

# BC Poultry Association

## British Columbia Poultry Captive Insurance Company

### ARI Project #40193 – Final Report

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#### *Project Purpose and Objectives*

The BC Poultry Association (BCPA) applied to the AgriRisk Initiatives (ARI) Program for funding to update and complete the work in developing and filing and application for registration for a “Captive Insurance Product” for Notifiable Avian Influenza (NAI) for poultry producers in British Columbia. The project will enable the poultry marketing boards and commission in British Columbia to assess the need for imposing mandatory insurance on registered poultry producers in British Columbia; for the BCPA to finalize coverage levels, premium schedules and insurance coverage wording for each sector and specialty segments within each sector; and finalize documentation to be able to file an application for registration with the British Columbia Financial Institutions Commission for a newly established British Columbia poultry insurance product, including preferential tax treatment by the Canada Revenue Agency.

#### *Project Description*

The purpose and objectives for the project would be realized through the implementation of eight activities. The eight activities and desired outcomes set out in the project plan were:

**Activity 1** – Project Management – to effectively manage the project to ensure that the work plan is completed on time, on budget, and that project reporting is filed in accordance with agreed upon time lines.

**Activity 2** – Determining the Tax Status of the Captive Insurance Company – to determine if the Captive can receive preferable corporate tax treatment on net income as an agricultural organization.

**Activity 3** – Loss Quantification – to update the current models for breeders, broilers, layers and turkey broilers, hens and toms based on the 2014/15 HPAI outbreak; to augment the existing loss models for breeders, broilers, layers and turkey broilers, hens and toms to tailor coverage for specialty poultry production systems in British Columbia; and to enable the Captive to provide appropriate levels of coverage, indemnification and premium pricing for all forms of regulated poultry production in British Columbia.

**Activity 4** – Premium Structure and Insurance Policies – to develop a revised premium structure for the Captive that may or may not include differential premium by production type with the poultry sector; and to demonstrate coverage and indemnification levels that are reflective of the production systems.

**Activity 5** – Captive Financing – to develop and present a sustainable capital financing plan that will enable the Captive to meet insurance regulatory requirements to cover expected losses.

**Activity 6 – Captive Management** – to register the captive insurance company with the British Columbia Financial Institutions Commission.

**Activity 7 – Industry Engagement** – to learn from the 2014 HPAI response and modify and adapt proposed insurance policies and coverage to better align with recent experience; to evaluate the need for mandatory insurance in the regulated poultry sector to enable a determination by the poultry marketing boards and commission to require licenced producer to maintain disease insurance; to engage members of the regulated poultry sector to ensure comprehensive awareness and understanding of the insurance program and its underlying benefits; and to demonstrate the level of industry support for mandatory poultry disease insurance to policy decision makers.

**Activity 8 – Program Management – ARI Project Reporting** – to provide timely program financial and progress reporting throughout the project.

Activity specific details and deliverables are included in the Project Work Plan.

### *Background*

The discovery of Notifiable Avian Influenza (NAI) in commercial poultry has significant impact and effect on the infected premise and the poultry industry as a whole within the province and nationally. The confirmation of the presence of NAI results in movement controls within the country and closure of export markets for poultry and poultry products from the province. Facilitating a prompt response and recovery is critical to restoring the system of orderly marketing of poultry in the province.

Through experience gained from managing and recovering from NAI outbreaks in 2004, 2005, 2009 and 2014, the British Columbia poultry industry has identified key areas to improve risk management and response to NAI discoveries. In 2009, the BCPA adopted a four-part risk mitigation strategy: mandatory biosecurity; improved emergency response capacity; enhanced surveillance; and an integrated financial management and compensation program. The focus for this project was on furthering the development of the integrated financial management and risk mitigation program.

Since 2009, the BCPA has been working with the federal and provincial governments and insurance industry specialists to define and design an insurance based product to address the financial consequences of a NAI discovery. Initially the work identified three components, market loss to cover the gap in the market value of the birds ordered destroyed and the value paid by the Canadian Food Inspection Agency (CFIA) under the *Health of Animals Act*; the extraordinary cost of cleaning and disinfecting (C&D) infected premises (IP); and business interruption to cover the inability of a producer to place the next scheduled flock. Work done prior to the 2014 HPNAI outbreak had estimated the ground-up expected losses resulting from future NAI discoveries at:

- Annual expected loss           \$287,183
- Low Pathogenic Event           \$95,971
- Highly Pathogenic Event       \$573,405
- Catastrophic Event             \$9,892,548

The initial project work plan was designed to continue to design an insurance product for the three types of coverage.

In British Columbia, the British Columbia Farm Industry Review Board (BCFIRB) plays both appeal and supervisory roles to the marketing boards in British Columbia. In order to implement a mandatory disease insurance program, the poultry marketing boards and commission are required to seek BCFIRB prior approval. The requirement came as a result of the August 2014 BCFIRB Supervisory Review decision that provided guidance and direction to the poultry marketing boards and commission with respect to future consideration of implementing mandatory insurance requirements for licenced poultry producers in British Columbia. More specifically, the poultry marketing boards and commission were required to demonstrate to BCFIRB in seeking prior approval of implementing mandatory disease insurance requirements that they had addressed the question of whether or not requiring producers to maintain disease insurance was in keeping with sound marketing policy and was necessary to ensure the timely return to a system of orderly marketing.

In order to enable Canada to return to NAI-free status, CFIA must be able to demonstrate to the World Organization for Animal Health, the Office International des Epizooties (OIE) that necessary measures have been implemented and undertaken to destroy any potential residual virus. This requires the owner of the infected premise to C&D to a higher standard than the normal between cycle cleaning and disinfecting. The additional cost for the higher level C&D is not covered by CFIA under the compensation provisions of the *Health of Animals Act*. After serious review and consideration of the options, the poultry marketing boards concluded that the need for a predictable response to cover the extraordinary costs to C&D premises declared infected was in keeping with sound marketing policy and to enable the BC poultry industry to return to a system of orderly marketing. The conclusion was reinforced by the stated federal and provincial government position that neither would consider a future AgriRecovery request to cover infected premise C&D costs.

While losses relating to gaps between CFIA compensation and the market value of birds ordered destroyed and business interruption were important to producers, they were not considered to be essential in returning the industry to a system of orderly marketing and as such in keeping with sound marketing policy. In November 2016, a decision was made to narrow the scope of insurance coverage to the extraordinary costs of C&D only.

The extraordinary cost of C&D places an added financial burden for the individual poultry producer during a highly stressful time. The cost is primarily dependent on the production type, barn design and number of barns. Based on the 2014 Highly Pathogenic Notifiable Avian Influenza (HPNAI) outbreak, one operation incurred costs in excess of \$250,000 to complete the required C&D equating to nearly \$5 per bird. While the 2014 case was an exception, the typical range in C&D cost is from \$1 per bird for broilers and up to \$2.65 per bird for other production types with a total cost per average farm ranging from just over \$30,000 for turkeys to almost \$60,000 for layers.

Timely and prompt C&D of the infected premise is critical for the poultry marketing boards and commission in British Columbia to return to a system of orderly marketing. Delays in infected premise C&D do not only affect the infected premise's (Index Farm) ability to restock, but also poultry farms within three kilometers of the infected premise. CFIA designates all premises within three kilometers of the infected premise as being Infected Premises irrespective of whether their flocks have tested positive or not for NAI. Restocking of infected premises cannot commence until CFIA has removed the declaration of infected premise which will not occur until the C&D of the Index Premise has been completed to the satisfaction of CFIA.

To facilitate the timely and prompt C&D of the infected premise, it is critical for the industry to have in place a financial response to cover some or all of the extraordinary cost of the enhanced C&D. In the past, the processing sector and boards (2004) and federal and provincial governments (2009 and 2014) covered the financial costs of infected premises C&D. Following the 2014 HPNAI outbreak, the federal and provincial government notified the BC poultry industry that they would not consider future requests for financial assistance for infected premises C&D.

## *Report on Activities*

### *Activity 1 – Project Management*

The BCPA supported the use of the AI Insurance Review Committee (IRC) to provide the oversight and direction with respect to the Project Work Plan. Considerable delay in the start-up of Activities 3 to 7 had resulted from the linkage of coverage to the *Health of Animals Act* compensation. Following the 2014 HPNAI outbreak, CFIA initiated a review of their compensation for birds ordered destroyed. The ability to finalize the market loss gap was contingent upon CFIA confirming the compensation to be provided under the *Health of Animals Act*.

In October 2016 the IRC made a decision to limit the scope of the proposed insurance coverage to align with sound marketing policy to enable the ability of the boards and commission to consider whether or not to require licenced producers to maintain disease insurance. This decision allowed the work on the majority of the Activities to be initiated, however, the delays resulted in a request to extend the Project deadline from March 31, 2017 to March 31, 2018.

### *Key Deliverables and Results*

The signed contribution agreement and amending agreement, along with IRC Minutes were the primary deliverables for this Activity. The Project was completed in accordance with the amended schedule and under budget.

### *Activity 2 – Determining the Tax Status of the Captive Insurance Company*

The services of MNP LLP were retained to conduct an assessment of the ability of the proposed Captive to be considered income tax exempt. Three exemptions provisions of the *Income Tax Act* were considered:

1. Paragraph 149(1)(e) of the Income Tax Act (the “ITA”) – exemption for agricultural organizations (and other types of entities);
2. Paragraph 149(1)(l) of the ITA – exemption for non-profit organizations; and

3. Paragraph 149(1)(t) of the ITA – exemption for insurers of farmers and fishermen.

### ***Key Deliverables and Results***

It was determined by MNP that option 3, exemption for insurers of farmers and fishermen provided the best opportunity for gaining income tax exemption and subsequently filed a request for an advance tax ruling with the Canada Revenue Agency (CRA). In March 2017, the CRA notified MNP that Budget 2017 proposes to eliminate the income tax exemption for insurers of farming and fishing property. It was decided to withdraw the request and not proceed further with a subsequent ruling request under another exemption provision of the *Income Tax Act*.

### ***Activity 3 – Loss Quantification***

Serecon was engaged to update their prior work on Loss Quantification Models (LQM) for each of the four poultry types. While update to the model was a straightforward exercise and completed quickly, the lack of confirmation of the *Health of Animals Act* compensation for birds ordered destroyed precluded the ability to establish a definitive level for the market gap for birds ordered destroyed. The inability to establish the market loss gap through the updated LQMs was off-set by the decision to limit the proposed insurance coverage to the extraordinary cost of infected premise C&D.

### ***Key Deliverables and Results***

A revised set of LQMs for each sector was completed. The analysis of the results enabled the IRC to support the current CFIA compensation model. Despite not being directly applied to the BCPA Project, the results were used to support the work of other ARI poultry insurance projects.

### ***Activity 4 – Premium Structure and Insurance Policies***

In order to establish a premium structure for the proposed infected premises C&D coverage, an actuarial assessment was required to estimate the expected losses resulting from a broad range of NAI events. J.S. Cheng and Partners Inc. (JSCP) was retained to conduct the actuarial assessment and assess the risk and premium of the Captive; estimate the annual frequency and average claim size; estimate the annual claims amount and cost of reinsurance; estimate the funding requirement; allocate the funding between poultry sectors; prepare pro-forma financial statements; recommend a loss limit per occurrence and an annual aggregate loss limit; estimate the cost of stop-loss reinsurance; stress test the ability of the Captive to withstand adverse events; recommend an initial capital and surplus; and provide an opinion on the feasibility of the Captive to insure.

### ***Key Deliverables and Results***

The report conclude that based on their analysis, establishing a captive insurance company to provide C&D insurance to the regulated poultry industry in BC is feasible provided that:

1. The proposed Captive has proper reinsurance (preferably at least \$5.0 million per occurrence);
2. The aforementioned reinsurance is purchased from a number of financially strong reinsurance firms;
3. The proposed Captive has at least \$1.0 million start-up capital; and
4. The initial net retention is no more than \$250,000 per year and preferably at \$100,000 per year.

The report has provided the share of risk by sector under various coverage scenarios and enables the industry to develop agreements as required to share the costs. The report has enabled the defining of coverage and drafting of policy wording in the event that insurance is pursued.

#### [Activity 5 – Captive Financing](#)

The Work Plan was modified to bring into consideration the possible use of a group funded deductible plan to provide the insurance coverage as opposed to using a Captive. Guy Carpenter was engaged to conduct a risk transfer program analysis and review coverage options. As a result, further work was conducted on examining a group funded deductible plan as a mechanism to transfer the cost of infected premises C&D.

#### ***Key Deliverables and Results***

With the support of Marsh Canada, the requirements and costs of a group funded deductible were presented for consideration.

The IRC was presented with the details of the AAFC ARI – Administrative Capacity Building Component as a potential source of initial capital funding as well as administrative start-up funding. The Province of BC was approached and confirmed its willingness to receive an application from the BC poultry industry.

#### [Activity 6 – Captive Management](#)

As a decision has yet to be made with respect to the most appropriate, efficient and effective approach to risk transfer, the Project did not result in the filing of an application to register the Captive with the BC Financial Institutions Commission. Aon Risk Solutions was retained to assess the start-up costs and application requirements in the event the BCPA wished to pursue registration with the BC Financial Institutions Commission.

#### ***Key Deliverables and Results***

Aon Risk Solutions provided an updated list of requirements and start-up costs to complete an application for registration should the BCPA wish to pursue the Captive insurance company option as the risk transfer mechanism.

#### [Activity 7 – Industry Engagement](#)

The IRC initiated a five-phase Mandatory Notifiable Avian Influenza Insurance Review in January 2016. The five phases examined the need for, and scope of a financial response; whether the conditions of insurance existed; the options for transferring the risk and the appropriate insurance delivery mechanism and enabled the boards and commission to make a decision that it was not necessary to secure the authorities under the *Natural Products Marketing (BC) Act (NPMA)* to require BC poultry producers to maintain disease insurance.

#### ***Key Deliverables and Results***

Reports were prepared for each of the five-phases of the review. Overall, the review indicated that the lack of a formalized response to cover the extraordinary cost of infected premise C&D limits the poultry boards' and commission's ability to facilitate the recovery from a NAI discovery and the timely return to a system of orderly marketing in BC. An intervention by the boards and commission through their commitment of financial support to off-set the

extraordinary costs of infected premises C&D following a NAI discovery accords with sound marketing policy. Existing authorities under *NPMA* enable the boards and commission to use levy proceeds to cover the costs and losses in the marketing of a regulated product and as such would be able to internalize the extraordinary cost of infected premises C&D.

The review indicated the value and benefit of a collective approach to funding and sharing the extraordinary costs of infected premises C&D. A collective fund could provide the basis for an insurance policy. Utilizing the other Project Activity work enabled the IRC to evaluate the need for and mechanisms to transfer the risk and make recommendations to for consideration by the poultry boards and commission.

A website, <http://avianinsurancereview.com/> was developed to post all relevant documents regarding the Mandatory Insurance Review including the five review phase reports, decision notes and final reports from this Project. The website enabled the boards and commission to secure stakeholder input on the information and key decisions.

The IRC has provided a set of recommendations to the poultry boards and commission regarding the establishment of a collective fund; the level of coverage; the initial capital for the fund; the annual costs of the fund; the share of costs by sector; the transfer of risk; and the transfer mechanism. The poultry boards and commission will not be considering the recommendations until after April 1, 2018.

#### [Activity 8 – Program Management](#)

##### ***Key Deliverables and Results***

The BCPA has worked diligently to provide quarterly and annual financial and progress reporting on the Project Activities; budget adjustments and agreement extensions.

##### ***Conclusions***

In the absence of government commitment to consider requests for future financial assistance, the BC poultry industry set out to examine options for providing coverage for the cost of infected premise C&D and mechanisms to transfer the risk. Through the ARI funding, the BCPA working with the regulated poultry boards and commission initiated a five phase review that examined the need for, and scope of a financial response; whether the conditions of insurance existed; the options for transferring the risk and the appropriate insurance delivery mechanism. The initial view was to consider a captive insurance company owned by the poultry industry to deliver the insurance product, however, after completing the five phase review; reviewing the tax implications; defining the coverage; and conducting an actuarial assessment the full range of alternate options self-insurance, group funded deductible plan, reciprocal insurance exchange and captive insurance company was once again reviewed in order to ensure the best possible solution for risk transfer or retention.

As of March 31, 2018, the BC poultry industry remains committed to implementing a collective approach and have a plan in place for the fall of 2018 to provide an assured and predictable response for licenced poultry producers in British Columbia to cover the extraordinary cost of C&D of infected premises resulting from future NAI discoveries to enable a prompt and timely return to a system of orderly marketing in the BC poultry industry.

The ARI provided sufficient flexibility in funding to accommodate the necessary shift in focus of the proposed insurance and the supporting activities. The amendment to extend the Project by one year was important for the Project to realize the objectives. While the desired outcome of filing an application for registration with the BC Financial Institutions was not achieved, the Project results and deliverables will enable the BCPA to quickly achieve the result should decisions regarding transferring the risk lead to the use of the Captive.

### *Lessons Learned and Next Steps*

The Project enabled the poultry industry in BC to examine the full range of possibilities and options with respect to addressing the financial risks related to a NAI discovery. While a final decision has yet to be made with respect to insuring the risk, the Project enabled the industry to narrow the scope of financial risk to focus on the risk critical to supporting a timely recovery from a NAI discovery, the extraordinary cost of infected premises C&D.

The boards and commission are expected to make decision on the recommendations of the IRC on the outstanding issues regarding the establishment of a collective fund; the level of coverage; the initial capital for the fund; the annual costs of the fund; the share of costs by sector; the transfer of risk; and the transfer mechanism after April 1, 2018. Decisions to establish a collective fund and/or insure the fund will require the boards and commission to seek prior approval of BCFIRB prior to implementation. It is expected that the approval process will be conducted in time to meet the October 1, 2018 start-up to ensure coverage in time for the 2018/19 avian influenza season.