

July 31, 2011

COURIER AND EMAIL

Financial Sector Policy Branch
Department of Finance
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Attention: Jane Pearse

Dear Sirs/Mesdames:

Re: Consultation on a Demutualization Framework for Federal Property & Casualty Insurance Companies

We are writing on behalf of Gore Mutual Insurance Company (“**Gore**”) in response to the Ministry of Finance’s consultation paper released on June 30, 2011, entitled “Consultation on a Demutualization Framework for Federal Property & Casualty Insurance Companies” (the “**Consultation Paper**”). We consent to the posting of this submission on the Department of Finance website under Gore’s name.

Gore is Canada’s oldest property and casualty insurance company, and has been proudly serving Canadians since 1839. Our head office is located in Cambridge, Ontario, and we have an additional office in Vancouver, British Columbia. The Insurance Brokers Association of British Columbia and the Insurance Brokers Association of Ontario have ranked us as the #1 insurance company in British Columbia and Ontario.

We believe that our existing corporate structure and governance practices continue to serve us well. We wish to submit our views on an appropriate framework for demutualization of property & casualty (“**P&C**”) insurance companies as we would like to ensure that any regulations put in place are appropriately tailored to the circumstances of mutual P&C companies such as Gore.

In summary, we would like to highlight the following in our submission:

- ***Gore Mutual does not have current plans to demutualize.***
- ***The framework for demutualization should be prescriptive and detailed, including the allocation of demutualization benefits and the rules for determining who is an eligible policyholder.***
- ***Preserving the relationships between mutual P&C companies and their communities should be a policy objective of any new framework.***

- ***A demutualization framework for P&C companies should not create incentives for demutualization when that action would not be in the best interests of a company.***
- ***A dual policyholder structure where voting policyholders are determined through objective criteria is preferable from a governance, administration, communications and cost perspective to a structure where all policyholders vote.***
- ***The allocation of demutualization benefits to voting policyholders is appropriate where the voting policyholder base is established through objective criteria.***

Implementation of a new framework

As a result of the recent attention given to the demutualization of P&C companies, there is substantial uncertainty with respect to the rights of voting policyholders and non-voting policyholders upon a demutualization of a P&C company. We are concerned that this uncertainty has the potential to give rise to disputes among our stakeholders (as has been the case for at least one other mutual P&C company). This has the potential to divert the board's and management's attention. While we do not have current plans to demutualize, we are very much in favour of the swift implementation of a framework for demutualization in order to resolve this uncertainty. Finalization of such a framework will allow us and other mutual P&C companies to move forward with a focus on the success of our respective businesses. In our view, uncertainty should also be addressed through the establishment of a demutualization framework that is as prescriptive as possible. The number of significant matters left to the discretion of a company when it chooses to demutualize should be very limited. While this approach would be different from the demutualization framework established for life companies, there are a number of significant factors that distinguish P&C companies from life companies as discussed later in this submission.

Gore's dual policyholder structure

Like some other mutual P&C companies, Gore has a dual policyholder structure under which most policies issued by the company are non-voting, but a smaller number of policies having voting rights are issued to certain policyholders. Historically, this smaller group of voting policyholders grew out of Gore's community of interest. The dual policyholder structure facilitated and simplified the process of conducting policyholder meetings and circulating meeting materials. Gore has attempted to keep the size of its voting policyholder base relatively consistent over time, though it has continued to make efforts to improve the selection criteria and other governance practices relating to its voting policyholder base. In the majority of cases, Gore has in the past selected voting policyholders through consultation with brokers who do business with Gore and have long-term relationships with the company. These brokers have typically recommended as voting policyholders their long-term clients who are also long-term clients of Gore. In other cases, employees of Gore and other mutual policyholders have recommended potential voting policyholders to the company. Selection criteria for voting policyholders used by Gore have included demonstration of a good underwriting history and support for the mutual insurance model and independent broker system in Canada. Gore has also selected voting policyholders on the basis that they are stakeholders in the company, such as Gore's employees and the brokers Gore does business with.

Since our current voting policyholder base includes a community of interest, such as employees, retirees, brokers, and representatives of the communities in which we operate, we expect the interests of voting policyholders to be better aligned with the long-term interests of the company, relative to short-term non-voting policyholders. We believe the extent of participation by voting policyholders has been good and our voting policyholder base contributes to the good governance of the company. In our view, a large voting policyholder base consisting of policyholders who are less likely to take an interest in the long-term success of the company is not necessarily a better form of corporate governance. A smaller voting policyholder base that has significant engagement with the company may be more effective.

We believe that once regulations for the demutualization of P&C companies are in place, any decline in the voting policyholder bases of mutual P&C companies with a dual policyholder structure will cease. In fact, we anticipate that the size of voting policyholder bases will immediately increase. For example, given the current uncertainty surrounding demutualization of P&C companies, Gore has ceased issuing voting policies for the time being. This policy has been put in place until the situation is resolved, in order to avoid the risk of any disputes that might arise from the issuance of voting policies. Once regulations that provide clarity as to the demutualization process are in place, we anticipate that both mutual P&C companies and potential voting policyholders may have a greater interest in establishing more voting policyholders. We believe this may occur even without any intervention by the government directly relating to the size of voting policyholder bases.

Changes in P&C company governance

We note that the Consultation Paper questions the effectiveness of the governance of mutual P&C companies with a dual policyholder structure, such as Gore. Similar issues were also raised in the Department of Finance's 2003 consultation on the Corporate Governance of Financial Institutions. In addition to the implementation of a demutualization framework, the Department of Finance also appears to be proposing to implement changes relating to the governance of mutual P&C companies with a dual policyholder structure. Based on the 2003 consultation paper and more recent discussions with your office, we believe it to be probable that the Department of Finance will require an increase in the number of voting policyholders of mutual P&C companies with a dual policyholder structure. If that is the case, while we continue to prefer our current governance structure, we have carefully considered how the government might implement such a change in a manner that is least disruptive to the company.

In our view, it would not be appropriate or effective from a governance perspective if all policyholders of mutual P&C companies with a dual policyholder structure become voting policyholders. We believe that policyholders who have only been committed to the company on a short-term basis are less likely to participate in the governance of the company. Extending the right to vote to all policyholders of mutual P&C companies that have previously maintained a dual policyholder structure would impose a significant administrative and financial burden on those companies without necessarily resulting in improved governance.

Gore has in the past selected voting policyholders based on guidelines including many objective criteria, but this approach left Gore with some discretion as to the allocation of voting policies. We believe there has been value in that approach, as in our experience it has resulted in a voting policyholder base that is more likely to have the long-term interests of the company in mind. However, we recognize that, if used improperly, this process could permit the company to select only voting policyholders who are supportive of its existing agenda. If the government implements changes in mutual P&C company governance, we would prefer, as an alternative to our current governance model, a system where the voting policyholder base is determined solely

through objective criteria rather than through a selection process. Any governance framework implemented by the government should clearly prescribe these objective criteria for all mutual P&C companies with a dual policyholder structure.

We submit that an effective objective basis to distinguish between voting policyholders and non-voting policyholders would be to constitute those policyholders who have held policies with us for a period of five years as voting policyholders, while also retaining our pre-existing voting policyholders.¹ This method of allocating voting policies would only provide policyholders with new voting rights where they have demonstrated an ongoing commitment to the company. This method would also ensure that the allocation of voting policies would not be subject to any undue influence of the board or management of a company. Based on a preliminary estimate, if voting policies are allocated in this manner at Gore, we expect that approximately 40,000-50,000 of our policyholders will be constituted as voting policyholders.² This would represent a very substantial increase in the size of our voting policyholder base.

This increase in the size of our voting policyholder base will not increase administrative costs to the same extent as if all policyholders were given voting rights. However, the requirement to deliver policyholder meeting materials to such an expanded group is still likely to increase costs. Any new framework providing for an expanded voting policyholder base for mutual P&C companies with a dual policyholder structure should take into account this added administrative burden and cost. We would encourage further movement towards a framework that provides for paperless delivery or availability of meeting materials.

Questions for Consultation

We have responded below to each of the “Questions for Consultation” described in the Consultation Paper, and the applicable questions are replicated below in bold and italics.

A) *Policy Objectives*

The policy objectives for life companies were: a) providing fair and equitable treatment to policyholders, b) maintaining safety and soundness, c) fostering a competitive and efficient sector, and d) establishing an orderly and transparent process.

1. What should be the policy objectives for the demutualization of P&C companies?

We believe that the policy objectives for the demutualization of P&C companies should include the policy objectives for the demutualization of life companies. However, as described in our response to the next question, some of these objectives should be applied to P&C companies differently given the inherent differences between life companies and P&C companies.

¹ The status of a policyholder as a voting policyholder only exists to the extent the applicable policies remain in force. If a policy conferring voting policyholder status on a policyholder is terminated or cancelled, then the former voting policyholder does not maintain any voting rights or interest in the company (including with respect to any demutualization benefits).

² Gore has approximately 230,000 policies outstanding, and the above estimation of the number of policyholders who would be voting policyholders is based on the number of policies that have been held for longer than five years. This estimate is an approximation because the total number of policyholders and the number of policyholders who have held their policies for five years are not readily determinable, given that many policyholders may have more than one policy.

Community relationships

In addition to the policy objectives for the demutualization of life companies, a new framework for P&C company demutualization should also include the policy objective of preserving the community relationships and the representation of communities reflected in the operations and governance of many mutual P&C companies such as Gore. We are a proudly Canadian company that has consistently contributed to the communities in which we operate and we are a major employer in Cambridge, Ontario. We believe that a demutualization framework for P&C companies should enable a P&C company to maintain a governance structure that reflects these communities. Further, P&C companies should be encouraged to continue to contribute to and participate in these communities.

No incentives for inappropriate demutualization

We do not seek to foreclose demutualization as an option for Gore or for other mutual P&C companies. However, we do believe that another policy objective of a demutualization framework should be to prevent the creation of incentives for demutualization when that action might not be in the best interests of a mutual P&C company.

There are a number of advantages to the mutual structure that may result in it being the most appropriate corporate structure for some P&C companies, depending on their individual circumstances. A mutual structure may facilitate a longer-term corporate outlook, reducing incentives to take inappropriate risks in order to provide short-term value to shareholders. A longer-term corporate outlook may also encourage a company to increase its investment in technology. For example, as a result of substantial investment in technology, Gore was the first insurer in Canada to implement fully paperless operations and to offer brokers and clients the ability to manage commercial documents online. The mutual structure also encourages stability in ownership and governance, which may be an important advantage where an experienced board and management team continues to contribute to the success of a company. This stability permits mutual companies to develop strong ties with their community, both through contribution to charitable causes and through a role as a stable long-term employer and service provider in a given region. The mutual structure may also result in reduced administration costs and gives companies an incentive to manage their finances conservatively, reducing solvency risk and the number of failures.

2. *Are these also appropriate in the P&C context, and if so, should they be applied to P&C companies in the same manner or differently?*

Many of the life company policy objectives are appropriate and apply equally in the P&C demutualization context. Nonetheless, we believe it is important to highlight some of the differences between P&C companies and life companies, which in our view, require that some of the demutualization policy objectives applicable to life companies be implemented differently for P&C companies.

Fair and equitable treatment

We expect that, in particular, the objective of treating policyholders fairly and equitably will be implemented differently in the P&C demutualization context as compared to the life company context. Life insurance policies are generally long term and often represent an investment on the part of the policyholder. In contrast, P&C companies generally issue policies that are short term and represent a risk management strategy of the policyholder. Thus, P&C policyholders, particularly short-term policyholders, are much less likely to have a reasonable expectation of a

return on their investment and demutualization benefits are more likely to be viewed as a windfall to short term non-voting policyholders. P&C policies also differ from life policies in that important considerations in the allocation of demutualization benefits in the context of life companies are not applicable or not as relevant in the P&C context. Another significant distinction between P&C and life companies is the difference in actuarial methodology and experience. Life policies are longer-term in nature and life company actuaries have experience providing opinions relating to allocations made to participating policyholders. Thus, the actuaries of life companies are in a much better position to give an opinion that formulas developed for the allocation of demutualization benefits are “fair and equitable”. If P&C companies are given significant discretion to determine a fair and equitable allocation formula, any allocation formula that is arrived at may be more susceptible to challenge by stakeholders who take a different view. For this reason, Gore believes that a P&C demutualization framework must prescribe, in detail, an allocation formula to which all P&C companies will be bound.

Other objectives

Aside from the policy objective of treating policyholders fairly and equitably, we believe that the other policy objectives of maintaining safety and soundness, fostering a competitive and efficient sector, and establishing an orderly and transparent process, should be implemented in a similar manner as they were for life companies. We suggest a moratorium on takeovers of demutualizing companies similar to that put in place for life companies, but that takes into account the unique circumstances of the P&C sector.

Also, we would like to highlight the importance of implementing clear and detailed rules, procedures, and dates that will be relevant in establishing the definitive list of eligible policyholders in a demutualization. It is important that no one be unfairly included or excluded as an eligible policyholder. We expect that a demutualization framework will discourage those who might attempt to profit from demutualization by improperly manipulating their status as policyholders.

B) Demutualization Process

1. What should be the process for allowing a P&C company to demutualize? In particular, what should be considered in determining who should have the right to vote on, and receive the benefits of, demutualization?

We believe that, in general, the process for allowing a P&C company to demutualize should be similar to the process put in place for life companies. Again, though, the differences between P&C companies and life companies discussed above will need to be taken into account.

Eligibility to receive demutualization benefits

In considering which policyholders should be eligible to receive the benefits of demutualization, we have reflected on the important role voting policyholders play in providing good governance to a mutual P&C company. Voting policyholders contribute to the good governance of a company, which helps to create the value of the company to be distributed in connection with a demutualization. Given their contributions to the company and their reasonable expectations as voting policyholders, the voting policyholders of a mutual P&C company are the only group that can demonstrate that they are entitled to demutualization benefits. In contrast, short-term non-voting policyholders have not yet demonstrated the commitment and contribution to the company that other policyholders have. Short-term non-voting P&C policyholders do not have any reasonable expectation of receiving benefits upon a demutualization of the company, and

there is no basis under which they should be entitled to such benefits. In fact, the by-laws and incorporating documents of mutual P&C companies may in fact prohibit a non-voting policyholder from having any interest in the surplus of a mutual P&C company.

Balancing this view was the concern that in the past, the selection of voting policyholders may have been driven by a desire to provide for the good governance of the company, not an intention to allocate value should a demutualization occur. In the life company context, all or almost all voting policies are participating policies that expressly entitle the holders thereof to participate in the profits of the company through the payment of dividends. These policies generally cost more to purchase than non-voting policies that provide similar insurance coverage. In contrast, in the mutual P&C context, there is no difference in the cost or coverage provided under voting policies and non-voting policies. Importantly, policyholders of life companies generally have an option to choose whether or not they will purchase a voting or non-voting policy. Thus, life company policyholders' reasonable expectations as to their entitlement to demutualization benefits would be set in connection with such a decision. In the mutual P&C context, policyholders were not generally given a choice as to whether to purchase a non-voting policy or instead pay more for a voting policy.

Taking these considerations into account, it is our view that, in the context of P&C companies with a dual policyholder structure, the appropriate allocation of demutualization benefits is to voting policyholders, if those voting policyholders have been selected through objective criteria rather than a discretionary process. The group of voting policyholders entitled to demutualization benefits should thus include those who would become voting policyholders as a result of holding their policies for a period of five years, should the government mandate this increase in the voting policyholder base. This proposed allocation accounts for the fact that short-term policyholders of a P&C companies should have little expectation of any benefits from demutualization. This allocation would also ensure that demutualization benefits are not allocated to a smaller group of policyholders selected through a discretionary process, where the allocation of demutualization benefits was not a significant consideration at the time. This method of allocation reduces the perception that demutualization benefits will represent a windfall to their recipients (since the allocation would be based on objective criteria), while respecting the distinction between voting and non-voting policyholders.

Consistent with good governance practices and the avoidance of conflicts of interest, we of course believe that it is essential that directors and management of a P&C company do not receive any benefits from the demutualization process, except in their capacity as a policyholder eligible to receive demutualization benefits. Even where directors or management are eligible policyholders, they should only receive benefits to the same extent as other similarly situated eligible policyholders.

Voting on demutualization

Given our view that only voting policyholders should be entitled to receive demutualization benefits, it follows that only voting policyholders should be entitled to vote on the process of demutualization. As we believe a dual policyholder structure is effective and appropriate, we do not see a need to provide additional voting rights to non-voting policyholders simply because the matter under consideration is demutualization. Only the rights of voting policyholders would be affected by the outcome of a vote to approve a demutualization proposal, as the relationship of non-voting policyholders to the company would not be expected to change significantly on a demutualization. If as expected the government requires mutual P&C companies with dual policyholder structures to increase their voting policyholder base, demutualization benefits will

be allocated across a larger group. This in turn has the potential to reduce the role of self-interest in any vote to approve a demutualization proposal.

2. *What should be considered in ensuring that policyholders are treated fairly and equitably, including for determining the value of the company and apportioning the benefits of demutualization?*

The different forms of policies issued by P&C and life companies require that a much different approach should be taken to some matters relating to apportioning the benefits of demutualization in the P&C company context, compared to the life company context. In section 4(2) of the *Mutual Company (Life Insurance) Conversion Regulations*, the variable amount of demutualization benefits that may be allocated to an eligible policyholder of a life company may be calculated based on factors that include a policy's contribution to surplus, policy reserves, cash values, amounts of policy coverage and the duration of the policy. Generally, these factors are either not applicable or are not as relevant to distinguishing between policyholders in the P&C context. We suggest that a demutualization framework for P&C companies will thus need to take into account other factors. A determination of the appropriate factors that should apply to the allocation of variable demutualization benefits in the P&C context is a complex undertaking that Gore expects will require a significant amount of time to assess and deliberate, and may require the input of advisors. In our view, a precise allocation formula is beyond the scope and timeframe of this submission. We nonetheless submit that a precise allocation formula will eventually be a necessary and essential component of a demutualization framework for P&C companies. For reasons discussed earlier in this submission, we believe that, in the P&C context, a company's discretion as to the allocation of demutualization benefits should be minimized.

We would be in favour of the Department of Finance engaging in a second round of consultations relating to matters such as the precise formula for allocation of demutualization benefits and other details relating to demutualization of P&C companies, once the more fundamental questions raised in the Consultation Paper have been addressed.

C) *Impacts of Demutualization*

1. *What impacts could demutualization have on the P&C sector?*

In our opinion, the most significant impacts on the P&C sector that we expect to arise out of demutualization are an increasing consolidation in the sector that may cause companies to adopt a more short-term outlook, weakened ties between P&C companies and their communities and increased foreign ownership of P&C companies.

Demutualization will facilitate mergers and acquisitions of mutual P&C companies, and we understand that given the number and positioning of companies in the sector, increased consolidation is bound to occur. It is our view that the push for consolidation in the P&C demutualization context will be even greater than it was in connection with the demutualization of life companies. In some instances, a merger or acquisition may be appropriate and in the best interests of a demutualizing P&C company. However, we believe that in general, there should be protections put in place to deter the immediate takeover of P&C companies that might otherwise suddenly be put "on the market" once demutualization occurs. These protections would allow newly demutualized companies to mature and develop their value under their new corporate form. Transactions that might take advantage of demutualizing P&C companies that are in a transitional stage would be prevented. Such transactions might result in sale prices that do not appropriately reflect the long-term value of newly demutualized P&C companies. In addition, a

focus on the potential for mergers and acquisitions could result in companies adopting more short-term thinking, diverting the attention of management from the long-term strategies necessary to maintain a successful business.

Also, once a P&C company demutualizes, its shareholder base may become very different from its voting policyholder base as the company becomes widely held. In particular, the foreign ownership of P&C companies is very likely to increase. Such diversity in ownership may weaken the significant ties that P&C companies have established with the communities in which they operate.

2. *Would these need to be addressed, and if so, how?*

We propose that there should be a moratorium on takeovers of demutualizing P&C companies, in order to prevent the implementation of coercive and undervalued transactions during the transition period following demutualization. A similar moratorium existed in the life company demutualization context. While in the life company context the moratorium ran for two years, we propose that the moratorium would run for three years from the date of demutualization in the P&C context. The appetite for consolidation in the P&C sector is higher than it was in the life company demutualization context, in our view. Given this state of affairs, we believe that a moratorium should apply for all P&C companies. However, an absolute moratorium may in certain instances impede transactions that would be in the best interests of P&C companies and their stakeholders. Smaller P&C companies may be unable to demutualize except in the context of a merger or acquisition. Therefore, certain exceptions to the moratorium, such as in the case of sponsored demutualizations, may be appropriate. The concerns addressed by a moratorium may be less likely to arise in the context of a sponsored demutualization. Sponsored demutualizations are more likely to be friendly transactions that a company's board of directors determines to be in the best interests of the company. We also suggest that it should be possible to apply to the Minister of Finance for an exception to the moratorium, where it can be demonstrated that a P&C company and its stakeholders would be detrimentally affected by an inability to become the subject of a takeover transaction during the three-year moratorium period.

D) *Number of Voting Policyholders in Some Mutual Companies*

- 1. *What implications does a small and declining voting policyholder base have for the effective governance of a mutual company?***
- 2. *How can companies with a dual policyholder structure ensure that they continue to have effective governance structures?***
- 3. *Should measures be taken to increase the number of voting policyholders, and if so, what should those measures consist of?***

Our responses to the three questions above are largely set out under the heading "Dual policyholder structures" at the beginning of this submission. In summary, while we are satisfied with the effectiveness of our existing governance structure, we believe it to be probable that the government will require mutual P&C companies with a dual policyholder structure to increase their voting policyholder base significantly. If the government requires this change to be implemented, we feel that a method of change that would be least problematic would be to cause policyholders who have been with the company for a five year period to be voting policyholders, effective immediately on the implementation of the applicable legislation or regulations.

In our view, there are tensions between having a large number of voting policyholders who may have little interest in voting, and having an engaged, smaller group of voting policyholders where the selection of this group is susceptible to negative perceptions. If a change in governance is mandated, we believe that the alternative governance structure we have proposed balances these concerns by respecting those policyholders who have made a commitment to the company, while removing discretion from the process for allocating voting policies. It is also our expectation that longer-term policyholders will be representative of our community of interest, much like our existing voting policyholder base.

It is apparent from recent events and the matters addressed in the Consultation Paper that we are about to enter a new phase in the history of federally-regulated P&C companies in Canada. We expect that the rights of the policyholders of these companies will be definitively established, addressing significant and challenging uncertainties. However, it is of the utmost importance that these challenges be dealt with through a framework that takes into account the unique circumstances of P&C companies, and in particular, P&C companies with a dual policyholder structure such as Gore's. We look forward to participating in the next phase of this process, and we would be eager to contribute submissions in the case of further consultations on a demutualization framework.

Yours truly,

A handwritten signature in cursive script that reads "Kevin McNeil".

Kevin McNeil
President and CEO
Gore Mutual Insurance Company

cc: Charles A. Cipolla, Chair of the Board of Directors