



PRIORITIES FOR THE 2012 FEDERAL BUDGET

DOCUMENT PREPARED BY
THE CANADIAN ASSOCIATION OF MUTUAL INSURANCE COMPANIES

FOR THE HOUSE OF COMMONS STANDING COMMITTEE ON FINANCE

August 2011

The Canadian Association of Mutual Insurance Companies (CAMIC) commends the House of Commons Standing Committee on Finance for holding annual consultations allowing Canadians to indicate what should be the federal government's priorities in the next budget.

CAMIC represents 91 Canadian-owned property & casualty (p&c) mutual insurers, which is a sizeable portion of the 106 mutual insurers operating in Canada. In turn, these 106 mutual insurers represent a third of the about 316 p&c insurers competing on the Canadian market - 94 of which are federally supervised Canadian companies, 92 are federally supervised foreign companies and about 130 are provincially supervised Canadian companies. In 2010, CAMIC members served 5.1 million policyholders, employed directly and indirectly in excess of 15,000 people and underwrote \$4.9 billion in premium, or some 12% of the non-government Canadian market.

Consistent with their democratic values, mutual insurers provide their members with a right to vote at the annual and at special meetings of the members of the company. Policyholders elect the board of directors of their company, approve its by-laws, its financial statement and determine the company's orientation. Mutual insurers are renowned for their strong balance sheet and their community involvement. Most mutual insurers were formed by the farming communities between 100 and 170 years ago and today the large majority of them are still headquartered in rural Canada.

As mutual insurers do not have stockholders and are governed by their policyholders, they only have their policyholders' interest in mind when operating their business. Profits generated by mutual insurers are allocated by the board of directors to either, or a combination, of the following three purposes: 1) to strengthen the surplus of the companies (which allows them to serve a higher number of policyholders); 2) to provide policy refunds to policyholders (which allows the companies to reduce their profits and charge their members a final price that reflects their actual cost of delivering insurance products); and 3) to make contributions towards social goals.

1) Demutualization of property & casualty insurance companies.

Some 11-12 years ago, a number of life insurance companies indicated their intention to demutualize voluntarily to become stock companies traded on the stock market. In response, the government of the day amended the *Insurance Companies Act* to allow the demutualization of mutual insurance companies, *both life and p&c companies*. However, the details of how the demutualization of an insurance company would occur, i.e. the process under which the demutualization of an insurer would take place and how the proceeds of demutualization would be distributed, were left to be determined by regulations. As life insurers had asked to demutualize, the Minister of Finance developed the *Mutual Company (Life Insurance) Conversion Regulations* applicable for life insurers only. At that time, as no p&c mutual insurance company were interested in demutualizing, the Minister of Finance decided not to allocate resources towards the development of legislation/regulations for the demutualization of p&c insurance companies.

In December 2010, The Economical Mutual Insurance Company, a federally supervised p&c mutual insurer, announced its intention to voluntarily demutualize and transform into a stock company. This was the first p&c mutual insurer to do so in recent history.

In response to Economical Mutual's request, the Minister of Finance announced in the June 6, 2011 budget his intention to develop a process under which the demutualization of a p&c insurance company could occur. The Budget Paper stated:

“The Government is developing a framework for the demutualization of federally regulated property and casualty mutual insurance companies, which will provide, for companies that choose to demutualize, an orderly and transparent process and ensure that policyholders are treated fairly and equitably. The Government will be in a position to review applications to demutualize once regulations are in place. Amendments to the Insurance Companies Act, including amendments that would prevent any mutual company from demutualizing indirectly, will be introduced.” (Emphasis added)

In July 2011, the Department of Finance held consultations on the issue of demutualization. CAMIC participated in these consultations but would like the House of Commons Standing Committee on Finance to express its support for our position to the Minister of Finance.

CAMIC is strongly opposed to creating an environment where advisors, board of directors, management and policyholders could withdraw substantial personal financial benefits from the demutualization of p&c insurance companies. CAMIC believes that if the value of mutual entities is distributed to current policyholders only, or especially if it is distributed to a small minority of current policyholders, this will create a “circle of self-interest” amongst stakeholders that will become one of the most significant drivers of the process.

Determining what should be the process for allowing a p&c company to demutualize and in particular, what should be considered in determining who should have the right to vote on, and receive the benefits of, demutualization, requires an appreciation of how mutual insurers were formed, how they are governed and their business model.

P&C mutual insurers were formed 4-6 generations ago at a time when it was difficult for individuals, mostly farmers, to find insurance or to find insurance at a reasonable cost. To obtain the insurance they needed, they formed mutual insurance companies which were based on a commitment by each participant (called members) to insure each other against named perils. The objective of the mutual insurer was then, and still is, to provide the insurance products needed by the members at the best cost possible. As mentioned earlier, the governance of *most mutual insurers* is totally democratic, i.e. each member has the right to vote and each member has one vote only. The members elect the board of directors of their company and the elected directors govern the company on behalf of the members. Each year, as the case may be, the board of directors decides to allocate the profits generated in that year to the surplus of the company, or to provide policy rebates to policyholders or to use the money for social goals. The current surplus of mutual insurers is the accumulation of the allocations of profits to the surplus fund of the company. As mutual insurance companies do not have access to outside capital; they tend to ensure their solvency with large surplus funds. Those companies who successfully build large surpluses become vulnerable to demutualization attempts for the purpose of generating personal windfall revenues.

When individuals become members of a mutual insurance company and purchase an insurance policy, they do not make an investment in the company. In the course of their membership, they may receive policy rebates in the form of lower premium or cash refunds if the board of directors so decides. However, when they stop doing business with the mutual company, they leave without further compensation, even if they did contribute to the profitability of the company and to the build-up of the company's surplus by purchasing insurance products from the company. The policyholders' “individual ownership” in the company is not tradable or exchangeable and cannot be transferred from generation to generation. While the member votes at annual meetings and is allowed to the rebates declared by the board of directors, the insurance policy does not provide the member with an ownership of the underlying equity of the company

or a right to demand distribution of a portion, or of the entire, surplus of the company. The absence of shareholders in a mutual insurance company should not be interpreted as giving the mutual policyholder an ownership interest in the company. Providing the current slate of policyholders with the surplus built since the formation of the company would constitute a strong encouragement to demutualize mutual insurers and would constitute unjust enrichment.

Distributing the surplus of demutualizing companies to current policyholders, or a small minority of current policyholders, without providing all policyholders, past and present, with their fair share of the distribution would represent windfall revenue. CAMIC contends that the current generation of policyholders has not generated the surplus that exists in these companies today and that, in fact, it has contributed very little or nothing to that surplus. Allowing these policyholders to be the recipients of this windfall revenue would constitute a strong encouragement to demutualize federally supervised p&c mutual insurers.

CAMIC claims that the surplus fund of a mutual insurer is permanent and non-divisible; it is owned by the mutual insurance company, not the members and is not destined to be owned by the members. The surplus fund's purpose is 1) to ensure the solvency of the insurer; 2) to provide a high quality of service and 3) to assure the sustainability of the mutual insurer over future generations.

Dual policyholder structure. As mentioned above, most p&c mutual insurers provide a right to vote to all their policyholders. A small number of federally supervised mutual insurers, however, have a dual policyholder structure: voting and non-voting and the voting policyholder base of these companies has been diminishing over the years. It is CAMIC's opinion that, by pure design, the mutual insurance company that has publicly announced its intention to demutualize has restricted the number of voting policyholders to an infinitesimal portion of its policyholder base. It appears that for years, "mutual" policies have been offered to some individuals only. Due to the very small number of companies with the dual structure even knowledgeable insurance consumer may not be aware that there are voting and non-voting insurance contracts. In some mutual companies the voting policy option is well known and published, in others the voting policyholder option may have only been offered to a selective minority. In some instances Board of directors, officers, employees and other "chosen individuals" have been granted the right to vote. CAMIC recommends that all policyholders should have the right to vote and that all policyholders should be treated in the same manner with respect to the distribution of the company's surplus.

Recognizing that The Economical Mutual Insurance Company has a surplus of \$1.2 billion, has about 1 million policyholders and less than 1,000 voting or "mutual" policyholders, each mutual policyholder could, in theory, receive in excess than \$1 million upon the demutualization of the company. In CAMIC's opinion, this would constitute unjust enrichment.

The distribution of the proceeds of demutualization to all policyholders, voting and non-voting, past and present, based on each policyholder's contribution to the surplus of the company would be fair but would be very difficult to accomplish. Indeed, it would be cumbersome to determine to what extent each current policyholder participated to the profit of the company in any given year, let alone the profits generated by successive generations of policyholders. Consequently, CAMIC recommends that the federal government recognizes the surplus of a p&c insurance company as indivisible and as owned by the mutual insurer and that, upon the demutualization of a company, the surplus of that company be retained for the long term benefit of the mutual and cooperative economic sector or be distributed for the benefit of all Canadians through the charitable sector.

CAMIC's proposal to distribute the surplus of demutualizing companies to the mutual/cooperative/charitable sectors is not without precedent. Among others, the "Code des assurances" in France and the Quebec "Loi sur les coopératives de services financiers" and the Quebec "Loi sur les associations coopératives" contain similar provisions.

While the French legislation requires that the demutualizing company transfers its surplus to another mutual insurer or to charitable organization(s), the Quebec legislation requires that the "demutualizing" cooperative transfers its surplus to the company's federation, to other cooperatives operating in the same sector of activity, or to the Quebec association of cooperatives of all type.

Without a doubt, these two jurisdictions have established stringent rules recognizing that it would be unfair for a group of individuals at any given time to appropriate the surplus built by predecessors for the sole purpose of putting in place an insurance company that could serve future generations of policyholders.

Before a company be allowed to demutualize, CAMIC recommends that the company be required to demonstrate that all reasonable alternatives to demutualization have been considered and that demutualization would serve the best interests of *all policyholders*.

In conclusion, our recommendations with respect to demutualization rules are:

- 1- That the federal legislation/regulation on demutualization provide fair and equitable treatment to all policyholders, voting and non-voting, past and present, through the distribution of the proceeds of demutualization to the mutual/cooperative and charitable sectors;
- 2- That before being allowed to demutualize, a company be required to demonstrate that all reasonable alternatives to demutualization have been considered and that demutualization would serve the best interests of all policyholders; and
- 3- That all policyholders have the right to vote at the demutualization meeting and that all policyholders be treated in the same manner with respect to the distribution of the company's surplus.

2) How to reduce the federal deficit

In your invitation to produce pre-budget documents, you ask how to achieve a balance budget. According to Labour Force Survey produced by Statistics Canada, on average private sector employees retire at 62 years old while public sector employees on average retire at 59 years old.

This phenomenon can partly be explained by the fact that public servants enjoy a very stable working environment and most often work for the same employer during their entire working career. It can further be explained by the fact that public servants contribute to a fully indexed defined benefit registered pension plan, a plan that is substantially subsidized by the taxpayer.

By contrast, almost three quarter of the population working in the private sector does not have a registered pension plan, let alone a fully indexed defined benefit registered pension plan. Upon their retirement, these individuals will rely on their savings inside and outside their RRSP, their Canada Pension Plan, and on other government programs if applicable – a much less generous package than their public sector counterpart.

Recommendation: The federal government should put in place measures that will significantly level the playing field in terms of retirement age and pension benefits between private sector and public sector employees.

3) How to create quality sustainable jobs

In your invitation to produce pre-budget documents, you ask how to create quality sustainable jobs. CAMIC contends that the mutual and cooperative type of ownership is ideal to create quality sustainable jobs as that business model is not based on the maximization of profits but rather on the maximization of benefits for the client (member). The sustainability of mutual insurance in Canada is a case in point. Canadian mutual insurers have been in existence in Canada for the last 100-170 years and have never been the source of business excesses that require the intervention of the government. Because profit is not the prime motive of their business model and because mutual and cooperatives have no stockholders to whom they need to give a return on investments, mutuals and cooperatives can operate with a lower rate of return than most privately and publicly (stock) owned companies. We support the Canadian Cooperative Association and the Conseil canadien de la coopération et de la mutualité recommendation to put in place a Co-operative Investment Plan similar to the Quebec *Régime d'investissement coopératif* in existence since 1985.

Recommendation: Support the creation of jobs through the formation of a federal Co-operative Investment Plan which would provide a federal tax credit for co-op members and employees who invest in producer (agriculture, fishery, forestry) and employee-owned co-operatives.

Summary: CAMIC makes the following three recommendations:

- 1- With respect to the demutualization issue:
 - a. That the federal legislation/regulation on demutualization provide fair and equitable treatment to all policyholders, voting and non-voting, past and present, through the distribution of the proceeds of demutualization to the mutual/cooperative and charitable sectors;
 - b. That before being allowed to demutualize, a company be required to demonstrate that all reasonable alternatives to demutualization have been considered and that demutualization would serve the best interests of all policyholders; and
 - c. That all policyholders have the right to vote at the demutualization meeting and that all policyholders be treated in the same manner with respect to the distribution of the company's surplus.
- 2- With respect to reducing the federal deficit:
 - The federal government should put in place measures that will significantly level the playing field in terms of retirement age and pension benefits between private sector and public sector employees.
- 3- With respect to the creation of jobs:
 - The federal government should put in place a Co-operative Investment Plan which would provide a federal tax credit for co-op members and employees who invest in producer (agriculture, fishery, forestry) and employee-owned co-operatives.