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SUPPLEMENTARY INSURANCE COSTS

The Finance and Administration Committee recommends the adoption of the recommendations contained in the following report dated September 15, 2009, from the Commissioner of Finance.

1. RECOMMENDATIONS

It is recommended that:

1. Payment in the amount of $1,264,093, plus any applicable taxes, be made to the Ontario Municipal Insurance Exchange ("OMEX"), to satisfy the obligation by the Region associated with its unfunded insurance liabilities for the period January 1, 2006 to December 31, 2007.
2. Payment in the amount of $238,506 plus any applicable taxes, be made to the Ontario Municipal Insurance Exchange ("OMEX"), to satisfy the obligation by the Region associated with its arbitration unfunded insurance liabilities for the period January 1, 1998 to December 31, 2005.

2. PURPOSE

The intent of this report is to seek approval for the payment of supplementary insurance costs incurred and to recommend payment of the various supplementary assessments to OMEX. These payments are as a result of a new requirement indentified by the Financial Services Commission of Ontario (FSCO) and claims history.

3. BACKGROUND

Downturn in Financial Markets Results in Financial Services Commission of Ontario (FSCO) Action

In light of the recent economic downturn, FSCO has been diligently scrutinizing each insurance company to ensure financial stability. One measurement currently in use is the Minimum Capital Test (MCT); an initiative to ensure adequate capital exists to provide a cushion for financial institutions during difficult economic times. In the past reciprocals have had less stringent capital tests to meet however FSCO is now exercising their option to enforce these same stringent tests on reciprocal carriers.

Municipalities continue to be the target for the litigiously inclined through the "deep pocket" theory of joint and several liability where one percent of the liability can result in it assuming 100% of the cost of the claim.

Transit and automobile insurance has also been adversely affected by provincial legislative changes over the past several years. Insurers that have experienced larger than expected losses are still catching up through premium increases. In fact, some insurers are no longer offering automobile/transit coverage as it is not a profitable line of business.

In addition, the property insurance market has suffered as a result of several natural disasters such as hurricanes and tsunamis that have occurred globally.

Finally, the insurance market as a whole has had lower than anticipated rates of return on their investments which have traditionally been used to offset some of the cost of their claims.

Reciprocal Insurance Exchanges ("Reciprocals") are different from Traditional Insurers

The insurance market has always been subject to cycles of boom and bust of an unpredictable duration.

Hard markets often have given rise to the creation of new and innovative approaches to help lower the cost of premiums and obtaining coverage. The formation of "Reciprocals" was one such innovation.

Originally thought to be a short term response to a hard market, Reciprocals, insurance pools and captive insurance companies have been a cost effective means of financing insurable losses. The number of industry specific groups utilizing these mechanisms continues to grow. In Ontario the best known Reciprocals are: the Ontario School Board Insurance Exchange (OSBIE); the Canadian Universities Reciprocal Insurance Exchange (CURIE); Municipal Electric Association Reciprocal Insurance Exchange (MEARIE); and OMEX. Reciprocals are the result of a homogenous group, corporation or other entity in the same business joining together and agreeing to share each other's losses on a not-for-profit basis. The underlying principle of a Reciprocal is similar to that of traditional insurance; achieving "spread of risk" from which loss experience is evened out and made more predictable.

Like traditional insurance companies, Reciprocals are licensed and governed through the *Insurance Act* and monitored by the Financial Services Commission of Ontario (FSCO). They operate similar to other insurance companies with a few notable exceptions:

- they are not incorporated, but rather are a collection of "members";
- members retain responsibility for funding all liabilities that occur during their membership period; and
- they operate through a principal attorney with an advisory board.

In most cases Reciprocals provide coverage on a primary basis for the first layer of a claim (eg. $2 million) and then use reinsurers or specialty markets to cover the excess layers. Handling the primary losses in their own layer is one of the methodologies utilized to stabilize the loss patterns and yet still have coverage for the occasional shock loss.

Provincial regulations dictate that all insurance companies, including Reciprocals, must maintain fully funded reserves in order to cover the cost of all known and potential claims for which it may be responsible. The adequacy of these reserves is determined from time to time by an independent actuarial review. Reciprocals will not usually maintain a large buffer of reserves to cover unexpected claims because of their ability to call upon its members to make up any funding shortfall through supplementary assessments. This has now changed with the enforcement of Minimum Capital Test (MCT).

History of the Ontario Municipal Insurance Exchange

OMEX was licenced as a Reciprocal in 1989. It has grown from eight in 1998 to thirty member municipalities currently, principally from its ability to control escalating insurance costs. Six of the nine municipalities in York Region are now members of OMEX. The Region has been a member since September, 1996. Through OMEX, the Region purchases insurance coverage for property, transit, auto, crime, boiler and machinery, municipal liability and errors & omissions.

The relationship between OMEX and each member municipality is governed by a Subscriber Agreement that was approved by Council and signed in September 1996. As a member, York Region belongs to several underwriting groups based on the types of coverage it contracts.

A municipality has the ability to terminate its participation in OMEX after any fiscal year upon six months written notice. However, should a municipality decide to leave OMEX, it still remains responsible for any unfunded liabilities that arose during its membership period including supplemental assessments and any such assessments must be paid immediately upon withdrawal. Any payments made for liabilities that are not eventually realized will be paid back proportionately to each member of the underwriting group regardless of membership status.

OMEX shortfall must be funded

Reciprocals use their best efforts to prudently forecast the true cost of claims at the time they set their premiums. However, unforeseen events can occur which produce a different result, often several years down the road. One reason that Reciprocals can offer lower premiums is because they do not need to build large buffer reserves to deal with these unforeseen events. They can share the additional obligation, when and if it is ever required, among all its members. The funding of this additional obligation is referred to as a supplemental assessment.

In October 2006, Council reviewed a report that the Region had received a supplemental assessment of $ 3,365,766 from OMEX for the period 1998 to 2005. Council approved the staff recommendation that this assessment be paid in full immediately from 2006 surplus funds.

After this assessment was approved and each member municipality was informed of their obligation, four municipalities declared that OMEX had given them verbal and written assurances that OMEX would not impose supplemental assessments relating to their first contract periods ranging between 2003 and 2005. Based on these assurances, the four municipalities, (cities of Burlington, London, Sarnia and Windsor) refused to pay their assessments and invoked the Arbitration section of the Subscriber agreements. Following an arbitrator's decision, the amounts assessed to these four members was then re-distributed proportionately to all of the other members. As a result, the Region was advised that it will be required to pay an additional supplemental assessment of $238,506 which could be paid immediately or payable in instalments in 2010, 2011 and 2012.

Given the recent, unprecedented down-turn in the economy, Financial Services Commission of Ontario (FSCO), who regulates Ontario's insurance industry, decided that OMEX needed to increase its surplus reserves for 2006 and 2007 coverage periods. Therefore, the Board of Directors of OMEX has issued a second supplemental assessment totalling $5 Million to be shared among 39 municipalities proportionately. The Region's share was assessed at $1,264,093 which could be discounted if paid in full, instead of over a four year period.

Traditional Insurer Insurance Cost

It is extremely difficult to provide an accurate cost estimate of what an insurer in the traditional market would have charged the Region for insurance coverages over the same period as OMEX. Traditional Insurers interested in writing municipal business are limited to begin with; those with experience and an appetite for some of the Region's more complex exposures such as transit and police operations again would restrict the number of potential insurers. Couple this with the cyclic nature of the insurance market and the fact that insurers will at times deliberately undercut premiums in the first year to get the business, it is difficult to provide an accurate comparison of the Region's potential insurance costs. Conjecture based on a sixty five percent loss ratio which is a known acceptable standard with traditional insurers, the Region likely would have paid similar premium amounts as charged by OMEX (premiums plus assessments). With the traditional insurers however, all premiums would have had to be paid annually at the inception of each policy term and any premium increases each year would have been based on this base amount.

4. ANALYSIS AND OPTIONS

OMEX experienced increased costs for the underwriting period from 2006 and 2007 due to a number of factors which were not anticipated at the time the original premiums were established:

- Ontario municipalities are part of an increasingly litigious environment and have been increasingly targeted as the "deep pocket" in joint and several actions;
- Settlements have increased significantly, particularly with respect to road authority and public transit related claims, and;
- FSCO is exercising more stringent financial requirements on reciprocals due to the economic downturn.

As a result, OMEX's 2008 business plan included the strategic decision to review all existing claims, assess their position and dispose of those that have the potential to become more costly over time. While this should reduce costs to members in the long-run, it immediately decreased the Reciprocal's surplus reserve. In order to meet the reserve level obligations dictated by FSCO, OMEX had to issue another Supplemental Assessment to its members.
The Region does enjoy several benefits from participating in this Reciprocal that would not be available in the traditional insurance market, such as:

- Member controlled voice on the OMEX Board;
- High degree of involvement in the handling of Region claims;
- Municipal focused policy wordings that reflect municipal risk and interests,
- Supplementary Assessment based on cash need allows the Region longer use of funds rather than paying upfront higher premiums ,and;
- OMEX is driven by customer satisfaction not profit.

Recommended Supplemental Assessment Payment Option

OMEX has advised that member municipalities will be given the option to pay the supplemental assessments over four years starting in 2009. However, at this time staff is recommending that the Region recognize and fund this liability immediately. This will eliminate the need to establish a long term liability and will allow freedom to make future insurance choices without incurring a penalty should the Region decide to leave OMEX.

2010 Insurance Renewal

In 2008, Council directed staff to fully market the insurance program for the Region in 2009 to ensure that we maintain the best possible program for the best possible costs. This Request For Proposal (RFP) is currently open with a Council report to be tabled in November 2009.

5. FINANCIAL IMPLICATIONS

No provision was made for these supplemental insurance assessments as part of the 2009 Regional Budget as these costs were not anticipated. It is recommended that the full costs be paid in 2009 thus reducing the overall anticipated 2009 surplus.

6. LOCAL MUNICIPAL IMPACT

There is no direct local municipality impact with respect to the Region's portion of the supplement. However as five of the nine municipalities are also members, they will also share in their individual portion of any supplemental assessment for their underwriting group.

7. CONCLUSION

This report recommends that the supplemental assessments charged to the Region by OMEX be paid in 2009 from Surplus funds.

For more information on this report, please contact Tina Gardiner, Manager, Insurance and Risk at extension 1656.

The Senior Management Group has reviewed this report.

(The attachment referred to in this clause was included in the agenda for the October 8, 2009 Committee meeting).

Attachment 1

Our Current Members

Arnprior, Town of (July 01, 2006)
Brampton, City of (Jan 01, 1997)
Caledon, Town of (Jul 01, 1998)
Dufferin, County of (Feb 01, 2003)
East Gwillimbury, Town of (Jun 01, 1997)
Fort Erie, Town of (Jan 01, 2005)
Front of Yonge Township (Mar 31, 2006)
Gananoque, Town of (Oct 10, 2003)
Georgina, Town of (Oct 01, 1996)
Grimsby, Town of (Jan 01, 2003)
Halton Hills, Town of (May 31, 2003)
Kawartha Lakes, City of (Jan 01, 2007)
King, Township of (Aug 01, 2005)
Leamington, Municipality of (Nov 01, 2003)
Lincoln, Town of (Jan 01, 2006)
London, City of (Jan 01, 2003)
Milton, Town of (May 14, 2002)
Mississippi Mills, Town of (Jun 30, 2005)
Newmarket, Town of (Jan 01, 1996)
Norwich, Township of (Jan 01, 2006)
Orangeville, City of (Oct 31, 2007)
Owen Sound, City of (Jan 01, 2005)
Renfrew, County of (Mar 01, 2002)
Richmond Hill, Town of (May 01, 1995)
Sarnia, City of (Jul 01, 2004)
Thorold, City of (Jan 01, 2006)
Thunder Bay, City of (Jan 01, 2004)
Whitchurch-Stouffville, Town of (Mar 01, 2000)
Windsor, City of (Jan 01, 2004)
York, Regional Municipality of (Sep 1, 1996)