Members' Update

The Assuris Members' Update provides articles and papers on key industry issues as well as share insights on regulatory news, global perspectives and Assuris updates.

Issue I - May 2022

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Not Your Maytag Repairman

Stephanie Greer,
Executive Vice President, Risk & Resolution

I sometimes hear Assuris described as being "like the Maytag repairman", sleepily waiting for the rare call that an insurer has failed. It is certainly true that Canadian insurers rarely fail, but we do much more to protect policyholders and serve our members than wait around for a failure!

Borrowing the Coast Guard's motto, what we really are is *"Always Ready".*

We have deep expertise in insurance resolution and are focused on being ready to deal with a failure of any member life insurance company. We understand and anticipate industry-wide and company-specific scenarios that could cause a member to fail. We work closely with regulators and with partners like Property and Casualty Insurance Compensation Corporation (PACICC) and Canadian Deposit Insurance Corporation (CDIC) to support the overall soundness of the financial system and protect Canadians.

Part of being *Always Ready* is having the playbooks, tools, and capabilities to respond quickly if issues arise.

Our playbooks incorporate hard won knowledge and experience gained from past insolvencies but also crises, like the real estate bubble in the 90s, the Global Financial Crisis and more recently the COVID-19 pandemic, as well as the use of cutting-edge financial tools, like swaps and stop-loss reinsurance instruments, to support a resolution.

Because of the long-term nature of life insurance, the most appropriate resolution option is usually to transfer the policies to a solvent life insurer, instead of paying cash compensation or winding down the company. This court-driven restructuring process maintains the most value of the troubled company and, in our past experience, has proven to be the lowest cost solution.

While we were very successful with the past insolvencies, the next one will likely be different. The traditional court process works well, but the insolvency profession has evolved, and we are turning our focus to more modern restructuring practices.

Assuris has early intervention powers to support a transaction outside of the traditional court process, which may be a faster solution. We know from experience that moving quickly to resolve a failure is the best way to protect policyholders from loss, reduce the cost of failure for the industry, and maintain the public's confidence.

A great example of our unique capabilities is CompCorp Life, Assuris' fully licensed life insurance subsidiary. CompCorp Life can act as a bridging institution, giving us a wide array of options and tools for resolving a failed insurer. We used CompCorp Life in past insolvencies to provide reinsurance to the purchasing insurer who had concerns with the value of the assets supporting particular blocks of business. This allowed more time to work out troubled illiquid assets and to avoid an undervalued fire sale in liquidation.

Being *Always Ready* also means regularly testing our playbooks, tools, and capabilities, often in concert with our regulatory and other partners, through simulations and tabletop exercises. The exercises are designed to identify gaps in our playbooks and ensure that we will be ready to deal with the resolution of a troubled company.

Another component to ensure we are *Always Ready* is to have the appropriate funding mechanisms in place. Our industry-funded assessment system is designed to limit contagion by limiting the amount we can collect from the industry in a year. Assuris recently worked with the life insurance industry to increase our liquidity fund to $200 million to ensure we can meet immediate protection and avoid disruption to policyholders.

A brief summary of the Assuris assessment system is included in Table 1.

Table 1:	Purpose:
Specific Assessment	▶ To cover the cost of protecting policyholders. ▶ The maximum is 0.5% of that member's solvency buffer in Canada annually.
Loan Assessment	▶ To secure cash needed in excess from what is available from other sources such as the specific assessment and the liquidity fund. ▶ Used as an interim measure to meet the short-term funding needs in connection with a troubled company. ▶ The loans outstanding will not exceed 3% of that member's solvency buffer in Canada.
Extraordinary Assessment	▶ Implemented when the specific and loan assessments are inadequate to cover the cost of protecting policyholders. ▶ Based on new business premiums from life, health and wealth management business.
Liquidity Fund	▶ A $200 million fund invested in high-liquidity low-risk assets to supply immediate liquidity needs.

Canadian policyholders and Assuris members can take comfort knowing that we are here, always vigilant, and *Always Ready*. We've got your back.

Stephanie Greer FSA, FCIA, is the Executive Vice President, Risk & Resolution, at Assuris, and is responsible for identifying solvency risks and preparing for resolution. She actively works with the regulatory bodies to ensure a strong regulatory framework with a focus on early risk identification and readiness for life insurance insolvency issues.

Strength in Diversification: Industry Asset Value & Credit Risk Post-Pandemic

Steve McMahon
Assistant Vice President, Industry Risk

Credit risk managers have a (bad?) habit of using baseball analogies when talking about the investment cycle. A typical answer to the question, "Where are we in the cycle?" might be something like, "Feels like the 7th inning," to signal that a good credit cycle is getting long in the tooth and may turn soon.

To continue the analogy, the pandemic in many ways felt like a long rain delay. Unprecedented fiscal and monetary intervention pretty much side-lined any market-driven changes. With the development of vaccines in early 2021, the tarps started being rolled back and we began to anticipate a return to a more normal market dynamic in 2022.

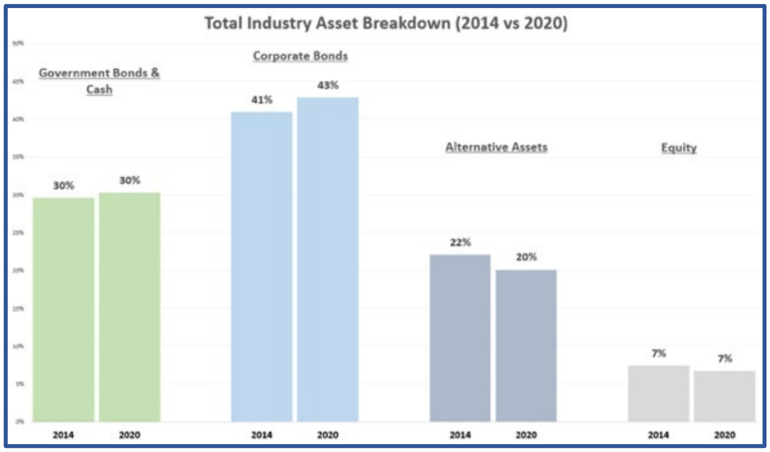
Here at Assuris, we spend a lot of time thinking about industry-wide and company-specific risk within the life insurance sector. So, it may not surprise you that asset values and credit risk were top of mind for us as we started to emerge from the pandemic. During 2021, we spoke to credit and asset specialists at our member companies, our regulatory partners, the Bank of Canada and other experts – as well as doing our own basic research – to develop a view on overall industry asset value and credit risk.

We found that our industry continues to be well diversified across asset classes and credit exposure and is well-positioned to continue successfully navigating through these uncertain times.

We did note a few sectors that have greater exposure to a decrease in value post-pandemic, such as non-essential retail, commercial and residential real estate, but found that the industry's overall exposure to these sectors is modest and well managed from a risk point of view.

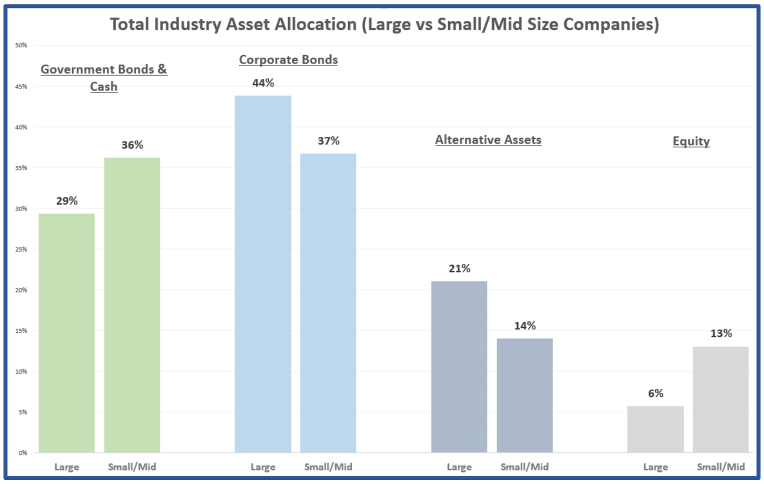
We thought you might be interested in a couple of snapshots of the industry's holdings.

Canadian insurers remain mainly invested in fixed income assets (making up 80-85% of total industry assets). Industry asset allocation has been stable over the last six years, as illustrated on the following table:



The alternative assets category is mainly invested in commercial mortgages, residential mortgages and real estate.

We do see a difference in portfolio holdings of the large companies compared to mid-sized and smaller companies:



As we move through 2022, inflationary pressures, interest rate changes, managing investment strategies under IFRS 17 and, above all, the reemergence of geopolitical risk have once again made it tough to call the credit cycle. While we remain vigilant, the life insurance industry is facing a new phase of uncertainty with a position of strength thanks to its diversification and focus on risk management.

Steve McMahon FSA, FCIA is the Assistant Vice President, Industry Risk, at Assuris, and is responsible for analyzing the broad economic and emerging industry-wide risks. He is also responsible for developing Assuris' views on capital and actuarial policy issues. Steve is actively involved with in-depth analysis of solvency risks of our member life insurance companies.

IFRS 17 – Profits or Prophecy

Monica Deschamps, *Manager, Risk Reporting*

Managing a life insurance company often involves a level of prediction and estimation that borders on prophecy. Prophecies of life, death and profitability must be made before the contract is even signed by the policyholder. On January 1, 2023, IFRS 17 will come into effect for all life insurers in Canada and will change how profitability is understood and managed.

IFRS 17 will significantly impact:

- the timing of profits and;
- how profits are presented and disclosed.

This will have a significant impact on the Key Performance Indicators (KPI's) used to steer the business.

It's important to remember that the overall profitability of an insurance contract will not be impacted under IFRS 17, but the timing of the release of profits will significantly change.

Under IFRS 17, when an insurance contract is sold, the expected profitability of the contract is calculated and deferred on the balance sheet as the contractual service margin (CSM). CSM will be recognized into revenues when the actual insurance services are provided.

And of course, the CSM will impact profitability and business volume KPIs.

The benefit of IFRS 17 is that the presentation and disclosure of the statement of comprehensive income, the insurance contract liability roll forwards and the CSM run-off schedule will provide rich information about the performance of the business.

The statement of comprehensive income will present the insurance result and the investment results separately. This will provide more transparency on the drivers of profitability.

The insurance contract liability roll forward is an additional disclosure under IFRS 17 that will show the detailed changes to the insurance contract liability during the reporting period. Changes to the insurance contract liability are related to changes in:

- financial assumptions
- past or current services
- future services

The CSM run-off schedule is a required disclosure which demonstrates the expected amortization of CSM. This disclosure can provide an understanding of expected future profits, as well as what part of the business is driving future profitability.

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Table 1	IFRS 4	IFRS 17
	Old world	New world
Measurement		
Timing of profit recognition	▶ The expected profits of a new contract are recognized immediately ▶ Revenues are based on premiums received	▶ Profits are recognized over the life of the insurance contract as services are provided to the policyholder
Insurance contract liability	▶ The measurement of the liability is linked to the assets held ▶ Return assumptions for the assets held impact the value of the liability	▶ Assets and liabilities are no longer linked ▶ Profits are deferred on the balance sheet as component of the insurance contract liability. The deferred profit component is called the contractual service margin (CSM)
Presentation		
Statement of comprehensive income	▶ Insurance and investment net returns are commingled on the statement of comprehensive income ▶ New business gains are recognized in the statement of comprehensive income as part of the changes in actuarial liabilities	▶ Insurance net returns and investment net returns are presented separately in the statement of comprehensive income
Insurance contract liability roll forward	–	▶ Key new disclosure that will tell a story about the business. See "Illustration – Insurance contract liability rollforward – measurement component view"
CSM Run-off schedule	–	▶ New disclosure that can be used to forecast future profitability

Table 2	
Earnings Strength KPI's	Impact
Volume	▶ The business volume KPIs based on premiums may no longer be a good indicator of growth however, IFRS 17 disclosures will continue to show premiums received ▶ The CSM generated by new business may be used to understand growth
Profitability	CSM sustainability index ▶ A CSM sustainability index can be used to understand the longer-term outlook for the company ▶ The CSM sustainability index is calculated as: CSM generated from new business/CSM recognized in the statement of comprehensive income ▶ An index number of 1 or greater may indicate growth of the company as it is generating sufficient new business profitability to replace the business that is in force
	CSM run-off ▶ The CSM run-off schedule can be used as part of the reporting to forecast future expected profitability ▶ The CSM run-off schedule can assist in understanding: o what part of CSM being released is as a result of CSM created on transition vs. new business CSM that was generated after IFRS 17 came into effect o how different business lines or operating segments contribute to CSM release
	Insurance service margin [1] ▶ The insurance service margin will indicate the profit margins on the insurance business ▶ The insurance service margin can be compared by line of business or by operating segment to understand if profit margins are aligned with the business strategy
	Investment return margin ▶ The investment return margin will indicate whether the invested asset returns are sufficient to offset insurance finance expenses. ▶ Insurance finance expenses are: o Unwinding of the discount rate for the insurance contract liability o The change in discount rates for the reporting period to reflect current market conditions
[1] The insurance service margin can be calculated from the statement of comprehensive income or the insurance contract liability rollforward – liability for remaining coverage view	

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Illustration – Insurance Contract Liability Roll Forward – Measurement Component View

Reconciliation of changes in insurance contracts

	PV of future cash flows	Risk Adjustment	CSM	Total
Opening insurance contract (asset)/liabilities	**1,845,673**	**245,101**	**684,216**	**2,774,990**
Changes in the statement of profit or loss and OCI				
Changes that relate to current services				
CSM recognized for services provided	-	-	(125,478)	(125,478)
Change in risk adjustment for non-financial risk for risk expired	-	(4,560)	-	(4,560)
Experience adjustments	(8,467)	-	-	(8,467)
Changes that relate to future services				
Contracts initially recognized in the period	(135,454)	23,451	112,003	-
Changes in estimates that adjust the CSM	45,768	-	(45,768)	-
Changes in estimates that result in losses and reversal of losses on onerous contracts	24,516	-	-	24,516
Changes that relate to past services				
Adjustments to liabilities for incurred claims	5,457	-	-	5,457
Insurance service result	**(68,180)**	**18,891**	**(59,243)**	**(108,532)**
Insurance finance expenses/(income)	55,370	7,353	20,526	83,250
Total changes in the statement of profit or loss & OCI	**(12,810)**	**26,244**	**(38,717)**	**(25,282)**
Cash flows				
Premiums received	24,678	-	-	24,678
Claims and other insurance service expenses paid	(158,000)	-	-	(158,000)
Insurance acquisition cashflows	(15,000)	-	-	(15,000)
Total changes cash flows	**(148,322)**	-	-	**(148,322)**
Closing insurance contract (asset)/liabilities	**1,684,541**	**271,345**	**645,499**	**2,601,386**

1
- Understanding the movement in CSM for each period will be vital for understanding the profitability of the business

2
- Is the CSM generated by new business sufficient to replace CSM recognized?
- The CSM sustainability index can give a signal

3
- Experience adjustments will represent the difference between expected claims and premiums vs actual claims and premiums
- Actual/Expected claims ratios can be calculated to determine underwriting strength

4
- Consistent negative estimate changes may indicate that underwriting estimates at issue need to be updated for more accurate pricing

5
- Compare to the investment income

6
- Business volume KPI's using premiums received can still be calculated but may not be indicative of profitability

Monica Deschamps CPA, CA., is the Manager of Risk Reporting at Assuris, and is responsible for understanding the industry's transition to the new accounting standards, IFRS 17. She is also responsible for evaluating the impact of changes in the accounting regime on our member life insurance companies and identifying how to use the new information under IFRS 17 to identify potential solvency risks.

Blueprint for OSFI's Transformation

Just a few months after his appointment as Superintendent of the Office of the Superintendent of Financial Institutions (OSFI) on June 29, 2021, Peter Routledge signaled a new era at OSFI with the release of A Blueprint for OSFI's Transformation 2022 – 2025. OSFI will continue to focus on strengthening public confidence in Canada's financial system, but it will adopt new approaches to its mandate, risk appetite, and culture.

Superintendent Routledge brings considerable knowledge of the life insurance industry with him, having been responsible for the sector as a credit analyst at Moody's and later as an equity analyst at National Bank. He also brings a strong sense of urgency to address an expanding and fast changing risk environment. We would sum up OSFI's new direction as a desire to become more transparent and proactive.

The bold risk appetite described in the Blueprint is striking. OSFI will be more vocal on public policy matters, make hard decisions sooner, and adjust quickly as needed. We also applaud OSFI's drive to build a modern data management and analytics platform to reduce the burden on regulated entities.

At Assuris, we believe the transformation will be positive for the life insurance sector and we look forward to partnering with OSFI as they move forward in this exciting new direction.

For a quick view of the 3 foundational elements of OSFI's blueprint and the 6 initiatives to support the transformation, have a look at the Blueprint on a Page.

A Blueprint for OSFI's Transformation 2022 - 2025

Global Standard Setters Set their Sights on Policyholder Protection

A perhaps unsurprising fallout from the COVID-19 pandemic is a renewed focus among global financial standard setters, like the Financial Service Board (FSB) and the International Association of Insurance Supervisors (IAIS), on financial stability mechanisms and policyholder protection plans (like Assuris!), in particular.

In fact, just in the past few months both the FSB and the IAIS have established working groups and initiated new research into how the insurance sector funds failures and the role of policyholder protection plans (like Assuris!) in a failure. As you might expect, cross border issues and multi-sector failures are high on the agenda.

Assuris, through the International Forum of Insurance Guarantee Schemes, is fully engaged with both the FSB and the IAIS working groups. Canada has a lot to offer the world on this topic. Much about Assuris' design is unique and has proven highly effective.

We are never complacent.

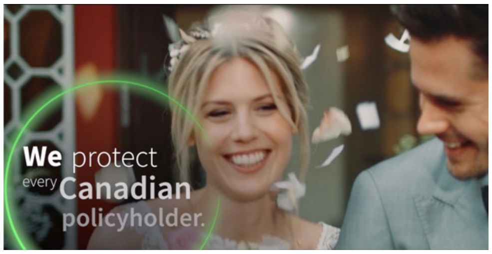
We look forward to learning about new techniques and best practices from around the world, always with a view to better protecting policyholders and keeping member costs down.

Stay tuned!

DID YOU KNOW?

Assuris is a founding member of the International Forum of Insurance Guarantee Schemes (IFIGS). Formed in 2013, IFIGS is group of insurance guarantee schemes from 24 countries across 4 continents who share their experiences in providing policyholder protection in the event of an insurance company failure.

Assuris – Looking Forward With Purpose



Assuris' mission is to protect policyholders if their life insurance company fails, with the goal of meeting the needs and expectations of our stakeholders. We achieve this by executing our three strategic priorities and performing in line with our values.

Resolution Ready

We focus on being ready to protect Canadian policyholders if a life insurance company is in trouble. We understand and anticipate the industry-wide and company-specific scenarios that could cause a member to fail, and tailor our risk detection and resolution work to our different member segments. We sharpen our company risk and resolution expertise by developing and deploying our resolution tool kit through frequent resolution preparedness testing.

2022 INITIATIVES

- Update IFRS 17 Processes – Update our analysis processes to handle the new information available under IFRS 17.
- Develop a Resolution Playbook – Build on our resolution contingency plans to develop a resolution playbook that will guide any interventions with member companies and how we work with our Board and external stakeholders.
- Develop a Plan for Run-off – Develop the resolution option to run-off unsaleable business in our bridge institution, CompCorp Life Insurance Company Inc. This includes analyzing the actuarial risk management considerations as well as the operational aspects such as legal, regulatory, finance and governance.
- Resolution Testing Centre of Excellence – Work with internal and external stakeholders to develop a Centre of Excellence to test our resolution playbook and ensure we are resolution ready.
- Review Assuris policyholder protection – Review our constating documents and test different protection levels to recommend potential changes to Assuris protection for implementation in 2023. Our preliminary view with the pilot survey in 2020 is that our protection levels might be inadequate to protect policyholders.

Stakeholder Engagement

We build and maintain strong relationships with our stakeholders by purposefully engaging with each stakeholder in a relevant manner. We firmly believe that strong relationships today are critical to effectively managing a potential future failure.

2022 INITIATIVES

- Enhance our stakeholder engagement program:
  - Policyholders and financial advisors: raise awareness of Assuris and its role in the industry and educate these stakeholders about Assuris' protection.
  - Members and Industry Advisory Committee: obtain industry-level insights that enhance Assuris' understanding of solvency risk matters and provide value-added information or best practices that enhance the Member's understanding of solvency risk matters.
  - Government & Regulator: obtain government-level insights that enhance Assuris' understanding of solvency risk matters and provide value-added information or best practices on solvency risk matters.
  - Industry Partner: engage with industry partners to keep abreast of developments and best practices to enhance our resolution expertise, to provide thought leadership, and to maintain strong relationships to support our overall resolution readiness.

- Communication Plan Implementation – Raise awareness of Assuris and its protection. Part of being resolution ready means that policyholders know that "you have Assuris' protection." The first time Canadians hear about Assuris should not be at the time of a life insurance company failure. The communication plan is an integral part of our stakeholder engagement program and is specifically targeted at increasing awareness with policyholders and educating financial advisors. Financial advisors are conduits for generating relevance and accurate messaging to the policyholders.

Operational Excellence

We deliver excellence in everything we do and approach our work with a continuous improvement mindset. We match our members' high expectations for sound financial discipline, effective risk management, best practices in corporate governance, leading human resources practices and highly secure technology for our members' regulatory filings.

2022 Initiatives

- Develop a Cybersecurity IT breach response playbook – Enhance our IT structure and mitigate potential cyber risks. This will include conducting a simulation with the Board of Directors to undertake a test of the company's response plan to a cyber breach.

- Update Investment Portfolio Policy and Practices – Assess the current mix of assets and consider whether we should widen the range of investment.

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Your Voice: Assuris' Industry Advisory Committee

The Industry Advisory Committee (IAC) is a committee of seven life insurance company representatives elected by you, the members. Established to encourage the exchange of information, improve communications and bring members' input on key industry issues, the IAC is an important link between the Assuris Board of Directors and the industry.

Formal Role

The formal role and responsibilities of the IAC provides advice by:

- Ensuring that we deliver adequate policyholder protection for all Canadians;
- Making any amendments to our By-laws and Memorandum of Operation, the formal documents that govern the corporation;
- Making sure that we provide appropriate and market competitive remuneration for Assuris' Board of Directors; and
- Recommending candidates to serve on the Assuris Board of Directors and IAC.

Current Industry Advisory Committee Members

Peter McCarthy (Chair)
President & CEO, BMO Life Assurance Company

Alec Blundell
EVP & COO,
Co-operators Life Insurance Company

Jean-François Chalifoux
President & CEO, Beneva

Denis Dubois
President & COO,
Desjardins Financial Security

Lisa Forbes
Chief Financial Officer,
Manulife Canada

Todd Lawrence
President & CEO, ivari

Jeff Macoun
President and COO, Canada,
The Canada Life Assurance Company

Industry Perspective

Over and above its formal role, the IAC provides invaluable input on emerging issues such as the standard approach to setting capital requirements, the implementation of IFRS 17 and the strategic direction of the organization.

We thank all the members of the IAC for their time and commitment.

DID YOU KNOW?

Peter McCarthy is the longest serving President & CEO of a life insurance company in Canada

Jean-François Chalifoux was named 2020 Financial Personality of the Year by Finance et Investissement