URBAN SCHOOLS INSURANCE CONSORTIUM

BUSINESS PLAN
FISCAL YEAR 2017

Draft
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1. EXECUTIVE SUMMARY

This report summarizes the business plan for the Urban Schools Insurance Consortium ("USIC") for fiscal year 2017. A copy of this report was submitted in draft to the Alberta Superintendent of Insurance ("Superintendent"), the regulatory authority responsible for the supervision of USIC under the Alberta Insurance Act. The report will be considered for approval at USIC's June 23, 2017 meeting.

1.1. OPERATIONS AND OPERATING ENVIRONMENT

USIC's core business objective is to meet the commercial insurance needs of its subscribers. Since its inception, it has provided Property insurance to 3 metro and 11 urban school boards in Alberta. Property claims are subject to significant volatility but are capped at an annual aggregate limit of $3,000,000. Since November 1, 2016, USIC no longer writes liability insurance (aside from limited coverage for drones) and is running off a portfolio of claims subject to a limit of $1,000,000 per claim and $2,000,000 annually in the aggregate.

In March 2013, the Superintendent adopted solvency, governance, and other supervisory guidelines that were historically applicable only to federally-regulated insurance companies. The adoption of these guidelines is part of a movement towards principle-based regulation and has led to additional governance requirements for USIC in recent years. The Superintendent has discretion in the application of these guidelines for reciprocal insurance exchanges.

1.2. SUMMARY OF FINANCIAL PROJECTIONS FOR 2017

The underwriting income and investment income for fiscal year 2017 are projected at ($127,000) and $180,000 respectively, for a total comprehensive income of $53,000. The surplus at December 31, 2017 is projected at $7,612,000.

USIC is expected to meet the Alberta Maintenance of Reserve and Guarantee Fund ("AMRGF") requirement with an excess margin of $8,410,000 at December 31, 2017.

Limitations

Financial projections are estimates. USIC's ultimate financial performance including policy liabilities and investment income will depend upon future contingent, and by definition, uncertain events. It must be recognized that the future emergence of loss and loss adjustment expenses may deviate from the estimates in this business plan by a significant margin.

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2. OVERVIEW OF USIC OPERATIONS

2.1. INSURANCE OPERATIONS

USIC is a reciprocal insurance exchange licensed in Alberta to undertake contracts of property insurance. The property policy provides a $3,000,000 annual aggregate limit and is the primary insurance policy for the subscribers of USIC. The policy is issued on a per-occurrence basis and claims are subject to deductibles ranging from $10,000 to $40,000, depending on the subscriber. Effective November 1, 2015, USIC is licenced to insure boiler and machinery and this coverage is provided under the property policy.

Until November 1, 2016, USIC also wrote contracts of commercial general liability and Board of Education liability insurance. The commercial general liability portion of the policy was written on a per-occurrence basis with a limit of $1,000,000 per occurrence. The Board of Education liability portion of the policy was written on a claims-made basis with a limit of $1,000,000 per claim. A $2,000,000 annual aggregate applied to all liability losses. Given competitive insurance marketplace conditions, USIC concluded that it would not insure liability for the policy year commencing November 1, 2016 and instead commercial insurance should be arranged. The exception to this is a low-limits policy providing limited drone coverage, as the market could not provide this coverage on a cost-effective basis. USIC remains committed to providing liability insurance and will revisit this issue annually.

Insurance in excess of the limits described above is placed directly with various insurers though a broker.

2.2. REINSURANCE

USIC does not purchase reinsurance. Evaluation of the need and use of reinsurance is conducted as a matter of course by the Board in consultation with its service providers. USIC currently has no plan to utilize reinsurance, but has a Reinsurance Risk Management Policy in place to provide guidance to the Board on the implementation and monitoring of reinsurance arrangements, if required.

2.3. SUMMARY OF OPERATIONAL RESULTS FOR FISCAL YEAR 2016

In 2016, USIC earned total premiums of $4,656,000. Other sources of income were commission income of $276,000 and investment income of $556,000, resulting in total income of $5,489,000.

Claims and operating expenses totaled $3,066,000, resulting in a total comprehensive income of $2,423,000 in 2016.

The subscribers' equity was $7,859,000 as at December 31, 2016 and the AMRGF regulatory requirement was met with excess assets of $7,928,000.

3. OPERATING ENVIRONMENT

To mitigate the significant volatility associated with insurance claims, USIC has maintained aggregate annual claim limits for all its insurance programs.

In March 2013, the Superintendent adopted solvency, governance, and other supervisory guidelines that were historically applicable only to federally-regulated insurance companies. The adoption of these guidelines is part of a movement towards principle-based regulation and has led to additional governance requirements for USIC in recent years. The Superintendent has discretion in the application of these guidelines for reciprocal insurance exchanges.

The following Office of the Superintendent of Financial Institutions' (OSFI) guidelines for federally-regulated insurers are applicable to Alberta-regulated reciprocals:

- Capital adequacy requirements:
  - Minimum Capital Test (MCT); and
  - Guideline A-4: Internal Target Capital Ratio for Insurance Companies.

- Prudential Limits and Restrictions:
  - Guideline B-1: Prudent Person Approach (investments);
  - Guideline B-4: Securities Lending;
  - Guideline B-9: Earthquake Exposure Sound Practices;
  - Guideline B-10: Outsourcing of Business Activities, Functions and Processes; and
  - Guideline B-11: Pledging.

- Sound Business and Financial Practices:
  - Corporate Governance Guideline;
  - Guideline B-3: Sound Reinsurance Practices and Procedures;
  - Guideline E-13: Regulatory Compliance Management;
  - Guideline E-15: Appointed Actuary – Legal Requirements, Qualifications and Peer Review;
  - Guideline E-17: Background Checks on Directors and Senior Management;
  - Guideline E-18: Stress Testing; and
  - Guideline E-19: Own Risk and Solvency Assessment.

- Accounting:
  - Guideline: IFRS 9 Financial Instruments and Disclosures;
  - Guideline C-1: Impairment;
  - Guideline D-1B: Annual Disclosures;
  - Guideline D-6: Derivatives Disclosure; and
  - Guideline D-10: Accounting for Financial Instruments Designed as Fair Value Option.

In recent years, USIC has taken steps to adopt and implement the above Guidelines.

4. SHORT-TERM OPPORTUNITIES AND THREATS

4.1. OPPORTUNITIES

Two main opportunities identified include the following:

- Expanding membership: A larger subscriber base would further increase USIC's buying power with excess reinsurers. In addition, spreading operating costs among a larger subscriber base would likely lead to premium reductions for all subscribers. Finally, depending on their geographical location, new members may provide a diversification benefit to the reciprocal.

- Expanding coverage: USIC is currently in a healthy surplus position to prudently take on additional risk through additional lines of business (e.g. General Liability) or higher limits, should it be more cost-efficient for subscribers to retain the additional risk via USIC than to insure it through excess insurers.

4.2. THREATS

As part of its risk assessment and ORSA, USIC identified the following three main threats to its continued operations:

- Insurance risk: The main threat to USIC is the potential for claims volatility. Claims volatility can originate from an increase in the frequency (i.e. number) or severity (i.e. dollar amount) of claims. USIC is also exposed to concentration risk, given that it operates in only one province with a limited number of subscribers and in a small number of lines of business. USIC has historically mitigated this risk through an annual aggregate limit on its insurance losses.

- Strategic risk: This risk pertains to underwriting, competitive pressures as well as the inability to implement business strategies. USIC strives to maintain an efficient cost structure and premium stability in a soft insurance market. The loss of a subscriber would most likely translate into additional concentration risk and increased operating costs for remaining subscribers.

- Investment risk: USIC takes calculated investment risk mainly through the purchase of equities and foreign investments. Investment losses would lead to a reduction in the surplus required to support USIC's operations, which, if substantial, could put pressure on the entity to meet regulatory requirements.

5. SHORT-TERM PRIORITIES AND INITIATIVES

In 2017, USIC will focus on the following initiatives in addition to the management of its usual insurance operations:

- Development of a business plan for fiscal year 2017;
- Adoption of a premium rate-setting policy;
- Renewal of November 1, 2017 insurance program;
- ORSA interim update.

6. FINANCIAL PERFORMANCE AND RISK MEASURES

USIC prepares financial statements and monitors its net income three times per year, with a focus on the following key elements of financial performance:

- **Claims**: All open claims are periodically reviewed and case reserve estimates are adjusted accordingly. Claims experience is measured against premiums collected for the year.

- **Expenses**: Expenses are tracked by category (e.g., management services, claims administration, audit services, etc.) and compared against the expense budget; and

- **Investment income**: Investment returns are compared against benchmarks established per the investment policy.

In addition, consistent with its adopted ORSA, USIC periodically monitors various metrics to assess its risk profile, including metrics related to insurance risk, investment risk, strategic risk, operational risk, etc.

The level of surplus that USIC maintains is set such that the reciprocal balances the probability of retro-assessment with the efficiency of operating with as little capital as is prudent and appropriate. USIC has adopted a surplus target based on a Minimum Capital Test ("MCT") ratio of 180%, which was equivalent to $4,176,000 at December 31, 2016.

USIC periodically monitors the following two regulatory solvency measures:

AMRGF

USIC must meet the AMRGF requirement set out in Sections 99 and 100 of the Insurance Act. Essentially, USIC must maintain cash and approved securities in excess of:

Reserve Fund	+ 50% x Premiums Written Gross of Reinsurance – 50% x Premiums Written Ceded to Licensed Reinsurers
Guarantee Fund	+ Total Liabilities – Gross Unearned Premiums – Claim Liabilities Ceded to Licensed Reinsurers + $50,000

Pursuant to Section 101 of the Insurance Act, if USIC does not meet the AMRGF requirement, the Subscribers or the Attorney-in-Fact must make up the deficiency forthwith.

USIC exceeded this requirement by $7,928,000 at December 31, 2016.

Minimum Capital Test ("MCT")

The Superintendent requires reciprocals to make annual regulatory filings including the MCT. The MCT is a solvency test which has historically applied to incorporated insurance entities. Although the AMRGF is the primary regulatory solvency requirement for reciprocals, the Superintendent has advised that its supervisory target ratio is an MCT ratio of 210%, higher than USIC's internal target of 180.

The MCT ratio is a calculated as follows:

$$\text{MCT Ratio} = \frac{\text{Capital Available}}{\text{Minimum Capital Required}}$$

The Capital Available would generally be equal to USIC's surplus.

The Minimum Capital Required is a function of the USIC's risk profile. The Minimum Capital Required accounts for risks such as the deterioration of asset values, adverse development on unpaid claims or credit risk related to balance sheet assets. Since 2015, the Minimum Capital Required also takes into account foreign exchange risk, operational risk and a diversification credit.

At December 31, 2016, USIC's MCT ratio was 326%.

7. FINANCIAL PROJECTIONS

Budget projections for fiscal year 2017 are presented in the following exhibits to this report:

- Exhibit 1: Statement of financial position
- Exhibit 2: Statement of comprehensive income
- Exhibit 3: AMRGF requirement

The 2017 statement of income projections presented in these exhibits are consistent with the budget prepared by the Executive Committee and approved by the Board in November 2016. However, due to the material difference between the forecast and the actual surplus position at December 31, 2016, the projections in this business plan were updated to reflect the actual surplus as at December 31, 2016.The following three elements of the statement of financial position differ from the original 2017 budget adopted by the Board:

- Retained earnings were recalculated based on the actual instead of forecasted retained earnings at December 31, 2016;
- Unearned premiums were assumed to be unchanged from December 31, 2016, consistent with the projected change of $0 in unearned premiums in the statement of income; and
- Investments were recalculated to be consistent with the updated surplus position.

The AMRGF calculations were also recalculated based on the updated statement of financial position.

Premiums earned, commission income and investment income were projected at $3,200,000, $453,000 and $180,000 respectively, resulting in total income of $3,833,000.

Claims were projected at $3,000,000 and total operating costs were projected at $780,000, resulting in total expenses of $3,780,000.

The total comprehensive loss for 2017 was projected at $53,000 and the surplus was projected at $7,612,000. The AMRGF requirement is expected to be met by a margin of $8,410,000.

Exhibit 1

Urban Schools Insurance Consortium
Operating Budget for 2017
Statement of Financial Position

As at December 31,	Projected 2017	Actual 2016
Assets		
Cash and cash equivalents	2,866,417	5,459,246
Marketable securities *	16,515,639	15,469,550
Insurance balances receivable	0	504,862
Losses recoverable	0	0
Accrued interest receivable	58,160	48,964
Deferred acquisition costs	106,667	106,249
Prepaid expenses	102,052	32,052
Total Assets	19,648,935	21,620,923
Liabilities		
Accounts payable and accrued expenses	54,097	259,935
Premium taxes payable	128,000	127,499
Unearned premiums *	2,656,235	2,656,235
Provision for unpaid claims and loss adjustment expenses	8,821,118	10,640,977
Deferred revenue	377,500	377,492
Total Liabilities	12,036,950	14,062,138
Subscribers' Surplus		
Subscribers' contributions	481,391	481,391
Retained earnings *	7,130,594	7,077,394
Total Subscribers' Surplus	7,611,985	7,558,785
Total Liabilities and Subscribers' Surplus	19,648,935	21,620,923

* This value was changed from the initial budget adopted by the Board in November 2016 to reflect the actual financial results of USIC as at December 31, 2016 (instead of the forecast financial results).

Exhibit 2

Urban Schools Insurance Consortium
Operating Budget for 2017
Statement of Comprehensive Income

For the year ended December 31,	Projected 2017	Actual 2016
Income		
Gross premiums written	3,200,000	3,187,482
Change in unearned premiums	0	1,468,765
Premiums earned	3,200,000	4,656,247
Other insurance income	453,000	276,330
Investment income	180,000	556,243
Total Income	3,833,000	5,488,820
Expenses		
Losses incurred	3,000,000	2,235,778
Premium taxes	128,000	145,000
Other insurance expenses	350,000	350,000
General and administrative expenses	301,800	334,818
Total Expenses	3,779,800	3,065,596
Total Comprehensive Income (Loss)	53,200	2,423,224

Exhibit 3

Urban Schools Insurance Consortium

Operating Budget for 2017

AMRGF Requirement

As at December 31,	Projected 2017	Actual 2016
Reserve fund		
Gross premiums written	3,200,000	3,187,482
	x 50%	x 50%
Total reserve fund	1,600,000	1,593,741
Guarantee fund		
Total liabilities	12,036,950	14,062,138
Less: unearned premiums	(2,656,235)	(2,656,235)
Add: statutory margin	50,000	50,000
Total guarantee fund	9,430,715	11,455,903
Cash, accrued interest receivable and marketable securities		
Required	11,030,715	13,049,644
Held	19,440,216	20,977,760
Held in excess of required amount	8,409,501	7,928,116