Public Works and Government Services Canada

Travaux publics et Services gouvernementaux Canada

Part - Partie 1 of - de 2
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**11 Laurier St. / 11, rue Laurier**
**Place du Portage , Phase III**
**10C1 - station 34**
**Gatineau, Québec K1A 0S5**

# LETTER OF INTEREST
# LETTRE D'INTÉRÊT

**Title - Sujet**
RFI-CHANGES TO PRODUCER PAYMENT

| | |
|---|---|
| **Solicitation No. - N° de l'invitation**<br>5K002-133712/A | **Date**<br>2012-12-20 |
| **Client Reference No. - N° de référence du client**<br>2013163712 | **GETS Ref. No. - N° de réf. de SEAG**<br>PW-$$ZG-410-25257 |
| **File No. - N° de dossier**<br>410zg.5K002-133712 | **CCC No./N° CCC - FMS No./N° VME** |

**Solicitation Closes - L'invitation prend fin**
**at - à 02:00 PM**
**on - le 2013-01-21**

**Time Zone**
**Fuseau horaire**
Eastern Standard Time EST

**F.O.B. - F.A.B.**
**Plant-Usine:** ☐ **Destination:** ☑ **Other-Autre:** ☐

| | |
|---|---|
| **Address Enquiries to: - Adresser toutes questions à:**<br>Gagnon, Jocelyne C. | **Buyer Id - Id de l'acheteur**<br>410zg |
| **Telephone No. - N° de téléphone**<br>(819) 956-0575 (  ) | **FAX No. - N° de FAX**<br>(819) 956-2675 |

**Destination - of Goods, Services, and Construction:**
**Destination - des biens, services et construction:**

CANADIAN GRAIN COMMISSION
CORPORATE SERVICES
700-303 MAIN ST
WINNIPEG
Manitoba
R3C3G8
Canada

**Comments - Commentaires**

**Instructions: See Herein**

**Instructions: Voir aux présentes**

**Vendor/Firm Name and Address**
**Raison sociale et adresse du fournisseur/de l'entrepreneur**

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**Vendor/Firm Name and Address**
**Raison sociale et adresse du fournisseur/de l'entrepreneur**

**Telephone No. - N°de téléphone**
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**Name and title of person authorized to sign on behalf of Vendor/Firm (type or print)**
**Nom et titre de la personne autorisée à signer au nom du fournisseur/ de l'entrepreneur (taper ou écrire en caractères d'imprimerie)**

**Signature** **Date**

**Issuing Office - Bureau de distribution**
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10C1, Place du Portage
Gatineau, Québec K1A 0S5

Canada

**THIS IS NOT A SOLICITATION DOCUMENT**
**THIS IS A REQUEST FOR INFORMATION (RFI) FROM INDUSTRY**

The intent of this Request for Information (RFI) is to solicit feedback on all aspects detailed herein so as to enable Canada to evaluate the strategy to be taken, if any, regarding further related activities.

More specifically, feedback is sought:

- to obtain feedback from the industry on the efficiency and effectiveness of the proposed program;
- to determine the degree of interest within the insurance industry for participating in the proposed program, and if any changes are required in order to facilitate a robust bidding process;
- to obtain concurrence that the quantification estimates are reasonable; and
- to obtain responses from the insurance industry to our specific questions in order to assist us in developing a Request for Proposal (RFP) with sufficient information for underwriters to prepare high quality proposals.

## Overview

The Canadian Grain Commission (CGC) is a federal government agency that administers the provisions of the Canada Grain Act (CGA). The CGC's mandate as set out in the CGA is, "in the interests of the grain producers, establish and maintain standards of quality for Canadian grain and regulate grain handling in Canada, to ensure a dependable commodity for domestic and export markets." The CGC's vision is to be "a leader in delivering excellence and innovation in grain quality and quantity assurance, research, and producer protection." The CGC reports to Parliament through the Minister of Agriculture and Agri-Food.

The CGC regulates the handling of 21 grains grown in Canada to ensure Canada's grain is safe, reliable and marketable, and Canadian grain producers are protected. The CGC regulates Canada's grain industry and is the official certifier of Canadian grain. Through its activities, the CGC supports a competitive, efficient grain sector and upholds Canada's international reputation for consistent and reliable grain quality. To achieve its mandate, the CGC:

- regulates grain handling in Canada through the grain quality and quantity assurance programs;
- carries out scientific research to understand all aspects of grain quality and grain safety and to support the grain grading system; and
- has implemented a number of producer protection programs and safeguards to ensure the fair treatment of Canadian grain producers when they deliver their grain to licensed grain elevators and grain dealers. This includes the licensing and security program, the producer car allocation program and the producer support program.

The Licensing Program includes a producer payment protection (also known as producer security) function that requires all licensed companies to tender financial security to cover eligible outstanding liabilities to producers for qualifying grain deliveries. If a licensee is unable or unwilling to pay producers for their deliveries, producers have the right to submit a claim to the CGC for compensation, and the CGC may draw upon that licensee's posted security to fulfill their producer payment obligations.

## NOTE TO SUPPLIERS

### Responses

The material in this RFI package is for the solicitation of **feedback only**. Responding to this RFI is not a prerequisite to receiving any Request for Proposal for the Canadian Grain Commission (CGC)

requirement. However, all Suppliers are encouraged to indicate their level of interest by responding to this RFI with their comments in order to facilitate a better understanding of requirements and capabilities from both PWGSC and Industry perspectives.

The publication of this RFI must not be construed as a commitment on Canada's part to issue a subsequent "Request for Proposal" for CGC's requirement and no contract or other form of commitment will be entered into with any Supplier based on responses to this RFI. This RFI must in no way be considered as authorization by Canada for Suppliers to undertake any work, which would result in costs to Canada. Canada will not be liable for, nor will it reimburse any Suppliers for any costs, fees or expenses which any Supplier incurs in the preparation or submission of its response to this RFI. Canada will not be bound by anything stated herein. Canada reserves the right to change, at any time, any or all parts of the requirement as it renders necessary.

Information provided will not be attributed to its source, but may be publicized in a manner that does not disclose the provider. Suppliers will not be bound by any aspect of their response to this RFI. All responses to this RFI will be held by Canada on a confidential basis (subject to applicable legislation), and remain the property of Canada once they have been received and may be used to support further development of internal planning documents and decisions, and possibly an RFP. Note that responses to the RFI will not be returned.

**Please note that any analyses contained within the Annex A - Statement of Work are intended to assist potential respondents to understand the context for the proposed program in order to provide meaningful responses to the questions in the RFI. When considering a bid resulting from a future RFP, respondents are encouraged to undertake their own analyses as they see appropriate, rather than rely solely on those provided by the CGC.**

**Clarification**

PWGSC may require clarification of written responses received and/or comments received as a result of the responses to this RFI. If required, any clarification will be requested by the Contracting Authority after the closing date of the RFI. Requests for clarification will be submitted in writing (by facsimile or email) and a response will be requested within two (2) working days of transmission of the clarification questions.
**Canada will not provide any guidance on how to prepare the responses or of any acceptable response strategy.**

If deemed necessary, the CGC reserves the right to arrange a meeting of interested parties to respond to questions or provide clarification on the proposed program.

**Closing Date**

Responses to this RFI will be accepted until 02:00 PM Eastern Standard Time (EST) on January 21, 2013.

Responses are to be submitted in writing by mail, facsimile or email to the identified Contracting Authority below:

Jocelyne C Gagnon
Supply Specialist
Public Works and Government Services Canada
Acquisitions Branch
Professional Services Procurement Directorate

Place du Portage, Phase III, 10C1
11 Laurier Street
Gatineau, Quebec
K1A 0S5

Tel: (819) 956-0575
Facsimile (819) 956-2675
Email : jocelyne.c.gagnon@tpsgc-pwgsc.gc.ca

## FORMAT OF RESPONSE

Suppliers are requested to review Annex A, Statement of Work, respond to the following questions in the tables below.

| TABLE 1 - RESPONSES TO QUESTIONS | |
|---|---|
| **QUESTIONS** | **RESPONSES** |
| A.1: Is your firm currently providing payables insurance or a similar program to clients? Have you in the past? | |
| A.2: Is a panel of insurance providers the most efficient and effective structure for Canadians? Are there other options that should be considered? | |
| A.3: When the program is to be tendered, which approach is preferable: RFP the program as a whole or RFP the underwriters separately from the broker? If separate, what sequence is recommended? | |
| A.4: Would you bid on this program as described herein? Why or why not? If not, please describe changes that would attract you into a bid. | |
| B.1: Is the information and data provided to the insurance providers from the CGC sufficient for developing a proposal in response to an RFP? If not, describe additional information that is required? | |
| B.2: Is the CGC risk assessment methodology sufficient to meet the needs of the insurance industry for assigning risk-ratings and determining insurance premiums? If not, what enhancements would be required? | |
| B.3: Is the CGC claims validation methodology sufficient to meet the needs of the insurance underwriters for verifying Producers' claims in the event of a Licensee failure? | |
| B.4: Do you expect there to be any administrative duplication of work by the CGC and insurance underwriters? | |

| | |
|---|---|
| C.1: Is the information and data provided to the insurance providers from the CGC sufficient for developing a proposal in response to an RFP? If not, describe additional information that is required? | |
| C.2: Based on the data presented, is a $100 million aggregate limit appropriate? If not, what limit (if any) would you propose? What would be the impact on premiums of varying aggregate limits (eg $50, $100, $200, unlimited)? | |
| C.3: Are there any additional costs that have not been considered in this document? | |
| C.4: How would you envision sharing premiums and losses between the insurance providers? | |
| C.5: Premiums will be reviewed on an annual cycle based on the risk, volumes of purchases, and loss history. Is this time period adequate? | |
| C.6: Would you accept the setting of premiums based reported purchases as of July 31st or with adjustments once year-end financial statements are received? | |
| C.7: What form of financial statements would be acceptable (eg audited, review engagement, other?). Note that the more stringent this requirement, the more costly for the Licensees. | |
| C.8: What would be a reasonable time frame for settlement of producer claims? | |
| C.9: How would disputes be addressed? | |
| C.10: Are the services being provided by the CGC reasonable and/or appropriate? | |
| C.11: Is a service agreement with the CGC appropriate for the insurance providers? | |
| C.12: What is the preferred method of transferring data/information between CGC, the Intermediary, and the insurance companies? | |
| C.13: What are your requirements for establishing a level of comfort with the underwriting services to be provided by the CGC identified in this section? | |
| D.1: Is this transition plan practical? How would you envision a claim being handled that relates to producer liabilities prior to implementation of the new program? | |

| | |
|---|---|
| D.2: This program must be operational by August 1, 2013. Are you aware of any roadblocks that will/would prevent this timeline from being achieved? | |
| D.3: What is your preference for an annual insurance policy renewal date? | |

| TABLE 2 - ADDITIONAL COMMENTS | |
|---|---|
| **SECTION/TOPIC REFERENCE** | **COMMENTS** |
| | |
| | |
| | |
| | |

# ANNEX A
# STATEMENT OF WORK

## A. Introduction

### 1. Overview of the Canadian Grain Commission

The Canadian Grain Commission (CGC) is a federal government agency that administers the provisions of the Canada Grain Act (CGA). The CGC's mandate as set out in the CGA is, "in the interests of the grain producers, establish and maintain standards of quality for Canadian grain and regulate grain handling in Canada, to ensure a dependable commodity for domestic and export markets." The CGC's vision is to be "a leader in delivering excellence and innovation in grain quality and quantity assurance, research, and producer protection." The CGC reports to Parliament through the Minister of Agriculture and Agri-Food.

The CGC regulates the handling of 21 grains[1] grown in Canada to ensure Canada's grain is safe, reliable and marketable, and Canadian grain producers are protected. The CGC regulates Canada's grain industry and is the official certifier of Canadian grain. Through its activities, the CGC supports a competitive, efficient grain sector and upholds Canada's international reputation for consistent and reliable grain quality. To achieve its mandate, the CGC:

- regulates grain handling in Canada through the grain quality and quantity assurance programs;
- carries out scientific research to understand all aspects of grain quality and grain safety and to support the grain grading system; and
- has implemented a number of producer protection programs and safeguards to ensure the fair treatment of Canadian grain producers when they deliver their grain to licensed grain elevators and grain dealers. This includes the licensing and security program, the producer car allocation program and the producer support program.

The Licensing Program includes a producer payment protection (also known as producer security) function that requires all licensed companies to tender financial security to cover eligible outstanding liabilities to producers for qualifying grain deliveries. If a licensee is unable or unwilling to pay producers for their deliveries, producers have the right to submit a claim to the CGC for compensation, and the CGC may draw upon that licensee's posted security to fulfill their producer payment obligations.

### 2. Modernization of the CGC through Bill C-45: Jobs and Growth Act, 2012

On December 14, 2012, the Jobs and Growth Act, 2012 (Bill C-45) received royal assent. This Act includes changes to the CGA designed to modernize the grain industry and to streamline the operations of the CGC. It is anticipated that the changes will take effect as of August 1, 2013.

Currently, the producer payment protection function of the Licensing Program requires the CGC to fix security to be provided by licensees on an individual basis, and that security be tendered to the CGC, which may then be used to pay eligible producers in the event of a licensee's failure or refusal to pay. Under the amended legislation, the CGC has authority to prescribe any form of security, including an aggregate risk-based insurance policy. By implementing an aggregate producer payment protection model, the CGC will maintain the integrity of the program with a streamlined and more efficient administrative structure. Licensees will no longer be required to report their outstanding producer liabilities to the CGC on a monthly basis as they do in the current program, resulting in a lowered

[1] Wheat, barley, oats, rye, triticale, canola, flaxseed, mustard, rapeseed, safflower seed, solin, soybeans, sunflower seed, beans, chick peas, fababeans, lentils, peas, mixed grain, buckwheat, and corn.

reporting burden for the grain industry. It is also expected that this model will take advantage of the aggregated experience to reduce the overall cost of producer payment protection coverage to the grain industry. This will also reduce the administrative burden associated with the current requirements of tendering security on an individual basis.

In preparation for the changes to the CGA, the CGC released its User Fees Consultation and Pre-Proposal Notification on November 1, 2012 to advise its stakeholders of the proposed updated user fees that reflect the streamlined costs in the modernized organizational structure effective August 1, 2013.

**3. Overview of Changes to Producer Payment Protection**

The CGC intends to replace the existing structure of the producer payment protection function of the Licensing Program with a streamlined more efficient risk-based model. The CGC is seeking a model that will maintain payment protection for producers, streamline the process of securing coverage, reduce the required servicing infrastructure, and reduce overall costs to the grain industry.

The CGC is interested in contracting with one or more underwriters to structure an umbrella insurance program that captures the benefit of pooling aggregate risks to provide financial protection to producers against their exposure for unpaid grain deliveries to licensed grain handlers.

The CGC anticipates integrating its current licensing and auditing services with similar processes provided by the underwriters to avoid duplication of work and to leverage the CGC's knowledge of the industry for efficient delivery of insurance coverage and settlements in the event of a claim.

The CGC is targeting implementation of the umbrella insurance program effective August 1, 2013, concurrent with the beginning of the 2013-2014 crop year. It is anticipated that this will involve a three-year agreement, with two option years, for a potential contract life of five years. In order to achieve this date, licensees will need to begin the process of transitioning to the new model at least three months in advance of this date.

## B. The Current Producer Payment Protection Model in the Licensing Program

### 1. Legislative and Regulatory Requirements

An overview of the amendments to the CGA is described in section A.2. Specific requirements for producer payment protection within the Licensing Program are:

- The CGC is mandated to provide producer protection as a condition of licensing. Therefore, every licensee must obtain and maintain security in an amount set by the CGC for the purpose of covering the licensee's potential obligations for the payment of money or the delivery of grain to holders of cash purchase tickets, elevator receipts, or grain receipts issued under the Canada Grain Act and shall maintain that security for as long as they are a licensee.

- The eligible period prescribed for producer payment protection is:

  - 90 days if an elevator receipt or grain receipt is issued on delivery of the grain;

  - if a cash purchase ticket or other bill of exchange is issued on delivery of the grain or is later issued on surrender of an elevator receipt or grain receipt in respect of the grain, the lesser of

    - 90 days, and

    - the period that ends 30 days after the day on which the cash purchase ticket or other bill of exchange is issued.

- Licensee security may be realized or enforced in relation to a cash purchase ticket, an elevator receipt, or a grain receipt if the licensee fails or refuses to meet any of their payment obligations to the producer to which the ticket or receipt relates within the prescribed period, and the producer has given notice in writing of the failure or refusal to the Commission within thirty days after the failure or refusal.

### 2. Current Licensing Program Structure

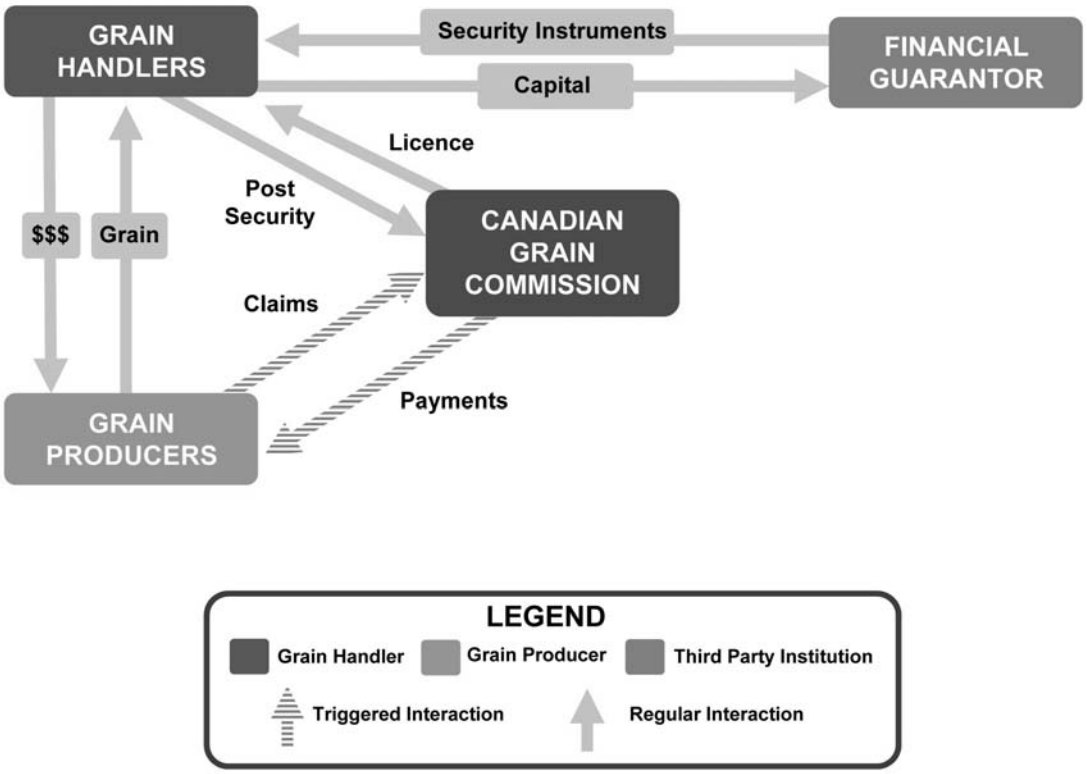
The current model is designed to provide up to 100%[2] coverage for all qualifying outstanding liabilities to producers. As at July 31, 2012, the CGC held approximately $600 million[3] in total security for all licensees. When the CGC encounters a licensee payment failure, producers only have access to the security held for that particular licensee. For example, if a licensee tenders $300,000 in security, and the total amount of valid producer claims exceeds this amount, the security would be pro-rated and distributed evenly so producers will only receive a percentage of their claims, while other security of approximately $600 million remains in place.

The current model requires licensees to post security which may be by way of bond, irrevocable standby letter of credit or guarantee, cash deposit, trust account, or payables insurance. Each of these instruments carries financing costs or premium charges. There is also a lost opportunity cost associated with providing security instruments. Each security instrument held by the CGC lowers the working capital of its respective licensee, which affects that licensee's ability to borrow funds. The impact of this cost can vary greatly among licensees, but may most negatively affect smaller and newer businesses with less access to capital.

[2] The set maximum percentage of security realized or enforced is prescribed in the Canada Grain Regulations.
[3] Total value of security held by the CGC for all licensees fluctuates monthly based on volumes and grain prices.

The current program is based on monthly reporting of liabilities by licensed grain handlers to CGC as well as a requirement to submit annual financial statements. The CGC's infrastructure monitors each licensee's outstanding liabilities to producers, the corresponding level of security required, and conducts compliance audits. An overview of the interaction between producers, licensees, financial guarantors, and the CGC under the Current Program is presented in the following graphic.

**Figure 1 - Structure of the Current Program**




The next table describes the breakdown of the current CGC licensee population, based on the volume of grain purchases and producer liabilities. Producer liabilities indicate the potential loss exposure within the current system.

**Table 1 - Breakdown of Licensees Loss Exposure (as at July 31, 2012)**

| Range of Annual Purchases | | | | |
|---|---|---|---|---|
| **Lower Bound** | **Upper Bound** | **Total Reported Purchases** | **Number of Licensees** | **Total Liabilities** |
| $0 | $500,000 | $3,039,876 | 20 | $306,606 |
| $501,000 | $1,000,000 | $6,710,356 | 9 | $410,069 |
| $1,001,000 | $1,500,000 | $10,391,284 | 8 | $703,315 |
| $1,501,000 | $2,000,000 | $4,959,677 | 3 | $499,976 |
| $2,001,000 | $5,000,000 | $68,912,295 | 21 | $4,669,260 |
| $5,001,000 | $10,000,000 | $81,343,697 | 12 | $6,620,659 |
| $10,001,000 | $20,000,000 | $222,473,038 | 14 | $16,626,547 |
| $20,001,000 | $50,000,000 | $725,178,425 | 23 | $31,112,013 |
| $50,001,000 | $75,000,000 | $343,715,992 | 6 | $6,063,965 |
| $75,001,000 | $100,000,000 | $684,869,619 | 8 | $27,540,284 |
| $100,001,000 | $1,000,000,000 | $3,457,241,489 | 9 | $128,317,327 |
| $1,000,000,001+ | | $9,877,384,846 | 3 | $399,245,202 |
| **TOTAL** | | **$15,486,220,594** | **136**[4] | **$622,115,223** |

Licensees have different annual renewal dates, and the CGC currently renews licences for one-year terms on a monthly basis. As of December 1, 2012, the CGC had 149 licensees. This amount varies throughout the year depending on the amount of new licensees entering the program relative to those exiting the business. The number of licensees presented in the above table compiled by a consultant only represents licensees that reported their outstanding producer liabilities to the CGC on a monthly basis, which are primary elevators, process elevators, and grain dealers. Terminal and transfer elevator classes are not represented in this table because they do not report their outstanding producer liabilities to the CGC. Under the amended CGA, the terminal and transfer elevator classes will merge into a single terminal elevator licence class. All licence classes including terminal elevators are included in the following table. The intent of the new producer payment protection model is that terminal elevator class licensees will be included.

**Table 2 - Breakdown of CGC Licensee Renewals by Month**

| Annual Renewal Date | Number of CGC Licensees |
|---|---|
| **December 1, 2012** | 7 |
| **January 1, 2013** | 16 |
| **February 1, 2013** | 37 |
| **March 1, 2013** | 8 |
| **April 1, 2013** | 7 |
| **May 1, 2013** | 13 |
| **June 1, 2013** | 0 |

[4] This total includes primary elevator, process elevator, and grain dealer licence classes only.

| | |
|---|---|
| **July 1, 2013** | 42 |
| **August 1, 2013** | 3 |
| **September 1, 2013** | 2 |
| **October 1, 2013** | 13 |
| **November 1, 2013** | 1 |
| **Total** | **149**[5] |

Under the current program, a total of 24 licensee payment failures (each failure has varying amounts of individual producer claims) have occurred in the past 31 years, totaling approximately $13.0 million ($20.0 million inflation adjusted) for average annual claims totaling $645,000 (inflation adjusted). In most instances, the program has fully compensated eligible producers. However, there have been some licensee failures where producers received less than full compensation for their losses.

**Table 3 - Summary of Annual Aggregate Losses (over the past 30 years)**

| Crop Year | Number of Failures | Total Amount | Total Amount, Inflation-adjusted |
|---|---|---|---|
| **1981** | 2 | $3,050,000 | $6,750,000 |
| **1982** | 0 | $0 | $0 |
| **1983** | 0 | $0 | $0 |
| **1984** | 2 | $293,153 | $583,773 |
| **1985** | 2 | $218,058 | $420,539 |
| **1986** | 0 | $0 | $0 |
| **1987** | 0 | $0 | $0 |
| **1988** | 0 | $0 | $0 |
| **1989** | 2 | $1,385,000 | $2,231,053 |
| **1990** | 0 | $0 | $0 |
| **1991** | 0 | $0 | $0 |
| **1992** | 0 | $0 | $0 |
| **1993** | 1 | $657,000 | $932,541 |
| **1994** | 2 | $445,095 | $617,341 |
| **1995** | 0 | $0 | $0 |
| **1996** | 0 | $0 | $0 |
| **1997** | 2 | $1,887,547 | $2,512,237 |
| **1998** | 0 | $0 | $0 |
| **1999** | 0 | $0 | $0 |
| **2000** | 0 | $0 | $0 |
| **2001** | 2 | $2,724,524 | $3,310,297 |
| **2002** | 2 | $294,788 | $348,412 |
| **2003** | 1 | $750,000 | $870,344 |
| **2004** | 2 | $248,949 | $288,895 |
| **2005** | 1 | $355,330 | $403,482 |

[5] This total includes all current licence classes: primary elevator, process elevator, grain dealer, terminal elevator, and transfer elevator.

| | | | |
|---|---|---|---|
| **2006** | 0 | $0 | $0 |
| **2007** | 1 | $129,215 | $137,595 |
| **2008** | 1 | $300,000 | $318,619 |
| **2009** | 0 | $0 | $0 |
| **2010** | 0 | $0 | $0 |
| **2011** | 1 | $264,461 | $264,461 |
| **Total** | **24** | **$13,003,119** | **$19,989,588** |

## 3. Actuarial Analysis

The CGC engaged an actuarial consultant to complete a review of the financial exposure of the program. This review determined that, on an annual basis, the expected level of annual losses estimated for the coverage period of August 1, 2012 to July 31, 2013 was $3.6 million. Further analysis provided a distribution of the expected losses by size to give an estimate of the probability of losses of which details are provided below.

Although their estimate exceeded the actual historical loss experience of the program (approximately $645,000), they indicated that relying solely on historical losses potentially under-estimated the exposure of a single large failure since none had occurred in the more recent history of the program. Instead, in developing these estimates, the actuaries relied on a simulation of losses based on the in-force payable exposure at July 31, 2012 amongst the current group of licensed grain handlers to generate an estimate of $3.6 million of annual losses. From that estimate, they indicated that their estimated average annual loss amount when the annual amount of aggregate claims was capped at $5 million was approximately $930,000. If the annual aggregate amount of claims is capped at $200 million, the average amount of estimated losses rises to $3.6 million, due to inclusion of the potential exposure of large failures within the year. Based on this approach, the estimated distribution of annual aggregate losses provided an estimate of the probability of annual aggregate losses to be at a given level or less which is summarized in the table below for several annual aggregate loss thresholds.

**Table 4 - Estimated Distribution of Annual Losses**

| Potential Annual Aggregate Claims Amounts | Estimated Probability of Adequate Insurance Coverage |
|---|---|
| **$250,000** | 62.13% |
| **$500,000** | 68.82% |
| **$1,000,000** | 74.84% |
| **$1,500,000** | 78.30% |
| **$2,000,000** | 81.26% |
| **$3,000,000** | 86.02% |
| **$4,000,000** | 89.53% |
| **$5,000,000** | 91.96% |
| **$10,000,000** | 95.87% |
| **$25,000,000** | 97.44% |
| **$50,000,000** | 98.85% |
| **$100,000,000** | 98.98% |
| **$200,000,000** | 99.58% |

The above chart provides the cumulative probability of a loss in a given year. For example, there is an estimated probability that 91.96% of the time the volume of annual losses would be $5 million or less.

## 4. Operational Considerations

The CGC currently carries out certain activities within the Licensing Program that are anticipated to continue under an insurance-based program.

The Licensing Unit will continue to issue licences upon confirmation of submitted financial information by the licensee and payment of the required deposit premium for the coverage provided by the umbrella insurance program, and other licensing requirements. The requirements associated with monthly reporting of liabilities and monthly monitoring of security will cease. Licensees will only require proof of security on an annual basis, at the time of licence renewal. The CGC will continue to enforce the requirements of the CGA. This includes enforcing licensing documentation and reporting requirements. The Audit Unit will continue to maintain an internal financial scoring system to assess the financial health of each licensee on an ongoing basis, complete detailed reviews of financial statements on an ongoing basis, conduct field audits on a monthly basis based on a risk-based audit plan, and administer the security claims process as required.

The CGC considers looking at nine factors related to financial risk rating:

- Financial Statement Type provided by licensee
- Sales Volume
- Earnings before interest, tax, depreciation, and amortization (EBITDA) level
- Number of losses over the past three years
- Equity level
- Working Capital level
- Debt to Equity ratio level
- Current Ratio level
- Audited Liability Report rating (not applicable under proposed new program)

In the event of a claim, the intent is to maintain the structure of the current claims process where producers submit their individual claim forms with required supporting documentation to the CGC, who will in turn seek recovery from the insurers as the beneficiary to the umbrella policy. The CGC will validate all claims utilizing the following existing procedures on behalf of the insurance providers:

- Attending onsite at the licensee premises to obtain and confirm documentation issued within the previous 90 days;
- Obtaining copies of bank statements;
- Sending claim forms to all impacted producers;
- Determining eligible and non-eligible producers and notifying said producers based on the documentation obtained from the licensee; and
- Maintaining continuous communication with impacted producers throughout the claims review process.

Upon receipt by the CGC of the claim settlement from the insurers, the CGC will proceed with compensating individual producers for their specific claims under the authorization of the CGC's Chief Commissioner.

## C. Proposed Insurance-Based Producer Payment Protection Model

### 1. Canadian Grain Commission Requirements

When considering the design for a potential insurance-based program, the CGC has established certain operating requirements, within its authority provided by the CGA in order to fulfill its mandate, function within delegated authorities, operate within budget constraints, and meet industry expectations. These requirements are:

- The CGC prefers that the insurance be provided by a panel of insurance underwriters, potentially with a separate intermediary to provide services required by a licensed insurance broker.

- Once established, the insurance-based security program will be mandatory for all licensees. No other security methods, nor other insurance programs, will be authorized for issuance of a licence.

- In order to issue a licence to a grain handling entity, proof of sufficient insurance coverage ("security") will need to be provided. This confirmation could be provided to the CGC by the licensee or directly from the insurance underwriter or intermediary.

- The CGA does not authorize the CGC to directly collect or handle insurance premiums from licensees, maintain an in-house "fund", nor manage investment accounts. This could change in the future, pending further amendments to the CGA.

- The CGC anticipates using its knowledge of the industry and its current licensee risk assessment methodology to support the determination of insurance premiums to be collected from licensees.

- The program will provide at least 95% and up to 100% compensation to producers in the event of a licensee failure up to an annual aggregate limit of $100 million. The CGC is interested to know the cost differences between limits ranging from $10 million to unlimited subject to the underwriter's premium costs and the underwriter's own analysis of potential loss exposures. The CGC is also interested in the cost differences associated with 95% (5% deductible) and 100% (no deductible) coverage levels for these limits.

- Assurance regarding the validity/reliability of producer claims will be determined by CGC personnel who will utilize current claims processes to verify appropriate records and provide the results of reviews of claims to the underwriters. Additional audits of the licensee and/or producer records by underwriters should be unnecessary.

- In order to fulfill its governance role and obligations in the event of a failure or refusal to pay by a licensee, the CGC must issue claims settlement payments to the producers. Therefore, insurance settlements must be paid to the CGC who will then issue cheques to the affected producers.

- The costs absorbed by the CGC to perform the risk assessment to determine premiums, administer the claims process, and validate data should be excluded from the premium costs with the savings passed on to licensees through reduced premiums.

## 2. New Insurance-based Producer Payment Protection Model

Description

The current producer payment protection model requires licensees to post security with the CGC on an annual basis, with the potential for monthly amendments in the event of a shortfall, based on the reported liabilities of each licensee for unpaid balances owed to grain producers. This is expensive and time consuming for both the CGC and the licensees. In its review of the current producer payment protection program, the CGC concluded that a reduction of the costs and opportunity costs of the current system could be addressed within a risk-based umbrella insurance program covering the overall exposure of all licensees and providing at least 95% and up to 100% compensation to producers in the event of default.

Furthermore, a risk-based insurance program would take advantage of:

- Pooling the combined expected risk of all licensees to reduce the cost by explicitly recognizing the inherent benefit of risk diversification;
- Reducing the operational structure needed to enforce and monitor the program further reducing cost;
- Enhancing the protection for producers by offering coverage without a deductible or with a fixed percentage deductible that would eliminate uncertainty about the amount of reimbursement expected in the event of a loss; and
- Guaranteeing recovery up to a maximum annual aggregate amount.

Structure

Under the proposed umbrella insurance program, the CGC will work with insurers to structure the terms and conditions of the insurance program. The insurance program will be designed on an aggregate basis meaning it would encompass the combined exposure of all licensees as opposed to individual licensees purchasing their own form of security.

The underwriting of each licensee would be integrated with the licensing of each licensee such that the underwriter would have the benefits of the CGC's current processes in assessing each licensee which should reduce any duplication of efforts between the CGC and the underwriter when the CGC processes licence applications. The CGC is interested to hear any requirements and/or suggestions from the underwriter regarding these processes. The CGC is seeking input regarding best use of both CGC and underwriter resources.

The CGC expects that individual premium rates chargeable to a licensee would reflect the inherent risk assessed for each licensee. In the actuarial review completed for the CGC, it was suggested that premium rates should vary according to a number of rate criteria. Based on the financial information currently being collected and the risk analysis being performed by the CGC, a robust risk assessment is available that would consider the annual purchase volume of each licensee, their debt to equity ratio, their cash liquidity, and other factors to be agreed upon with the insurers as criteria that would ultimately determine the premium payable by each licensee.

The required coverage would be provided under a master policy agreement between the CGC and a lead underwriter that could subscribe part of the exposure or underwrite the entire exposure themselves. Individual licensees would be covered as part of the licensing process by being issued an insurance certificate for their insured exposure which would be at least 95% and up to 100% of their unpaid grain purchases owed to producers.

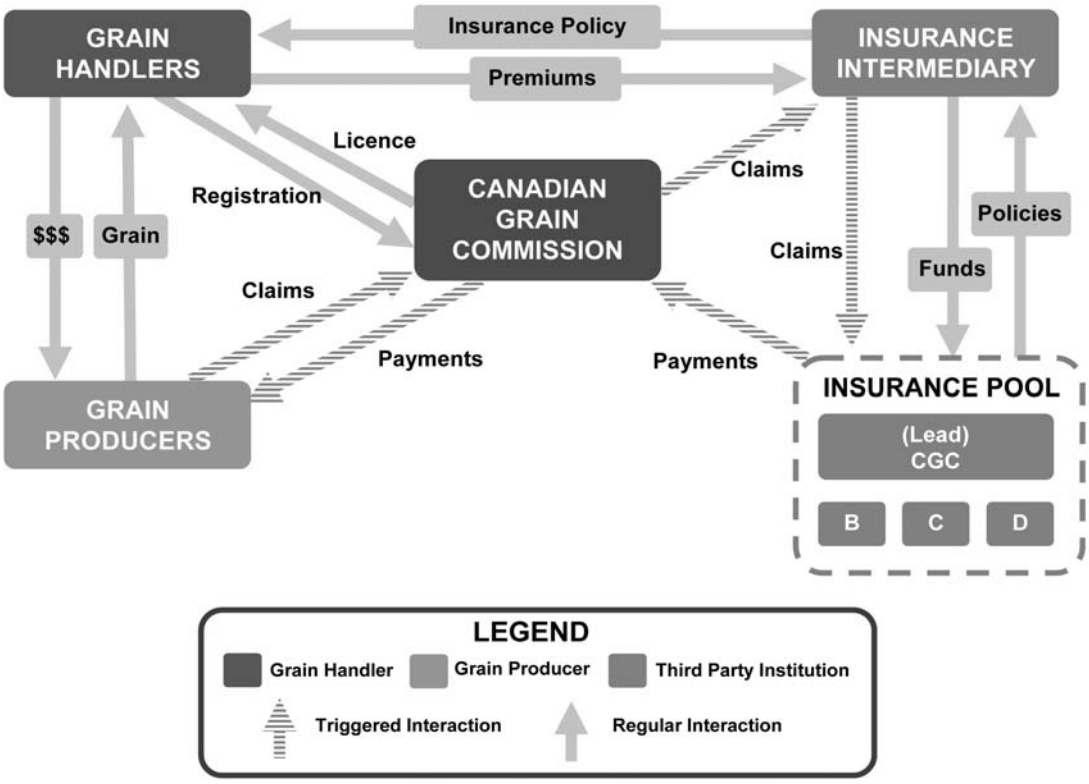
The ultimate beneficiary of the policy will be eligible producers, with the CGC administering their claims, and the proposed maximum annual aggregate limit being considered is $100 million. The CGC is interested in hearing from insurers whether this limit is appropriate, along with any cost considerations of alternative limits.

The premium payable for the policy would be the sum of each individual premium collected from each licensee at the time of renewing a licence or applying for a new licence. The premium rate that would be chargeable for each licensee would be a rate applied to the annual volume of grain purchased by each licensee during the effective year of coverage.

An initial deposit premium would be collected at the inception of the coverage year for each licensee based on their reported grain purchases based on their most recent year end. At the time of licence renewal, licensees will be required to report to the CGC the value of producer purchases in the current year and the estimated producer purchases in the upcoming year.

Claims will continue to be reported to the CGC from producers not receiving payments within the prescribed eligible period; the CGC would then investigate the claims for eligibility and amount. The claim confirmation process currently used by the CGC will continue to be used.

**Figure 2 - Structure of an Umbrella Insurance Program with a Pool of Insurers**



Contractual Arrangement

Under the umbrella insurance program, the CGC would propose to enter into a 3-year contract agreement, with two option years, for a potential contract life of five years at the mutual agreement of the CGC and the insurer. During the contract term, variables such as premium rates and the annual aggregate coverage limit would be reviewed annually based on the emerging claims experience within the contract term. The CGC is targeting implementation at the start of the 2013/2014 crop year effective August 1, 2013.

CGC Services to be provided

The proposed umbrella insurance program is intended to streamline operating costs by eliminating the duplication of processes between the CGC and the insurer. To avoid duplication of underwriting processes, a service level agreement will be negotiated with the underwriter to establish the CGC's role in:

- Confirming the coverage required by each licensee and the annual producer grain purchases for the purpose of determining the premiums;
- Monitoring and analyzing financial information for the purposes of assessing risk level of each licensee in order to determine individual licensee premiums;
- Periodically, as required, auditing the financial records of licensed grain handlers to confirm the integrity of the records; and
- Processing reported claims and confirm the aggregate value of all claims submitted by producers.

The services of the CGC to the underwriter of the insurance will be integrated with the licensing process of each licensee and consequently the acceptable rules of eligibility of the underwriter will need to be integrated with the rules used by the CGC when issuing licences. The CGC is interested in any requirements and suggestions from underwriters that should be considered in this model. The CGC is seeking feedback on this proposed assignment of responsibilities, and would like input regarding what underwriters' require to establish a level of confidence in the CGC's abilities to administer these functions.

Calculation of Premiums

Based on the estimate of $3.6 million of annual losses, the actuarial consultant also recommended that such amount be collected directly from licensees at the time of renewing their licence or applying for a new licence. The consultant recommended collection of a charge from each licensee based on a rating plan that would specifically recognize some inherent risk factors specific to each licensee.

The CGC is proposing to implement a risk rating structure with input from the underwriters that would explicitly adjust the amount to be collected from each licensee based on analysis of various financial indicators as described previously.

As an example, the actuarial consultant developed the following grid with three potential risk assessment factors identified. Using this grid on a basis of $1,000 of producer grain purchased by each licensee would apportion the estimated $3.6 million annual loss exposure. This table is used for illustrative purposes only, as a grid that could be considered reasonable according to the actuarial consultant to the CGC. A similar table, or a version of this table, could be implemented subject to amendments based on risk factors that the CGC and/or underwriter determine to be more reasonable.

**Table 5 - Estimated Rates per $1,000 of Purchases (Crop Year 2012/2013)**

| Annual Volume of Grain Purchased by Licensee | Debt to Equity Ratio | Cash to Sales Ratio <10% | 10-15% | >15% |
|---|---|---|---|---|
| Less than $5 million | > 100% | $2.6901 | $1.7965 | $1.2149 |
| | 50-100% | $1.8485 | $1.3081 | $0.9376 |
| | <50% | $0.9871 | $0.9175 | $0.8535 |
| Over $ 5 million but less than $20 million | > 100% | $1.7169 | $1.1631 | $0.8026 |
| | 50-100% | $1.1953 | $0.8604 | $0.6308 |
| | <50% | $0.6615 | $0.6183 | $0.5786 |
| Over $20 million but less than $100 million | > 100% | $1.1096 | $0.7678 | $0.5454 |
| | 50-100% | $0.7877 | $0.5810 | $0.4393 |
| | <50% | $0.4583 | $0.4316 | $0.4071 |
| Over $100 million | > 100% | $0.6704 | $0.4820 | $0.3593 |
| | 50-100% | $0.4929 | $0.3790 | $0.3008 |
| | <50% | $0.3113 | $0.2966 | $0.2831 |

For example, a licensee purchasing $4.0 million of grain annually from producers with a debt to equity ratio of 75% and a ratio of cash-to-sales of 12.5% would be charged $5,232.40 annually at the time of licence renewal for their estimated annual loss exposure for the crop year taking effect August 1, 2012. The estimated charge was calculated as 4,000 units of $1,000 times a rate of $1.3081 per $1,000.

In addition to the potential rates shown in the above table, it is accepted that the administrative cost of the program as well as a cost of capital charge would need to be added on behalf of the insurer. These terms would be negotiated and stipulated within the term of the agreement with the underwriter.

Program Monitoring

The agreement contemplated between the CGC and the underwriter will stipulate a regular program monitoring structure. The CGC anticipates that this will include a quarterly meeting of the parties to the agreement and an annual review of program performance. Both the CGC and the insurers will be required to provide regular reporting regarding the insured exposure, any emerging issues regarding claims, and financial and operating performance.

## D. Transition to the Proposed Program

The CGC's intention is to consolidate monthly renewals into one annual renewal date for all licensees. The monthly renewal process was established for historical purposes based on the reporting requirements of the current Licensing Program. When a new insurance-based producer payment protection model is implemented, these requirements will no longer be necessary. A licensing transition period is being considered from August 1, 2013 to July 31, 2014 to bring all licences and licensees into alignment with the new program. Subsequent to this, all licences may be renewed on a common date. The intent is to align the insurance policy renewal date and the licence renewal date. The common licence renewal date currently being considered is August 1, 2014. This date is flexible based on the requirements of the underwriters. Any month during the year could be implemented as a common renewal date, and the CGC is proposing August because of its alignment with the crop year.

In order to begin this transition, all licensees must be included in the new insurance model effective August 1, 2013. This will require all licensees to be evaluated using a risk-rating methodology at least four months prior to August in order to establish premiums. Each licensee will be required to provide their most recent audited financial statements showing producer grain purchases in order to determine level of coverage required.

Starting August 1, 2013, pre-existing security and/or insurance arrangements from the current program will begin to be terminated with funds returned and/or released as required by each specific financial institution. Because of this, the new umbrella insurance policy will be required to provide coverage for producers for unpaid grain deliveries dating up to 90 days prior to August 1, 2013. This is required to ensure a smooth transition to the new model and that producer payment protection coverage does not lapse during the transition period.

Details about the transition plan will be established by the CGC and the insurance providers.

## Acronyms and Definitions

| | |
|---|---|
| Annual Aggregate Losses | The cumulative amount of reported losses from all claims submitted by producers over a defined 12-month period |
| CGA | Canada Grain Act |
| CGC | Canadian Grain Commission |
| CGR | Canada Grain Regulations |
| Crop Year | The annual period in the grain industry from August 1 to July 31 |
| Licence | A document issued by the CGC that authorizes grain handlers to purchase grain from producers of Western grain |
| Licensee | A grain handling company licensed by the CGC, as per the requirements of the CGA |
| Producer | A farmer or business that grows and sells Western grain to CGC licensees |
| Security<br>CGC to | Negotiable instrument or insurance tendered by a licensee to the cover its outstanding liabilities to producers |