amendments are included in the budget to be tabled in early 2020.

5. Cannabis legalization

The P&C insurance industry supports cannabis legalization within a legal framework that protects public safety and minimizes the harm associated with cannabis use. With the legalization of cannabis imminent, IBC has concerns about public safety consequences.

Legalization might normalize and increase cannabis use, resulting in a corresponding increase in the risk of harm due to impaired behaviours, especially as they relate to road safety. Although impaired driving due to alcohol consumption has become taboo, the same cannot be assumed for cannabis-impaired driving. It is important that impairment laws be applied equally to all drivers, regardless of whether they use cannabis for recreational or medical reasons.

Failure to develop a means of detecting impairment caused by cannabis will have significant road safety implications. Detecting impairment by cannabis is not as straightforward as that by alcohol, and no test comparable to the breathalyzer is available at this time.

IBC encourages the federal government to ensure sufficient resources for provinces and municipalities to enforce cannabis-impaired driving laws, including investing in accurate impairment-detection devices and personnel training.

IBC believes that education is a crucial element of a comprehensive public safety and awareness framework that encourages responsible cannabis use. To that end, IBC will launch a public education initiative on the risks of cannabis consumption as they relate to road safety and liability ahead of the legalization of recreational cannabis in October 2018.

IBC encourages the government to invest sufficiently in public education that emphasizes the risks associated with cannabis-impaired driving and advocates for preventive measures. This can complement deterrents such as penalties and convictions for offending drivers.