The MEARIE Group May 2008

Reciprocal News

Helping to Manage Your Risk

The MEARIE Group's Reciprocal Newsletter

A publication designed for the benefit of Ontario's Energy Industry.

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The Reciprocal Advantage

Triple digit premium increases, cancelled policies, non-renewals, reduced policy limits, sub-limits, exclusions, higher deductibles. Although this may sound familiar to anyone managing an insurance portfolio in 2003, this was the condition of the insurance market place in the mid-1980's.

The hard market conditions of years ago led various organizations, such as municipalities, hospitals, school boards, universities, public utilities, legal associations, community newspapers, etc., to seek alternative risk financing programs in order to obtain the insurance coverage they required at a stable, reasonable cost. For each of these groups, the formation of a reciprocal insurance program was a long-term solution to meeting the insurance needs of its membership - a solution that continues to prove its' value against the current difficulties, with both availability and cost, being experienced in the commercial market place.

So, what exactly is a reciprocal?
A reciprocal insurance exchange is an unincorporated group or pool of organizations with similar risks that agree to share those risks with each other. A contract (Subscriber's Agreement) is signed by each member of the group, which essentially "reciprocates" the agreement to share in each others' losses. The agreement is renewable periodically, and while the length of commitment can vary, most reciprocals require 3, 4 or 5-year memberships to ensure the stability of the pool for claim funding purposes.

Reciprocals are provincially licensed insurers, and in Ontario, are governed under Part XIII of the Insurance Act (Ontario). Some reciprocals carry licenses to operate in other provinces across Canada, and would be subject to regulations in those provinces as well.

Like conventional stock insurance companies, reciprocals operating in Ontario are monitored by the Financial Services Commission of Ontario (FSCO), or by an equivalent regulatory body in each province where they operate.

Reciprocals are required to submit periodic statutory reports on their financial operations, and reserving levels, as well as report claims and premium data to the Insurance Bureau of Canada on specified lines of business, such as Liability and Automobile. Most reciprocals utilize the services of actuaries to develop premium-funding strategies, and have access to reinsurance markets to protect members from catastrophic losses.

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The Reciprocal Advantage (Continued)

Reciprocals differ from conventional insurance companies in several important ways:

- it is not an incorporated entity, but, rather a contractual arrangement between the members;
- the risks shared in the reciprocal are pooled for all the members;
- a reciprocal is a non-profit organization;
- a reciprocal does not require the same capitalization as a stock insurance company. (In Ontario, the minimum capital requirement is $50,000);
- reciprocals can tailor insurance products to meet the specific needs of their members and ensure availability of coverage, independent of conventional insurance market cycles;
- since the members of the reciprocal carry out similar activities and have similar risks, this enables the development and maintenance of good risk control programs that are tailored to the specific needs of the membership, which can reduce the loss profile for the group.

Other benefits of reciprocal insurance exchanges include, but are not limited to:

- cooperative philosophy - member owned and operated;
- any surplus is owned by members and can be used to smooth out future premium increases or be re-distributed periodically;
- claim funding is based on loss experience of the members - not directly affected by volatility of commercial insurance market.

The highly publicized "down side" facing reciprocal members is the possibility of being retro-assessed to make up for any shortfall in claims funding. This can occur if a large claim occurs, an unusual number of moderate to large claims occur in a given operating period, or there is adverse development on any outstanding claims. If any of these situations occurs, the reciprocal can call on each member for additional funding to compensate for any deficiency in the underwriting pool. Although retro -assessments are a possibility for members of a reciprocal, with the use of reinsurance programs and surplus funds built up over years of successful operation, the prospect of this occurring for most financially sound reciprocals is fairly low. The bottom line is that, in the unlikely event of a retro -assessment, the impact to a member may be no worse than the premium increases many organizations are experiencing in the current commercial market place.

The reciprocal insurance exchange is a time - tested concept which continues to provide contemporary solutions to the insurance needs of its membership. Its' cooperative format and flexibility in providing properly priced insurance coverage and effective risk management programs make it a strong alternative risk financing strategy for groups or industries with similar risks.

David Beal,
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