Assurances

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Volume 52, numéro 2, 1984

URI : https://id.erudit.org/iderudit/1104375ar
DOI : https://doi.org/10.7202/1104375ar

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Éditeur(s)

HEC Montréal

ISSN

0004-6027 (imprimé)
2817-3465 (numérique)

Découvrir la revue

Citer ce document

Ross, A. (1984). The Ontario Insurance Exchange – Do we need it? *Assurances*, *52*(2), 153–159. https://doi.org/10.7202/1104375ar

Résumé de l'article

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The Ontario Insurance Exchange
– Do we need it ?

by

Angus H. Ross[1]

Dans son article, M. Angus H. Ross traite de la Bourse des assurances dont il est question à Toronto, c'est-à-dire The Ontario Insurance Exchange. *Sa conclusion est intéressante. Il se dit que l'industrie de l'assurance, déjà encombrée, risquerait de l'être davantage, même si l'on doit admettre que le nouvel organisme rendrait service. Pour en arriver à une conclusion définitive, il faudra avoir plus de détails. Pour l'instant, il faut s'en tenir au texte présenté par la Commission chargée d'étudier le problème et les solutions.*

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The Canadian insurance industry in recent years has operated in the most natural of fashions ; just as nature abhors a vacuum, so Canadian underwriters also seem to eschew an underwriting profit. Net results of the industry over the past five years can be seen in Table I. An analysis of companies' gross figures suggests that the overall result of the entire market is substantially worse.

TABLE I

	Underwriting Profit/(Loss)
1978	$46 million
1979	($186 million)
1980	($591 million)
1981	($932 million)
1982	($522 million)
TOTAL	($2,285 million)

Despite several bankruptcies of insurers – Strathcona, Pitts, Cardinal and Northern Union and government control of another (Canadian Great Lakes Casualty & Surety) there has been no move

(1) Mr. Ross is Senior Vice President of *The National Reinsurance Company of Canada.*

toward rate increases in commercial business and on personal lines, after substantial increases, fairly hefty rate reductions are now being pushed through.

There are undoubtedly too many companies and too many reinsurers chasing after the business (with much unused premium capacity) to anticipate any early return to consistent profit, and more companies are becoming licensed each year.

Needless to say, against this background, it was with some surprise that the industry learned on November 4th 1982, of the Ontario Government's approval in principle of the establishment of an Insurance Exchange in Toronto. What was behind this unexpected move ? What form would the Exchange take ? What business would it obtain ? Do we need it ? In this article, I hope to throw some enlightenment on these questions.

Why ?

Although the Pitts, Cardinal and Strathcona were federally registered companies, their ceasing to do business had a serious effect on Ontario insureds. One common (and in certain instances decisive) factor in their downfall was the inability to collect from unregistered reinsurers. The Ontario government felt that some control over the unlicensed market could be effected by a reduction in the volume of reinsurance placed on an unlicensed basis, and on insurance placed outside Canada.

In their initial reviews the Department of Consumer & Corporate Affairs (which is responsible for insurance in Ontario) estimated that over $1 billion is placed outside the country, made up of unregistered reinsurance plus insurance marketed outside Canada by the major brokers. A local insurance Exchange should reduce this outflow.

Finally, an Exchange would enhance Toronto's place as a major financial centre and attract fresh investor capital whilst operating as a self-regulating entity.

These then were the basic stated reasons of Dr. Elgie, Minister of Consumer & Corporate Affairs, for the approval in principle. At the same time, he announced the setting up of an Insurance Exchange Committee to prepare a report on the feasibility of an Insurance Exchange with the committee's terms of reference encompassing thirteen specific areas.

Exactly one year later, on November 4th 1983, Dr. Elgie tabled in the Ontario Legislature a 76-page feasibility report which recommended "that the Government authorize work to begin on Phase II – implementation studies into the legislative framework, the management and administrative structure and licensing requirements of an Exchange". It would appear the setting up of an Exchange should be a formality.

Form

It is understood that the Exchange would be a Lloyd's type of operation, but with certain differences initially evidenced in the U.S. Exchanges. Capitalization for a syndicate would be around $2.5 million, of which $500,000 would be part of an overall security fund. Liability would be limited to the amount of capital subscribed. Investment would be open to individuals, insurance companies, corporate investors and, with a limited involvement, brokers. The licensing – federal or provincial – would have to be determined.

Business would be brought to the Exchange purely through intermediaries subject to the discipline of the Exchange. Eligibility for broker membership would be open to any broker, agent or reinsurance intermediary licensed in any Canadian jurisdiction.

Taxation advantages would be sought solely for Canadian individual investors (to bring at least equality with the current Canadian Department of Revenue treatment of Lloyd's names).

Business to be obtained

There are four areas of potential business :

1. Canadian Treaty Reinsurance. / Grouped together for
2. Canadian Facultative Reinsurance. / projection purposes.
3. International Reinsurance.
4. Direct Insurance.

Projections for the Exchange show it growing from a total of $20 million in 1985 (the anticipated first year) with the split 75% reinsurance 25% direct insurance formerly placed outside Canada to $540 million eight years later with the split 85%/15% respectively.

So, on the face of it, the proposed Exchange would appear to be an eminently laudable proposition – repatriating to Canada business which could or should be written in the country. But is this view held up in an analysis of the report. Let's have a look.

1. Business written

The estimate of business sent outside the country is $1 billion ($1,000 million) split 60% unregistered reinsurance and 40% direct insurance placed outside Canada. (It should be noted that this latter figure is an estimate by the Brokers and Insurers Sub-Committee. It should also be noted that it is unclear in the report whether these figures include Lloyd's, although from the general tenor of the report, Lloyd's appears to be treated as an out of Canada placement). One extremely important omission in the report, however, is the overall result of the business sent overseas ; unfortunately there are no statistics available on this aspect of invisible balances but, given the overall results of the Canadian market in the past few years, one would have to assume that the claims paid to Canada have far exceeded the net premiums sent outside the country.

It is difficult to comment on the direct side, since no statistics can be found, but on the reinsurance side some questions have to be posed.

a) Is the available market as large as it seems ?

There are a number of factors which would make the answer "No !" Firstly there are cessions to Head office of affiliates from branches or subsidiaries ; and there are many cases where Canadian business is included in the head office treaties. By using the Insurance T.R.A.C. Report (Canada) 1983, we can analyse reinsurance cessions to affiliates and non-affiliates for all federally registered companies as follows :

	Direct + R/I Assumed in $'000s	*% Ceded to Affiliates*	*% Ceded Elsewhere*
1979	6,411,897	13.4%	13.3%
1980	7,020,397	16.1%	23.8%
1981	8,068,385	15.0%	14.2%
1982	8,836,477	13.5%	14.4%

If we conservatively say that 50% of the amount ceded to affiliates is duplication of cession and only 50% of the balance goes outside the country then the reinsurance premium which would reasonably be expected to be sought after by the Exchange would be reduced by some $300 million in 1982 terms.

b) Repatriator or competitor ?

But here the report diverges from its concept of repatriation for in the estimates of production it states that for 1985 the estimated available reinsurance market is $3,900 million, or the total reinsurance placement of the Canadian market.

The report states "In the reinsurance field the longstanding relationships between primary insurers and reinsurers will continue to be tested by the competitive environment of an Insurance Exchange". The conclusion to be drawn from this is obvious.

Returning however to the true unregistered reinsurance there are still other hurdles. Broker reciprocity accounts for a certain amount of overseas placement which could not expect to change ; reciprocal arrangements between direct insurers or between reinsurers account for more as does a certain amount of business which the local reinsurance market has, for valid reasons, rejected in part or in whole. Business fronted for perfectly respectable and financially solid overseas markets probably exceeds $100 million. This would not be open to the Exchange.

The Exchange either will not get or will not want the reinsurances mentioned here. Finally, there are strong national economic arguments for a certain amount of (particularly) catastrophe business to be placed overseas. In the event of a major earthquake in Montreal or Vancouver, it would be devastating to the Canadian economy on its own to try to finance the rebuilding. Far better to draw from the worldwide catastrophe reinsurance pot, which is one of the main functions of reinsurance.

2. *Finance & Capacity*

Where *would* the money come from ?

Private individuals, assuming favourable tax treatment might consider joining a syndicate, although recent performances of the Canadian property/casualty market have hardly been conducive to investment. Existing Canadian registered insurance companies would hardly wish to join syndicates to compete with themselves; likewise Canadian registered reinsurers. There is also a major difference between the U.S. and Canada for non-registered companies ; to set up a Canadian branch at present requires minimum deposits of $1.8 million, in the U.S. it is far greater. Therefore the impetus to join the N.Y. Exchange came in part from foreign companies unwilling to put up a substantial amount of money to become licensed – this impetus will probably not be seen in Canada, particularly when a comparison of the size of market is made. (State Farm alone in the U.S. is close to the size of the entire Canadian market).

Existing captives (provided they do not have Canadian operations) might join syndicates, although the Phillips/Walton experience must make many reconsider the benefits or writing unrelated business.

Banks and other financial institutions might see the Exchange as a way to get into the insurance business (although their natural market would be personal lines) and some corporations could look on a small investment as a means of diversification. Overall, however, I could not envisage much early syndicate activity. If we look at another angle, how much financial capacity would be needed ?

In terms of premium ratio (and we must assume it would not be permitted to write more than 3 times capital/surplus – indeed the report states "An Exchange should not seek preferential tax or regulatory treatment to the disadvantage of present members of the insurance industry) it would need capital/surplus of $7 million in 1985 rising to $180 million by 1992. In terms of underwriting capacity the limits it would have to offer to attract business would have to be substantial.

And here there is one aspect which the report has completely ignored : the reinsurance needs of the Exchange itself. If the Exchange is to offer substantial limits, and if it is to be prudent and protect investors, then it must purchase reinsurance – both proportional and non-proportional. Since there is almost no retrocession market in Canada (and between 75% and 85% of the projected premiums are from reinsurance) there is only one place for its retrocessions to go – outside the country !

Also in terms of underwriting capacity, the Canadian market currently suffers a lack of underwriting expertise – particularly in reinsurance. Whence will come the experts to write the business – with a particular knowledge of the Canadian market ?

Finally, with regards to international reinsurance as a means of improving the balance of payments, I can only assume that neither the Committee nor Dr. Elgie have seen the annual reports of such major international reinsurers as the Munich Re, Swiss Re, M & G or SCOR.

Limited space prevents me from touching more areas of concern but in summary I can only say : the exercise of studying an Exchange has been a good one ; in my opinion the wrong recommendation has been made to take it further. The insurance industry should assert itself in supporting realistic changes in the Federal Insurance Act which, if properly applied, would bring back to Canada a certain amount of the business currently going overseas without bringing new, competitive pressures into the already overcrowded domestic scene.

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