



# CANADA

## FINANCIAL SECTOR ASSESSMENT PROGRAM

March 2014

### INSURANCE CORE PRINCIPLES—DETAILED ASSESSMENT OF OBSERVANCE

This Detailed Assessment of Observance of Insurance Core Principles on Canada was prepared by a staff team of the International Monetary Fund as background documentation for the periodic consultation with the member country. It is based on the information available at the time it was completed in February 2014.

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### DETAILED ASSESSMENT OF OBSERVANCE

Prepared By  
**Monetary and Capital  
Markets Department**

This Detailed Assessment Report was prepared in the context of an IMF Financial Sector Assessment Program (FSAP) mission in Canada during June 2013, led by Aditya Narain, IMF and overseen by the Monetary and Capital Markets Department, IMF. Further information on the FSAP program can be found at <http://www.imf.org/external/np/fsap/fssa.aspx>

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## Acronyms

AA	Appointed Actuary
AASB	Canadian Auditing and Assurance Standards Board
AI Act	Access to Information Act
AMF	Autorité des Marchés Financiers
AMF Act	An Act Respecting the Autorité des Marchés Financiers
ASB	Accounting Standards Board
BAAT	Branch Adequacy of Assets Test
BDR	Bureau de Décision et de Révision
BoC	Bank of Canada
CAD	Chambre de L'assurance de Dommages
CALM	Canadian Asset Liability Method
CBA	Canadian Bankers' association
CCG	Corporate Governance Guideline
CCIA	Canadian Institute of Chartered Accountants
CCIR	Canadian Council of Insurance Regulators
CCRA	<i>Conseil Consultatif de Régie Administrative</i>
CDIC	Canada Deposit Insurance Corporation
CEO	Chief Executive Officer
CFO	Chief Financial Officer
CG Guideline	Corporate Governance Guideline
CIA	Canadian Institute of Actuaries
CISRO	Canadian Insurance Services Regulatory Organizations
Civil Code	Civil Code of Québec
CLHIA	Canadian Life and Health Insurance Association
CMHC Act	Canada Mortgage and Housing Corporation Act
CoB	Conduct-of-Business
CPAB	Canadian Public Accountability Board
CRR	Composite Risk Rating
CSA	Canadian Securities Administrators
DA	An Act respecting the Distribution of Financial Products and Services
Disclosure-Reg	Regulation Respecting Information to be Provided to Consumers
DA-Reg	Regulations under DA
DPR	Departmental Performance Report
DoF	Department of Finance
DWR	Distribution with a Representative
ERM	Enterprise Risk Management
FCAC	Financial Consumer Agency of Canada
FESP	Framework for Exercising the Superintendent's Powers
FIs	Financial Institutions

FINTRAC	Financial Transactions and Reports Analysis Centre of Canada
FIPPA	Freedom of Information and Protection of Privacy Act
FRFIs	Federally Regulated Financial Institutions
FRIs	Federally Regulated Insurers
FRHOG	Federally Regulated Head of Group
FISC	Financial Institutions Supervisory Committee
FSCO	The Financial Services Commission of Ontario
FSCO Act	Financial Services Commission of Ontario Act, 1997
FST	Financial Services Tribunal
FTE	Full Time Equivalent
Government	Government of Canada
GWL	The Great West Life Assurance Company
GWS	Group-wide Supervisor
HoG	Head of Group
IA	An Act Respecting Insurance (Québec)
IA-Reg	Regulation under the Act Respecting Insurance
IFRS	International Financial Reporting Standards
IBC	Insurance Bureau of Canada
ICA	Insurance Companies Act
ILS	Insurance Linked Securities
ITCR	Internal Target Capital Ratio
IVIC Guideline	Guideline on Individual Variable Insurance Contracts Relating to Segregated Funds
JFFMR	Joint Forum of Financial Market Regulators
LTV	Loan-to-Value
L&H	Life and Health
MAR	Minimum Asset Requirement
MCT	Minimum Capital Test
MCCSR	Minimum Continuing Capital and Surplus Requirement
MFC	Manulife Financial Corporation
MFEQ	Minister of Finance and the Economy
MGAs	Managing General Agencies
Minister	Minister of Finance
MoU	Memorandum of Understanding
PACICC	Property and Casualty Insurance Compensation Corporation
P&C	Property and Casualty
PCTFA	Proceeds of Crime (Money Laundering) and Terrorist Financing Act
PSC	Public Service Commission
PSOA	Public Service of Ontario Act, 2006
OIA	Insurance Act of Ontario
ORSA	Own Risk and Solvency Assessment

OSFI	The Office of the Superintendent of Financial Institutions
OSFI Act	The Office of the Superintendent of Financial Institutions Act
RAM	Risk Assessment Model
RBSF	Risk-based Supervision Framework
Representatives-Reg	Regulation Respecting the Pursuit of Activities as a Representative
RIB Act	Registered Insurance Brokers Act
RIBO	Registered Insurance Brokers of Ontario
RM	Relationship Manager
RoE	Return on Equity
SLF	Sun Life Financial Inc.
SROs	Self-regulatory Organizations
TAR	Target Asset Requirement
TAAM	Test of Adequacy of Assets and Margin
VaR	Value at Risk
WURA	Winding-Up and Restructuring Act

## EXECUTIVE SUMMARY

**The insurance sector in Canada is mature and diversified.** Assets held by federally regulated insurers (FRIs) are limited by comparison with those of banks, accounting for only 21 percent of total financial system assets. The number of FRIs has been reducing through consolidation from 290 in 2008 to 264 as at end-2012. The life and health (L&H) industry accounted for about 83 percent of the assets held by FRIs and is dominated by three large internationally active insurance groups with significant operations in the US, Asia and Europe, who held just under 76 percent of total life industry assets in 2012. The property and casualty (P&C) industry is less concentrated, with foreign-owned branches having significant market share. The number of provincially incorporated insurers (240) has been decreasing, offset by growth in captive insurers (all 23 are based in British Columbia). Assets held by provincial insurers (Can\$75.4 billion) represent about 11 percent of the assets held by FRIs as at end-2011, of which provincial insurers in Québec accounted for 80 percent (Can\$60 billion). The insurance sector is served by a wide range of intermediaries, comprising approximately 154,000 insurance agents and 44,000 to 45,000 brokers as at end-2012

**The performance of the L&H industry has been dampened by the global financial crisis and the ongoing volatile financial markets.** Total assets held by L&H FRIs reached Can\$602 billion as at end-2012. The market share of annuities products, comprising largely segregated fund policies, fell to 52 percent in 2012 (Can\$4.7 billion gross premiums) from 61 percent in 2010. Group business recorded a 21 percent increase (to Can\$2.6 billion) while individual business remained steady (Can\$ 1.7 billion). L&H FRIs have been repricing their products in recent years in response to the low interest rate environment and have also been removing or weakening product guarantees, transferring more risks to policyholders. In the absence of growth, profitability has been declining, compounded by the protracted low interest rate environment.

**The P&C industry is much smaller and writes almost exclusively domestic risks, with motor insurance as the dominant line of business.** Total assets of P&C FRIs as at end-2012 were Can\$124.6 billion. Growth in the sector has been modest; premiums rose by 10 percent in 2012 (Can\$43.7 billion). Ontario automobile insurance is the single largest P&C product, accounting for about 25 percent of the premiums of the P&C industry. While operating results have been strong, declining investment returns have stimulated a focus on improving underwriting discipline. The mortgage insurance market has insured loans in-force of Can\$730 billion with written premium of Can\$2.2 billion in 2012 and is dominated by the state-owned Canada Mortgage and Housing Corporation (with about 70 percent market share).

**The solvency position of the L&H industry has been eroded since 2010, while the overall solvency of the P&C industry has remained stable.** At the aggregate level, both sectors report solvency ratios that are well above the regulatory minimum. The key exposures of L&H FRIs are to continuing low interest rates, volatile equity markets and slow economic growth, while P&C FRIs have to confront difficult investment market conditions and increased frequency and severity of natural catastrophes.

**Federal and provincial authorities share responsibilities for supervising the insurance sector in Canada.** OSFI is responsible for the prudential supervision of FRIs and Canadian branches of foreign insurers. Insurers incorporated in a province are subject to the solvency oversight of that province's insurance supervisor. The provincial supervisors are also responsible for licensing and supervising the conduct-of-business (CoB) of insurers, including FRIs, operating in their provinces. There are various supervisory coordination mechanisms at both the federal and provincial levels.

**The Canadian regulatory regime for FRIs has a high level of observance with the ICPs, supported by robust prudential supervision by OSFI.** OSFI's risk-based Supervisory Framework facilitates structured and comprehensive supervisory risk assessments and the industry has a high regard for the professionalism of OSFI supervisors. The supervisory intervention process is transparent and supports timely intervention to address emerging concerns. OSFI has adequate supervisory resources and technical capacity to conduct effective supervision. Minor gaps in the regulatory regime have been addressed by OSFI through its guidelines and supervision. While OSFI has been conducting active supervision of groups in practice, the transparency of its different approaches to supervising insurance groups should be improved. It is recommended that the authorities adopt a transparent and consistent regulatory regime for group-wide supervision, based on a clear definition of the group, which includes prudential and market conduct requirements at the group level as well as a consistent approach to group-wide supervisory work. Going forward, it is advisable that OSFI be empowered to take supervisory measures at the level of the holding company.

**The requirements on valuation of technical provisions and assets provide a comprehensive framework of standards.** They include a consistent economic basis for valuation across the balance sheet and margins for adverse deviation. While the approach to valuation of liabilities is principles-based and provides for significant discretion to be exercised by the Appointed Actuary (AA), it is underpinned by professional and regulatory requirements applying to the AA and a sound framework of oversight, peer review and audit requirements. The approach has been adapted where areas of weakness were highlighted by the financial crisis and OSFI's supervisory work.

**OSFI has robust capital adequacy requirements for L&H and P&C business, although there are gaps and inconsistencies in their application, at both group and solo legal entity levels.**

Separate capital frameworks apply to L&H and P&C business, capturing all material risks as well as requiring FRIs to hold capital for risks not covered by the standard requirements. OSFI allows firms to use internal models in limited areas, but applies a full model approval process and ongoing monitoring. A distinguishing feature and a strength of OSFI's regime is its application on a consolidated basis to each operating FRI. However, OSFI's approach to the application of group capital requirements varies across groups, reflecting the limitations on its powers over unregulated holding companies. Furthermore, its focus on consolidated capital adequacy is not matched by the application of a full framework of capital or disclosure requirements to all Canadian solo legal entity FRIs within groups. There is scope for strengthening OSFI's approach in the area of investments. While OSFI already requires FRIs to develop internal capital targets, requirements to develop an Own Risk and Solvency Assessment are scheduled to be implemented in 2014.



**CoB regimes across provinces are being harmonized and this should continue while ensuring adequate supervisory resources for effective CoB supervision.** The CoB regime adopted by AMF is in line with international best practice and it has adequate resources to conduct effective risk-based CoB supervision. Constrained by limited resources, FSCO has adopted both a reactive and industry-wide targeted approach to supervising the FRIs based in Ontario (the vast majority of the total) and large numbers of insurance intermediaries. It is essential that FSCO be equipped with adequate resources and financial capacity to deal with the size and diversity of the Ontario marketplace.

**There is scope for strengthening the legal capacity and operational autonomy of the supervisors.** OSFI has not been delegated powers to make directly binding rules. Its use of guidelines to set out detailed standards confers considerable flexibility, for example in responding to emerging risks, and its guidelines are treated by regulated entities as authoritative. Nonetheless, the authorities should consider the scope to strengthen regulation by empowering the supervisors to issue enforceable rules by administrative means rather than through legislation. In the case of OSFI and AMF, relevant laws should be updated to separate the provisions governing prudential decisions of the supervisors, for example on changes of control, from the national interest issues which the executive authorities must take into consideration; and in the case of FSCO, to limit the circumstances under which the provincial government can issue a policy statement to FSCO. Consideration should be given to exempting the supervisors from the government's fiscal controls and administrative guidance so as to strengthen their financial autonomy. There should be provisions in law requiring public disclosure of the reasons for a removal of the President and CEO of AMF and the Superintendent of FSCO, in line with international standards.

# ASSESSMENT OF INSURANCE CORE PRINCIPLES

## A. Introduction and Scope

**1. This report assesses Canada's regulatory regime and supervisory practices against the international standards established by the International Association of Insurance Supervisors (IAIS), as part of the 2013 Financial Sector Assessment Program (FSAP) of Canada.** The assessment was conducted by Su Hoong Chang (IMF) and Ian Tower (external expert engaged by the IMF) and from 12 to 28 June 2013.

**2. The assessment is benchmarked against the IAIS Insurance Core Principles (ICPs) issued in October 2011,** as revised in October 2012. The ICPs apply to all insurers, whether private or government-controlled. Specific principles apply to the supervision of intermediaries. The scope of the assessment covers: a) the prudential supervision exercised by the OSFI at the federal level based on materiality considerations<sup>1</sup> i.e. prudential oversight of insurer by provincial authorities is not covered; and b) the conduct-of-business regimes of the Financial Services Commission of Ontario (FSCO) and the Autorité des Marchés financiers (AMF) in Québec, on a sampling basis. The institutional arrangements for financial sector regulation and supervision are outlined in Section C.

## B. Information and Methodology Used for Assessment

**3. The level of observance for each ICP reflects the assessments of its standards.** Each ICP is rated in terms of the level of observance as follows:

- a) **Observed:** where all the standards are observed except for those that are considered not applicable. For a standard to be considered observed, the supervisor must have the legal authority to perform its tasks and exercises this authority to a satisfactory level.
- b) **Largely observed:** where only minor shortcomings exist, which do not raise any concerns about the authorities' ability to achieve full observance.
- c) **Partly observed:** where, despite progress, the shortcomings are sufficient to raise doubts about the authorities' ability to achieve observance.
- d) **Not observed:** where no substantive progress toward observance has been achieved.

**4. The assessment is based solely on the laws, regulations and other supervisory requirements and practices that are in place at the time of the assessment in June 2013.** Ongoing regulatory initiatives are noted by way of additional comments. The authorities have provided a full and well-written self-assessment, supported by anonymized examples of actual supervisory practices and assessments, which enhanced the robustness of the assessment. Technical

<sup>1</sup> Currently, the vast majority of Canadian insurers are incorporated at the federal level. Insurers that incorporate in a specific province are subject to the solvency oversight of that province.

discussions with and briefings by officials from OSFI, FSCO and AMF also enriched this report; as did discussions with industry participants.

**5. The assessors are grateful to the authorities for the full cooperation and thoughtful logistical arrangements,** particularly the helpful co-ordination of various meetings with industry participants. The assessors also benefitted from the valuable inputs and insightful views from meetings with insurers as well as industry and professional organizations.

## C. Overview—Institutional and Macroprudential Setting

### Institutional Framework and Arrangements

**6. The responsibilities for financial sector supervision in Canada at the federal level are undertaken by a number of agencies:** a) the Department of Finance (DoF) is responsible for the overall stability of the financial system and financial sector legislation at the federal level; b) the Bank of Canada (BoC) provides liquidity to the Canadian financial system, oversees key payment, clearing and settlement systems, and assesses risks to financial system stability; c) OSFI exercises prudential regulation and supervision of federally regulated financial institutions (FRFIs), including federally regulated insurers (FRIs); d) the Canada Deposit Insurance Corporation (CDIC) insures deposits of member institutions and is the bank resolution authority; and e) the Financial Consumer Agency of Canada (FCAC) has the mandate to strengthen oversight of consumer protection measures, expand consumer education activities, and enforce consumer related provisions in statutes covering FRFIs. The Minister of Finance (Minister) has overarching authority over federal financial sector legislation, including the governing legislation that establishes the mandates and powers of financial sector regulatory agencies and is supported by the DoF in fulfilling this mandate.

**7. Supervisory coordination amongst the federal agencies is facilitated by various collaborative mechanisms:**

- a) The Financial Institutions Supervisory Committee (FISC) facilitates consultation and the exchange of information between OSFI, CDIC, BoC, FCAC and the DoF. It is chaired by the Superintendent of Financial Institutions;
- b) The Senior Advisory Committee acts as a discussion forum for financial sector policy issues, including macroprudential oversight and financial stability issues. It is chaired by the Deputy Minister of Finance with the same membership as the FISC although other government agencies may be invited, where appropriate;
- c) The Heads of Agencies Committee acts as a forum for exchange of information and views and coordinate actions on issues of mutual concern, such as hedge funds and OTC derivatives. It is chaired by the BoC Governor and includes the DoF, OSFI, the four largest provincial securities regulators and the Chair of the Canadian Securities Administrators (CSA).

**8. Federal and provincial<sup>2</sup> supervisors share responsibilities for supervising the insurance sector.**

The insurance regulatory system in Canada reflects the cooperative federalism that characterizes the Canadian approach to government. OSFI is responsible for prudential supervision of insurers incorporated under the federal Insurance Companies Act (ICA), which are referred to as federally regulated insurers (FRIs) in this report. Insurers that are incorporated in a specific province are subject to the solvency oversight of that province. OSFI also regulates the solvency and soundness of licensed Canadian branches of foreign insurers. The relevant provincial supervisors supervise the market conduct of all insurers (including FRIs) operating within their provinces.

**9. OSFI exercises prudential regulation and supervision of FRIs.** Its primary activities are to: protect the rights and interests of depositors, policyholders, pension plan members and creditors of financial institutions (FIs); and contribute to public confidence in a safe and sound financial system. OSFI's mandate does not include consumer-related issues or the securities industry. OSFI also works closely with the Financial Transactions and Reports Analysis Centre of Canada (FINTRAC), which is responsible for ensuring compliance with Canada's Proceeds of Crime (Money Laundering) and Terrorist Financing Act.

**10. While some provincial supervisors delegated prudential supervision of insurers incorporated in their jurisdiction to OSFI in the past under supervisory memoranda of understanding (MoUs), this practice has discontinued.**

Historically, provincial supervisors harmonized their solvency standards with those of OSFI, to minimize regulatory arbitrage. Over the past two decades, OSFI has updated its solvency regime for FRIs, in line with evolving international regulatory and market developments. However, the declining number of provincially incorporated insurers raised pertinent costs-and-benefits considerations for some provincial supervisors faced with a need to invest significant resources to continuously update and maintain their solvency regimes in line with international standards. While some provinces, especially those with a significant mass of provincial insurers (e.g., Québec) have chosen to retain their autonomy in prudential supervision, a number of provinces<sup>3</sup> are considering other policy options. All the MoUs have expired and OSFI no longer conducts on-site examination of provincially incorporated life insurers and fraternal benefit societies.

**11. The provincial supervisors are responsible for licensing and supervising the conduct-of-business (CoB) of insurers operating in their provinces<sup>4</sup>.** The scope and approach adopted for CoB supervision of insurers and intermediaries in each province vary. In some provinces, insurance

<sup>2</sup> There are 10 provinces that are considered to be co-sovereign divisions and three territories that derive their mandates and powers from the federal government.

<sup>3</sup> For example, FSCO has proposed to cease providing for the provincial incorporation of new insurers. It would continue to license insurers subject to the licensing condition that insurers are incorporated in a jurisdiction that meets international solvency standards.

<sup>4</sup> The Supreme Court of Canada has recognized that insurance contracts and the general organization of insurers fall under the exclusive jurisdiction of the provinces (Canadian Indemnity Co. et al. v. A.G. of British Columbia, [1977] 2 S.C.R. 504, p.511-512 and 519; Canadian Western Bank v. Alberta, [2007] 2 S.C.R. 3, par. 80 and 81.)

brokers and agents are regulated in the same manner and by the same supervisor while in other provinces, SROs may be given delegated powers to supervise certain categories of intermediaries.<sup>5</sup>

**12. This assessment does not cover the FCAC in view of its limited role in supervising the insurance sector.** FCAC is an agency of the federal government and falls under the purview of the Minister. It was established by Parliament in 2001 under the Financial Consumer Agency of Canada Act to consolidate<sup>6</sup> and strengthen oversight of consumer protection measures in FRFIs, and to expand consumer education. FCAC focuses on the lending activities of FRFIs and administers the consumer provisions<sup>7</sup> under the ICA. It also monitors FRFI's compliance with voluntary codes of conduct and public commitments.

**13. Coordination amongst provincial supervisors is facilitated by the Canadian Council of Insurance Regulators (CCIR).** The CCIR is a long-established inter-jurisdictional association of insurance regulators (i.e., federal, provincial and territorial authorities) with the mandate to promote an efficient and effective insurance regulatory system in Canada. OSFI participates in the meetings of the CCIR as an observer. CCIR is also a member of the Joint Forum of Financial Market Regulators (JFFMR), a mechanism through which pension, insurance and securities regulators co-ordinate, harmonize and streamline the regulation of financial products and services in Canada. The other JFFMR members are the Canadian Association of Pension Supervisory Authorities, the CSA and the Canadian Insurance Services Regulatory Organizations (CISRO).<sup>8</sup>

## Market Structure and Industry Performance

### *Industry Structure and Recent Trends*

**14. The insurance sector in Canada is small relative to the banking sector.** Assets held by insurers accounted for only 21 percent of financial system assets. Domestic banks own six life-and-health (L&H) FRIs and 12 property and casualty<sup>9</sup> (P&C) FRIs, as part the conglomerate groups. The insurance subsidiaries are not considered material in the context of the banks' overall business. Only one very small P&C FRI was part of a financial conglomerate headed by a securities firm.

**15. Insurance penetration and density<sup>10</sup> for the Canadian L&H industry and the P&C industry has seen modest increases.** Over the past 5 years, L&H insurance penetration has

<sup>5</sup> For example, in Ontario, agents are regulated by FSCO, while brokers are regulated by a SRO.

<sup>6</sup> While some consumer protection activities existed previously, they were dispersed among various federal bodies.

<sup>7</sup> Paragraphs 165(2)(f) and (g), subsection 469.1(3), sections 479 to 489.3, subsection 542.061(3) and sections 598 to 607.2 of the ICA together with related regulations.

<sup>8</sup> CISRO is an inter jurisdictional group of regulating authorities who are dedicated to developing consistent standards of qualifications and practice for insurance intermediaries dealing in insurance of persons and property.

<sup>9</sup> The P&C industry provides coverage for all risks other than life, including automobile, property and liability insurance.

<sup>10</sup> Insurance penetration is premiums as a percentage of GDP while insurance density is premium per capita.

increased modestly from 3.1 percent to 3.2 percent and insurance density increased slightly Can\$1,687 (from Can\$1,548). This is comparable to the average penetration and density for advanced markets of 3.6 percent and US\$1,543 as at end-2011. The penetration and density ratios of the P&C industry as at end-2012 were 2.37 percent and Can\$1,234, respectively. The P&C ratios are significantly lower than the average ratios for advanced markets of 5.0 percent and US\$2,168, respectively, as at end-2011.<sup>11</sup> Reinsurance penetration and density is low at 0.63 percent and Can\$330, respectively, in 2012. The number of domestic employees in the Canadian insurance industry is approximately 254,400 as at end-2011.

**16. The number of FRIs has been consolidating while there is a shift in the composition of provincial insurers** (Table 1). As at end-2012, there were 264 FRIs, down from 290 in 2008, with P&C FRIs accounting for 57 percent of FRIs, despite the higher reduction in numbers. The P&C industry is much smaller than the L&H industry and accounted for 17 percent of total industry asset in 2012. In addition, 80 foreign insurers had been licensed to operate as branches in Canada. The reduction of L&H and P&C provincial insurers were offset by increase in captive insurers<sup>12</sup> and other types of insurers. All the 23 captive insurers are based in British Columbia. Although the number of provincial insurers is comparable to FRIs, assets held by provincial insurers (Can\$75.4 billion) represent about 11 percent of the assets held by FRIs as at end-2011. Provincial insurers in Québec had the largest provincial asset base at more than Can\$60 billion.<sup>13</sup>

**Table 1. Insurance Market Structure as at end-2012**

	Federal			Provincial		
	2008	2012	Inc/Dec	2008	2012	Inc/Dec
L&H	74	65 <sup>14</sup>	(9)	25	20	(5)
P&C (1)	187	150	(37)	143	137	(6)
Reinsurance	13	36	23	3	3	0
Captives	0	0	0	16	23	7
Fraternal benefit societies	16	13	(3)	7	6	(1)
Others	0	0	0	48	51	3
<b>Total</b>	<b>290</b>	<b>264</b>	<b>(26)</b>	<b>242</b>	<b>240</b>	<b>(2)</b>

(1) Reinsurers were included under P&C in 2008

Source: OSFI

**17. The L&H industry is dominated by three large internationally active insurance groups with significant operations in the US, Asia and Europe.** Together, Manulife Financial Corporation

<sup>11</sup> Source: World Insurance in 2011, Swiss Re (data on advanced markets).

<sup>12</sup> An insurer that insures risks within the group and only a small part (if any) of its portfolio covers risk from unrelated parties.

<sup>13</sup> Source: CCIR Report on provincially chartered insurers and provincial solvency supervision frameworks, March 2013.

<sup>14</sup> The figures for L&H FRIs include FRIs that are in run-off or inactive (34 as at 2012).

(MFC), Sun Life Financial Inc. (SLF) and The Great West Life Assurance Company (GWL) held just under 76 percent of total life insurance assets in Canada in 2012, at the legal entity level. MFC had the highest asset base at the consolidated level and it is the only top-3 insurance group with larger foreign than domestic operations. Domestically, with the benefits of economies of scale and pricing powers, these groups enjoy competitive advantages against their smaller domestic and foreign peers.

**18. In recent years, SLF and MFC have retrenched their US operations significantly, particularly in the variable annuities business.**<sup>15</sup> The low interest climate has affected the competitiveness of Canadian insurers in the US as they are required to hold higher technical provisions compared with their US peers owing to differences in valuation bases. Overall, 48 percent of the consolidated assets of the top-10 insurance groups are attributable to domestic operations, while 69 percent of gross premium is generated through domestic operations. The largest foreign market for the top 3 insurance groups is the US, accounting for 37 percent of assets and 17 percent of premiums in 2012, followed by Europe (11 percent of assets and 12 percent of premiums). While assets held in respect of their Asian operations were relatively low at 9 percent of total assets, it is viewed as a potential growth market, representing 19 percent of premiums written in 2012.

**19. The P&C industry is less concentrated than the L&H industry, with foreign-owned insurers having significant market share.** It comprises local subsidiaries of the large global groups, subsidiaries of the large Canadian banks as well as mutual/co-operative organizations. The top-10 P&C FRIs produced 46 percent of total industry premium in 2012.

**20. Branches or subsidiaries of large global reinsurance groups dominate the reinsurance sector.** The scale of the reinsurance industry in Canada is small; assets held by reinsurers totaled only Can\$29 billion or 3 percent of the assets of direct insurers. For better focus, the following market analysis is limited to the L&H and P&C industries, excluding reinsurers.

**21. The insurance sector is adequately served by a wide range of intermediaries.** As at end-2012, there were approximately 154,000 insurance agents (or approximately one for every 225 Canadians), up from 133,000 in 2008. Over the same period, the number of insurance brokers increased from approximately 44,000 to 45,000. Brokers have diverse business models comprising: a large number of small, often family-owned, "main street" brokers; larger regional brokers; and the largest international brokerage groups. In recent years, managing general agencies<sup>16</sup> (MGAs) have gained almost half the market share for L&H distribution channel (please refer ICP 18).

<sup>15</sup> AM Best: Canadian Insurers Maintain Capitalization Despite Economic Headwinds.

<sup>16</sup> In the late 1990's, many major life insurers began to dismantle their career agency distribution model through their branch networks in favor of contractual arrangements with life brokerage firms, which became known as MGAs.

## Assets and liabilities

**22. The investment portfolios of L&H FRIs are diversified, with moderate exposure to real estate** (Table 2). Excluding the segregated funds, FRIs' investments in real estate (directly and through mortgage loans) accounted for 20 percent of their assets as at end-2012, a decline from the 25 percent recorded as at end-2008. Allocation to fixed income securities has been consistently above 65 percent of investment portfolios (excluding the segregated funds) in the last five years. L&H FRIs also invested in alternative asset classes, e.g., some Can\$20 billion was invested in private placement debts although direct exposures to Europe were modest. Nonetheless, sensitivity to market risks (especially equity risk) arising from their legacy segregated fund guarantees<sup>17</sup> is a concern, particularly for insurers who did not adequately hedge their equity exposures. The L&H insurance groups wrote more than half of their segregated fund portfolios outside of Canada, with assets totaling Can\$422 billion at the consolidated level as at end-2012, a significant 32 percent increase from 2008 (Can\$320 billion).<sup>18</sup>

**Table 2. Composition of Assets—L&H FRIs (Legal Entities)**

<i>In Can\$ millions</i>	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>	
						<i>% of total</i>
Bonds	115,474	127,323	141,221	157,926	165,094	27 %
Equities	13,745	17,213	18,377	19,729	21,062	3 %
Real estate and RE related	48,425	46,170	45,936	48,768	49,188	8 %
Cash and bank balances	12,316	14,251	11,686	13,105	13,517	2 %
<b>Subtotal</b>	<b>189,961</b>	<b>204,957</b>	<b>217,221</b>	<b>239,528</b>	<b>248,861</b>	<b>41 %</b>
Segregated Funds	29,218*	34,345*	37,653*	178,449	192,432	32 %
Other assets	87,491	112,768	110,205	153,575	160,724	27 %
<b>Total</b>	<b>306,669</b>	<b>352,070</b>	<b>365,080</b>	<b>571,551</b>	<b>602,017</b>	<b>100 %</b>

\* Prior to 2011, "in Canada" data was not collected for conglomerates.

Source: OSFI

**23. The investment profile of the P&C industry is conservative, heavily weighted in fixed income securities** (Table 3). Government and corporate bonds constituted more than 85 percent of the investments of P&C FRIs for the last five years. In addition, almost the entire debt security portfolio was invested in Canadian debt securities. They have negligible exposures to the real estate sector.

<sup>17</sup> Segregated fund policies are insurance products with investment features. Insurers are required to maintain separate funds for these policies where premiums are allocated in bonds, equities etc, depending on the stated investment objectives of the funds. Segregated funds policies provide for guaranteed death benefits and various levels of guaranteed returns. Thus, as equity markets decline, insurers would have to meet the guarantee.

<sup>18</sup> Much of this is due to the increase in the market indices, not due to a significant increase in sales/new business.



**Table 3. Composition of Assets—P&C FRIs (Legal Entities)**

<i>In Can\$ millions</i>	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>	<i>% of total</i>
Government securities	35,349	38,803	41,550	40,309	46,551	37 %
Corporate securities	19,475	22,377	23,200	22,723	26,375	21 %
Equities	4,222	5,815	7,186	6,970	7,585	6 %
Real estate & real estate related	27	53	32	6	6	0 %
Cash and bank balances	3,760	2,551	2,209	2,961	2,675	2 %
Other assets	42,720	43,197	43,987	43,382	41,430	33 %
<b>Total</b>	<b>105,554</b>	<b>112,795</b>	<b>118,164</b>	<b>116,352</b>	<b>124,623</b>	<b>100 %</b>

Source: OSFI

**24. While L&H FRIs have negligible off-balance sheet activities, some P&C FRIs are active in securities lending.** L&H FRIs engaging in securities lending to generate fee income generally hold collateral with market values that exceed the value of securities lent. They also engage in limited amounts of repurchase and reverse repurchase transactions. With the bulk of their investments held in securities, 27 P&C FRIs are active in securities lending and a total of Can\$2.4 billion of securities were lent in 2012. A small number of P&C FRIs use derivatives in hedging programs. Canadian P&C FRIs have not participated in insurance linked securities (ILS). However, some parent entities have participated in the ILS market for Canadian perils but the Canadian FRIs are not taking credit on the balance sheet for these ILS.

**25. Asset transfers between parent banks and insurance subsidiaries (both L&H and P&C) are permitted for capital management purposes.** OSFI monitors these transactions to ensure that these are consistent with the capital framework. Some bank-owned FRIs invest in bank parent-originated National Housing Act Mortgage-Backed Securities. This program is overseen by CMHC and the pool of assets is guaranteed by CMHC.<sup>19</sup> While P&C FRIs reported negligible intra-group balances as at end-2012, the L&H FRIs held Can\$85.6 billion in intra-group assets.

**26. L&H FRIs have been increasing their technical provisions, despite the steady decline in premium revenue while the technical provisions for P&C FRIs remain stable** (Tables 4 and 5). The significant increase in technical provisions (26 percent excluding segregated funds) in 2011 was mainly due to the adoption of IFRS requiring technical provisions to be reported on a gross basis, and from a rapid decline in fixed income yields. Non-participating policies<sup>20</sup> account for the bulk of the technical provisions for traditional policies. The amounts reported under segregated fund

<sup>19</sup> CMHC also determines issuer eligibility requirements and approves the issuers and acceptable custodians. The issuer assigns all rights, title and interest in the pool to CMHC as trustee on behalf of investors.

<sup>20</sup> Participating policies or with-profits policies are those that entitle the policyholders to share in the profits of an insurer by way of policy dividends, which are declared at the discretion of the insurer in with policyholders' reasonable expectation. Non-participating policies do not offer such profit sharing.

policies reflect the assets deposited in the segregated funds, while some Can\$10 billion in provisions for the embedded guarantees are included as technical provisions for non-participating policies. Given recent market volatilities, OSFI has been closely monitoring the adequacy of technical provisions for the segregated fund portfolios.

### Operating performance and solvency position

**27. The demand for L&H products has been affected by developments in the financial markets** (Table 6). Notably, the market share of annuities products, the bulk of which are segregated fund policies, has declined from 61 percent in 2010 to 52 percent. Only group business recorded a 21 percent increase in premium volume (to Can\$2.6 billion) while individual business remained steady at around Can\$ 1.7 billion. New product initiatives for the last five years have featured price increases and the removal or weakening of guarantees. Product re-designs have resulted in a transfer of investment risks from insurers to policyholders, and some FRIs have attempted to re-establish participating insurance as a major product line, albeit with limited success. In the absence of growth, profitability of L&H FRIs has been declining, compounded by the protracted low interest rate climate. In addition to the impact on their investment performance, the record low interest rate level also resulted in the need to increase insurers' technical provisions, with significant impact on their profitability.

**Table 4. Trend in Technical Provisions—L&H FRIs**

<i>In Can\$ millions</i>	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>
Participating policies	44,632	48,630	52,372	54,558	57,369
Non-participating policies	131,904	142,298	151,287	202,379	209,719
Sub-total	176,537	190,928	203,659	256,937	267,088
<i>Inc/Dec from previous year (sub-total)</i>		8 %	7 %	26 %	4 %
Segregated funds	29,218*	34,345*	37,653*	177,734	192,025
Other reserves <sup>21</sup>	21,020	21,131	18,546	30,383	29,986
<b>Total</b>	<b>226,775</b>	<b>246,403</b>	<b>259,858</b>	<b>465,054</b>	<b>489,099</b>
<i>Inc/Dec from previous year (Total)</i>		9 %	5 %	79 %	5 %
Gross premiums	51,577	54,818	56,343	59,871	58,861

\* Prior to 2011, "in Canada" data was not collected for conglomerates.

Source: OSFI

<sup>21</sup> Reserves that are not actuarially determined, mainly unpaid claims and amounts on deposits.

**Table 5. Trend in Technical Provisions—P&C FRIs**

<i>In Can\$ millions</i>	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>
Gross premiums	38,748	39,236	40,089	40,201	43,040
Technical provisions	70,079	73,362	76,229	75,087	80,682
<i>Inc/Dec</i>		5 %	4 %	-1 %	7 %

Source: OSFI

**Table 6. Gross Premiums by Major Lines of Business in 2012—L&H FRIs**

<i>In Can\$ millions</i>	<b>2010</b>	<b>2011</b>	<b>2012</b>	<i>% of total</i>
Individual	1,615	1,739	1,705	19 %
Group	2,237	2,192	2,646	29 %
Annuities	5,977	5,497	4,715	52 %
<b>Total</b>	<b>9,828</b>	<b>9,428</b>	<b>9,066</b>	<b>100 %</b>

Source: OSFI

**28. The P&C industry writes almost exclusively domestic risks; with motor insurance as the dominant line of business** (Table 7). Growth has been modest; gross written premiums rose by 10 percent in 2012 (Can\$39.7 billion in 2011) after a slight drop of 3 percent in 2011. Ontario automobile insurance is the single largest P&C product, accounting for about 25 percent of the premiums of the P&C industry. While operating results have been favorable, declining investment returns has motivated a refocus on underwriting discipline. In 2011, the overall results for automobile insurance improved, largely due to reforms introduced in Ontario in September 2010, partly offset by higher third party liability claims. In addition, extreme weather and natural catastrophes had dampened results as the industry experienced its third straight year of catastrophe-related insurance claims above Can\$1 billion.

**Table 7. Premiums by Major Lines of Business in 2012—P&C FRIs**

<i>In Can\$ millions</i>	<b>Gross</b>	<i>% of total</i>	<b>Net</b>	<b>Retention</b>
Automobile	18,809	43 %	16,977	90 %
Property	15,542	36 %	12,143	78 %
Liabilities	5,202	12 %	4,048	78 %
Accident & health	1,176	3 %	949	81 %
Others	3,018	7 %	2,254	
<b>Total</b>	<b>43,746</b>	<b>100 %</b>	<b>36,370</b>	<b>83 %</b>

Source: OSFI

**29. The state-owned Canada Mortgage and Housing Corporation (CMHC)<sup>22</sup> is currently one of the largest FIs in Canada.** In Canada, federally regulated lenders are required to insure residential mortgage loans with loan-to-value (LTV) ratio of greater than 80 percent against default by either the CMHC or by a private mortgage insurer.<sup>23</sup> Non-federally regulated lenders may choose to insure residential mortgages through CMHC or the other private mortgage insurers in order to access CMHC securitization programs. The mortgage insurance market has insured loans in-force of Can\$730 billion with a written premium of Can\$2.2 billion in 2012 and is dominated by CMHC (about 70 percent market share) and Genworth Financial Mortgage Insurance Company Canada (25 percent). Canada Guaranty Mortgage Insurance Company also underwrites mortgage insurance in Canada. With the increase in home ownership and rising housing prices, CMHC's assets increased more than twelve-fold between 2000 and 2010. CMHC is the only insurer permitted to insure commercial mortgages. The federal government guarantees 90 percent of a private insurer's residential mortgage loans in the event of insolvency. The federal government requires CMHC and the two private mortgage insurers to observe specific underwriting parameters. The private mortgage insurers are subject to OSFI's prudential regulation. The National Housing Act establishes authorities for OSFI to examine and report on CMHC's commercial operations to determine whether CMHC is carrying on its activities in a safe and sound manner and to access CMHC's books and records. As CMHC is a Crown corporation, OSFI does not have legal authorities to take enforcement actions in the case of CMHC. OSFI is required to report the results of its examinations, including any recommendations, to the CMHC's responsible Minister, the Minister of Finance and CMHC's board of directors at least once per year.<sup>24</sup>

**30. The solvency position of L&H industry has been eroded since 2010 while the overall solvency of P&C industry has remained stable** (Table 8). The solvency regimes applicable to L&H and P&C FRIs are different, including the solvency control levels (described in ICP 17). All L&H and P&C FRIs meet the minimum ratios of 120 percent and 100 percent, respectively. OSFI's has set a supervisory target of 150 percent for both classes of FRIs. The capital resources of fraternal benefit societies are well above the supervisory target of OSFI, as they have no external access to capital, either through equity investment or debt issuance.<sup>25</sup> The two largest fraternal benefit societies constitute approximately 90 percent of the fraternal industry, both have high capital ratios.

<sup>22</sup> CMHC is a federal Crown corporation, incorporated under the Canada Mortgage and Housing Corporation Act (CMHC Act), and is accountable to Parliament through the Minister responsible for CMHC. In addition to the CMHC Act, the legislative framework governing CMHC consists of the National Housing Act and the Financial Administration Act.

<sup>23</sup> Banks may insure loans with less than 80 percent LTV to reduce capital requirements and for securitization. CMHC-insured mortgages have a capital risk weight of zero, compared to 35 percent for uninsured mortgages. Mortgages insured by private insurers have higher risk weights (e.g., 5 percent) in recognition of the 90 percent government guarantee for private insurers.

<sup>24</sup> CMHC is legally required to include a proposal on how it will address OSFI recommendations in its Corporate Plan. CMHC's Corporate Plan is submitted to the Governor in Council annually on the recommendation of CMHC's responsible Minister.

<sup>25</sup> Assessments through their fraternal members and sales of business units are the only mechanisms to acquire capital. Assessments are not desirable and adversely affect persistency.

**Table 8. Solvency Position of FRIs***(End-period)*

	2010	2011	2012
<b>Solvency Ratios</b>			
L&H - Minimum Continuing Capital and Surplus Requirement (MCCSR)	239 % <sup>26</sup>	218 %	212 %
P&C - Minimum Capital Test	248 %	246 %	247 %
Fraternal benefit societies - MCCSR	441 %	333 %	439 %

Source: OSFI

### Key risks and vulnerabilities

**31. L&H FRIs are exposed to protracted low interest rates, volatile equity markets and slow economic growth.** Given the long term nature of L&H liabilities, FRIs who did not have adequate asset-liability management are vulnerable to the reinvestment risks arising from their legacy portfolios. As part of their de-risking efforts, some FRIs have withdrawn from certain products or redesigned their product features. Increased capital requirements for segregated fund products and enhanced supervisory monitoring have also played a role in influencing product design and pricing. Generally, pricing has also been raised to better reflect risks, which may create opportunities for new entrants into the market. Slow economic growth may also influence policyholders' behavior adversely. However, policy surrenders have fallen due to rising premium levels (which increased the cost of policy replacement) and limited options for alternative investments. Wealth management products are seen as a growth area as insurers shift investment risks to policyholders, with more focus on fee-based income.

**32. P&C FRIs have to confront difficult investment market conditions and exposures to significant natural catastrophe.** The 2012 OSFI standardized stress test on earthquake identified insured losses of up to \$32 billion depending on the scenario.<sup>27</sup> As the population grows in vulnerable areas, insured exposures have grown. Severe weather related claims have grown, approaching or exceeding \$1 billion annually since 2009.<sup>28</sup> Rate increases in property insurance have kept pace and loss ratios have been declining since 2009. Further, with a large number of foreign owned P&C FRIs, there are potential contagion risks from their related entities and parents.

**33. Mortgage insurers are exposed to potential tail events that are inherently correlated to the housing market and macro-economic risks.** It is generally recognized that mortgage insurers

<sup>26</sup> Solvency ratios at the legal entity level as at end-2010 was not available for one large L&H group.

<sup>27</sup> Natural Resources Canada predicts that within the next 50 years there is a 30 percent chance of a significant quake in British Columbia and a 5 to 15 percent chance of one in the Ottawa-Montreal-Québec City region. (Source: Insurance Bureau of Canada).

<sup>28</sup> Extreme weather events that used to happen every 40 years can now be expected to happen every 6 years (Source: Insurance Bureau of Canada).

are more sensitive to mortgage defaults than the originating lenders because they bear substantially the losses arising from loan foreclosures, which would be amplified in a severe economic downturn or sharp decline in housing prices. As part of their credit risk management, mortgage insurers generally require that a borrower's gross debt service-to-income ratio to be lower than 32 percent and total debt service not exceeding 40 percent of gross household income.<sup>29</sup>

## D. Preconditions for Effective Insurance Supervision

### Sound and sustainable macroeconomic and financial sector policies

**34. Canada has a well-established framework of fiscal, monetary and other macroeconomic policies.** The Government of Canada prepares and publishes an annual federal government budget within the context of a medium term fiscal strategy, which is currently to return to balanced budgets by 2015-6. It publishes a debt issuance strategy and a program for debt issues. The Bank of Canada has a monetary policy strategy based on inflation targeting, flexibly applied to take account of prevailing monetary and financial conditions, including at present the deleveraging of the banking sector in response to the financial crisis. The current target is an annual rate of 2 percent.

**35. There is a comprehensive financial sector policy framework, which reflects a division of responsibility between federal and provincial authorities** (Section C above). Financial sector policy and legislation are subject to regular review. All financial sector legislation includes provisions requiring review and renewal five years from enactment. Recent legislative changes have included the extension of OSFI's responsibilities in 2012 to include reviewing and monitoring the safety and soundness of the commercial activities of CMHC, and reporting supervisory recommendations to CMHC's responsible Minister, the Minister of Finance and CMHC's board of directors.

### A well-developed public infrastructure

**36. The courts system and other legal infrastructure in Canada are highly developed and the independence of the judiciary is respected.** There is a comprehensive body of business laws, including on insolvency and on contractual and property rights. All legislation must be passed by the Federal Parliament or provincial legislative assembly. The Constitution recognizes a strict separation at federal and provincial levels between the judiciary, parliament and government. The principle of judicial independence, i.e., freedom from legislative or executive interference, is secured in practice through provisions in law or in practice for security of tenure, financial security and administrative independence.

**37. Canadian accounting and auditing standards are in line with international best practices.** Accounting standards are made by the Accounting Standards Board (ASB), drawing on

<sup>29</sup> Mortgage insurers are also subject to the rules for government-backed insured mortgages, including maximum gross debt service ratio (39 percent) and total debt service ratio (44 percent).

International Financial Reporting Standards (IFRS), which have applied to Canadian “publicly accountable profit-oriented enterprises” since the start of 2011. The ASB is involved in the International Accounting Standards Board’s standard-setting process. The Canadian Auditing and Assurance Standards Board (AASB) establishes auditing standards based on International Standards on Auditing. Oversight of the two bodies (including nomination of members) is undertaken on a public interest basis by bodies established by the Canadian Institute of Chartered Accountants (CICA): the Accounting Standards Oversight Council and the Auditing and Assurance Standards Oversight Council. CICA is a self-regulatory professional body. The Canadian Public Accountability Board (CPAB), established by CICA, OSFI and provincial securities regulators, oversees the quality of audit work of the larger auditing firms on the public financial statements of Canadian companies. CPAB is a member of the International Forum of Independent Audit Regulators.

**38. There is a well-established framework of actuarial standards.** The Actuarial Standards Board issues technical standards (Standards of Practice). The Canadian Institute of Actuaries (CIA) issues and enforces professional and ethical standards for its members. It had around 3,900 Fellows and 600 Associate members at June 2013. Only Fellows of the CIA who meet the additional requirements in OSFI guidelines are qualified to sign actuarial reports required by OSFI. The CIA is a self-regulatory professional body that is not subject to oversight. Its Rules of Professional Conduct are aimed at maintaining the quality, integrity, and professional standards of practicing actuaries and it has also established an internal disciplinary process. Disciplinary actions taken are published on the CIA’s website. Since 1992, it has received 173 complaints about members, undertaken investigations of 73 of these, of which 39 gave rise to charges being filed and 23 in Disciplinary Tribunal hearings. All but two cases led to findings of guilt. Some of the complaints were referred by foreign professional bodies.

**39. A wide range of statistics is available to support insurance business and effective regulation.** Social and economic statistics and data on the markets are issued by the Statistics of Canada and the BoC. Statistics on insurance risks such as mortality/longevity are issued by the CIA. OSFI makes available through its website and by arrangements with a third party database service extensive information based on the regulatory reporting of financial institutions that it regulates.

### **Effective market discipline in financial markets**

**40. Canada has well-developed arrangements promoting market discipline.** General corporate governance requirements are set out in Canadian federal and provincial corporate statutes, including the Canada Business Corporations Act. The statutes prescribe certain requirements in respect of the structure of the board of directors, basic qualifications of directors and requirements for a minimum number of independent directors. Securities laws set out other requirements in relation to companies issuing securities, including requirements for disclosure of governance arrangements. The Toronto Stock Exchange sets governance and disclosure requirements as conditions of listing. Financial analysis is widely available from media, rating agencies, brokers etc. OSFI sets disclosure requirements on FRIs (ICP20).

## Mechanisms for consumer protection

**41. There is a variety of mechanisms for consumer protection, with CoB regulation undertaken by provincial authorities.** Policyholder protection is effected through: market conduct requirements, complaints adjudication services; and the availability of policyholder compensation. There are national services for adjudicating on complaints against insurance companies (General Insurance OmbudService and the OmbudService for L&H insurance). There are also provincial mechanisms, some of which are outlined in this report in the assessment of ICP 19.

**42. Policyholder compensation schemes cover all relevant policyholders of companies incorporated federally or by a provincial authority.** For L&H insurance, the private not for profit body Assuris provides compensation in case of failure (defined as the issuance of a winding-up order). OSFI and provincial regulators require all insurers (excluding fraternal benefit societies) to be members of Assuris, which may levy assessments on the membership in case of a failure; it is also prefunded with \$115 million. Assuris has powers to support a failing company ahead of failure and, with certain constraints, to transfer business to other insurers. Benefits are capped, for example at the greater of 85 percent or \$200,000 for death benefits. In the P&C sector, membership of the compensation body Property and Casualty Insurance Compensation Corporation (PACICC) is required by provincial supervisory authorities rather than by OSFI as a condition of licensing. Compensation is subject to limits (for example, \$300,000 for personal property). Federal Government powers to provide financial support to institutions in order to preserve financial stability apply to insurers.<sup>30</sup>

## Efficient financial markets

**43. Canadian markets offer a broad range of instruments to facilitate insurers' asset-liability management.** The Toronto stock exchange is the largest of several exchanges in Canada, and ranks amongst the top 10 global exchanges by daily turnover and total; market capitalization (US\$2,010 billion at end-May 2013). There are liquid money and bond markets, with a range of instruments and maturities and active markets in derivatives. Insurers also have access to investments issued outside Canada. The payment and settlement systems infrastructure is comprehensive and are subject to oversight by the Minister, the BoC (in the case of the five systems designated as systemic) and provincial regulatory authorities (securities and derivatives).

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<sup>30</sup> Section 60.2 of the Financial Administration Act.



**Table 9. Summary of Compliance with the ICPs**

Insurance Core Principle	Level	Overall Comments
1 - Objectives, Powers and Responsibilities of the Supervisor	LO	<p>The responsibilities for the regulation and supervision of the insurance sector are shared between the federal and provincial authorities, each with a clearly defined mandate and objectives under the relevant primary legislation. OSFI, AMF and FSCO have taken action to recommend amendments to the relevant legislation when they identified conflicts between legislation and supervisory objectives. While the supervisors are authorized to issue guidance on their supervisory expectations, they are not empowered to issue directly legally binding rules. OSFI has not been delegated powers to make binding rules. The insurance legislation also does not explicitly address the objectives and authority for the supervision of insurance groups. Close coordination between the prudential and CoB supervisors is critical to achieving the overall objectives of insurance supervision, including striking an appropriate balance between the supervisory objectives of prudential and CoB supervision.</p>
2 - Supervisor	PO	<p>OSFI, AMF and FSCO have robust accountability frameworks and are generally transparent in how they discharge their supervisory responsibilities. While the supervisors have adequate delegated authority to conduct supervision within the parameters set out in the relevant legislation, their operational autonomy is affected by the statutory roles of the Minister (OSFI) and MFEQ (AMF) in institution-specific supervisory decisions or to take account of policy statements issued by the Minister (FSCO). The legal framework and operational safeguards for the protection of confidential information are strong. The heads of the supervisory agencies and their staff members are required to observe high ethical standards including effective management of conflicts of interest and they have adequate legal protection.</p> <p>OSFI and FSCO are subject to government-wide fiscal restraints and guidelines on their discretion to allocate resources and the AMF's budget and fees are subject to government approval. While the removal of the Superintendent of OSFI is subject to a parliamentary process that ensures accountability, there is no requirement for the reasons for the removal of the President and CEO of AMF and the superintendent of FSCO to be published. There is scope for OSFI to enhance the transparency of its different approaches to supervising insurance groups.</p>
3 - Information Exchange and Confidentiality Requirements	O	<p>All three supervisors are empowered to obtain and exchange information with relevant supervisors and authorities subject to confidentiality, purpose and use requirements. They have a wide network of bilateral MoUs and OSFI is a signatory to the IAIS Multilateral MoU. The existence of an MoU is not a prerequisite for information exchange and strict reciprocity is not required. OSFI's policy is to limit the sharing of written confidential information</p>

		unless a formal arrangement is in place and this has not posed practical issues as it has a wide network of MoUs and proactively initiates MoU discussions with relevant supervisors.
4 - Licensing	○	The licensing process for FRIs involves a three-stage process: a) approval by the Minister to incorporate or continue operations under the ICA; b) an Order to commence and carry on business issued by OSFI; and c) licensing by the relevant provincial supervisors in all the provinces that it intends to conduct insurance business. Foreign insurers intending to establish branches must obtain an Order from OSFI if they intend to “insure in Canada a risk”, along with a provincial license and they are required to include a statement in all policy documents that the policy was issued in the course of their insurance business in Canada. The criteria and procedures for the approval by the Minister and OSFI are clear and transparent. The process involves significant interaction with the applicants and the relevant home supervisors (if applicable) and OSFI typically conducts a pre-commencement on-site review of the FRI or branch before issuing the Order to Commence and Carry on Business or an Order to Insure in Canada Risks. Licensing criteria and processes adopted by AMF and FSCO are in line with international best practices, supported by a harmonised application form developed by the CCIR.
5 - Suitability of Persons	○	The ICA provides for the eligibility of Responsible Persons, which is supplemented by OSFI’s guidelines on its expectation for FRIs/branches to establish and implement assessment policies and procedures to assess suitability of persons, including the scope of persons to be assessed. OSFI generally relies on the internal processes of FRIs/branches and may require a FRI/branch to demonstrate the suitability of persons where warranted. Change in Responsible Persons (defined as a member of the Board or a Senior Officer) must be notified to OSFI. OSFI is empowered to disqualify or remove persons found not suitable to hold the relevant positions.
6 - Changes in Control and Portfolio Transfers	○	The ICA sets clear ownership and control thresholds above which approval is required. The Minister is vested with the authority to approve proposals to acquire or increase significant ownership or interest in a FRI, based on essentially the same criteria as those for the incorporation of FRIs. While FRIs are not explicitly required to notify OSFI in the case of a significant decrease in the ownership by a person(s) below the pre-determined control level, such cases may be identified through OSFI’s supervisory process. FRIs need to obtain approvals from the Minister to transfer all or substantially all of their business to another insurer while the Superintendent approves less substantial portfolio transfers.
7 - Corporate Governance	○	The ICA and OSFI Corporate Governance Guideline provide for an extensive framework of standards on corporate governance of FRIs. While certain requirements are set out in law and apply to all FRIs, including a requirement to establish an audit committee with prescribed responsibilities, the Guideline recognizes the need for

		<p>corporate governance arrangements to reflect the circumstances of individual FRIs. OSFI monitors and assesses corporate governance as part of its supervisory approach, looking both at compliance with minimum standards (including Chair/CEO separation as well as the role of the audit committee) and at the effectiveness of corporate governance in practice. OSFI's expectations of the larger FRIs are in line with international practice in areas such as the need for a board Risk Committee and CRO; and OSFI also devotes resources and specialist expertise to oversight of governance at the large insurance groups.</p> <p>AMF has published guidelines in this area and assesses governance in its supervisory work. FSCO's oversight work in this area primarily makes use of monitoring tools such as industry wide assessment questionnaires followed by selected field examinations in targeted risk areas. While FSCO has not published guidelines on governance, it is able to rely on OSFI and AMF Guidelines to set general expectations since the majority of insurance business in Ontario is transacted by companies subject to solvency regulations by OSFI or AMF.</p>
8 - Risk Management and Internal Controls	O	<p>OSFI has an extensive framework of requirements for risk management and control functions at FRIs and oversees the effectiveness of the arrangements as part of its supervision program. A particular emphasis of the approach is on ensuring that there is a CRO at the major institutions with appropriate stature and authority, including a reporting line to the board. OSFI's approach also provides for a balance between ensuring appropriate stature and significance for actuarial work, supported by the key role of the AA, and fully embedding actuarial work and decisions within the overall corporate governance framework.</p>
9 - Supervisory Review and Reporting	LO	<p>OSFI's risk-based Supervisory Framework facilitates structured and comprehensive supervisory risk assessment as well as prompt and consistent supervisory actions. While OSFI collects extensive regulatory, statistical and capital related information at the consolidated level and at the solo FRI level, some of the information collected is less granular on a non-consolidated basis. There is no standardized reporting of intra-group transactions. In addition, the current scope of related party transactions for the purposes of reporting to OSFI by FRIs' Conduct Committees is narrower than intra-group transactions with broad exemptions including reinsurance transactions (ICP 23). There are clear scoping statements and processes for onsite reviews. OSFI issues annual Supervisory Letters on its key findings and recommendations and Interim Letters, as appropriate. The Supervisory Framework helps to ensure that supervisory activities are documented and followed through in a timely manner. OSFI is empowered to inspect service providers of outsourced functions and has conducted such inspections.</p>

		Both AMF and FSCO adopt a risk-based approach to CoB supervision. AMF's Supervisory Framework is closely aligned with international best practices. AMF has authorized the CAD to conduct inspections of small-scale P&C intermediaries and claims adjustment firms, subject to its oversight. Constrained by limited resources, FSCO adopts both reactive and targeted industry-wide risk-based approach to CoB supervision.
10 - Preventive and Corrective Measures	○	The supervisors are empowered to take action against a person who conducts insurance business without the necessary Order from OSFI or license from AMF or FSCO. OSFI's Supervisory Framework supports early intervention and OSFI has published guidance on its approach to taking progressive escalation of actions or remedial measures at each stage of the intervention ratings assigned to FRIs and severity of the situation. OSFI has adequate powers to initiate timely and proportionate preventive and corrective measures where FRIs are unable or unwilling to adequately address supervisory concerns. Similarly, AMF and FSCO have adequate legal authority to take preventive and corrective measures relating to CoB issues.
11 - Enforcement	○	All three supervisors have adequate legal authority and tools to take enforcement actions and impose sanctions, in a progressive approach that is commensurate with the severity of the offence. There are established internal guides as well arrangements to ensure consistent and fair application of enforcement actions and sanctions. In practice, OSFI rarely takes enforcement actions as its moral suasion has been effective. FSCO and AMF have taken a number of enforcement actions on market conducts breaches.
12 - Winding-up and Exit from the Market	○	There are extensive provisions in the legislation for the authorities to manage the exit from the market of an insurance company, including Canadian branches of foreign insurers, in an orderly manner. These also provide for policyholders to rank above general (unsecured) creditors. For L&H insurance, these provisions are substantially untested for many years (notwithstanding the failure of a small provincially-incorporated company in 2012). In P&C insurance, the arrangements have been more often tested, although most failures have been smaller, provincially regulated companies.
13 - Reinsurance and Other Forms of Risk Transfer	LO	OSFI's guidelines on reinsurance, recently reissued after a full review, set out extensive standards on the management of reinsurance, with an emphasis on management taking responsibility for assessing reinsurance counterparties rather than relying on third parties, setting limits in line with risk appetite and documenting the approach in a board-approved statement. OSFI's policy to require collateral to be posted by foreign reinsurers as a condition of credit being taken for reinsurance enhances the security of these arrangements but needs to be accompanied both by requirements on FRIs to evaluate the residual risks and by systematic evaluation by OSFI of the supervision arrangements for the foreign reinsurers.
14 - Valuation	LO	The requirements on valuation of technical provisions and assets provide a comprehensive framework of standards, including a consistent economic basis for valuation across the balance sheet

		and margins for adverse deviation. While the approach is principles-based and provides for significant discretion to be exercised by the AA, it is underpinned by professional and regulatory requirements applying to the AA and a framework of oversight, peer review and audit requirements. The approach has been adapted where areas of weakness were highlighted by the financial crisis. Nonetheless, there remain aspects of the approach (allowances for credit spreads and the extent of discretion in relation to non-fixed income investments) where strengthening of the actuarial standards is appropriate. OSFI had identified the need for changes to the Canadian valuation of technical provisions and has supported work by the ASB in this area. It is also important that the oversight, peer review and audit requirements continue to provide a robust challenge to the assumptions and methods used by actuaries.
15 - Investment	LO	The framework of legislation and guidelines on FRI's investments includes restrictions on certain types of investment, hard limits on particular asset classes (though with exemptions for the largest insurers) and high-level requirements to manage investments in a prudent manner. These standards are complemented by the valuation and capital requirements that incentivise FRI's to undertake asset and liability matching and which require capital to be held in relation to particular classes of asset risk. In the nature of the valuation requirements, which allow FRI's to take account of the current yields on assets in their assumptions about reinvestment rates, FRI's have some incentives to invest in higher yielding assets for asset and liability management purposes and this needs to be accompanied by a more robust framework of requirements on FRI's investment in higher risk and more complex assets.
16 - Enterprise Risk Management for Solvency Purposes	LO	OSFI has an extensive set of guidelines that require FRI's to identify, measure and manage all material risks, taking into account the results of stress testing. These guidelines also require insurers to make their own evaluation of their capital needs, based on their own assessment of risks. OSFI's guideline on ORSA requirements, currently a draft standard which is scheduled to be implemented in 2014, will consolidate and extend this framework, emphasising the need for FRI's to take their own view of overall capital needs, independent of the regulatory framework - which is critical to ensuring that OSFI has the necessary input into its own process for evaluating the individual capital adequacy of FRI's. Full implementation of the approach will take some time, even if FRI's are already working on improving their framework based on the draft guideline.
17 - Capital Adequacy	LO	The capital requirements for FRI's are comprehensive, capturing all material risks as well as requiring FRI's to hold capital for risks not covered by standard requirements. The approach is risk-sensitive and encompasses operational risk, although on the basis of additional buffers rather than detailed quantitative requirements. OSFI also requires FRI's to calculate internal capital targets and uses their oversight of this process to assess whether capital of FRI's fully reflects their individual risks. OSFI allows firms to use internal

		<p>models in limited areas, but applies a full model approval process and ongoing monitoring.</p> <p>A distinguishing feature and a strength of OFSI's regime is its application on a consolidated basis to each operating FRI, even encompassing their foreign insurance operations. However, because of the limitations on its powers over unregulated companies within a group, OSFI's approach to the application of its capital requirements on a consolidated basis varies across groups. Although OSFI is developing a set of requirements for solo legal entity capital requirements to apply to material solo FRIs, the full capital requirements are not applied at the level of the legal entity.</p>
18 - Intermediaries	LO	<p>The provincial supervisors have been collaborating to promote harmonization of the different regulatory regimes for intermediaries, with CISRO taking a proactive role. Both AMF and FSCO supervise a large population of intermediaries in their respective jurisdictions. While the regulatory regimes for intermediaries in Ontario and Québec are broadly similar, there are differences in key areas e.g., the use of SROs. Licensing criteria and on-going compliance requirements are clearly established under both regimes, supported by supervisory guidance. Regulatory information is largely based on information submitted for renewals of licenses/certificates, supplemented by third party notifications e.g., from SROs or complainants. Most intermediaries are individuals and there are no explicit corporate governance requirements for intermediaries although incorporated entities are subject to general obligations under the relevant general corporate laws. However, insurance laws impose duties and prohibitions on the actions of intermediaries.</p> <p>AMF conducts routine inspections of intermediaries, generally targeting intermediaries with higher risks. FSCO's supervisory approach is more reactive, mainly in response to self-declarations of non-compliance or complaints/information received. While Ontario laws requires that insurers screen and monitor their agents and report non-compliance, this is complicated by the fact that a significant number of agents represent more than one insurer or place business through MGAs. While the CLHIA has established industry guidelines on MGAs, the trade-offs arising from a self-regulatory approach have to be weighed carefully and on an on-going basis.</p>
19 - Conduct of Business	PO	<p>At the national level, CCIR coordinates and promotes the harmonization of the CoB regimes of provincial supervisors and has developed a risk-based supervision approach, which is adopted by FSCO and played a large part in the development of AMF's framework. The JFFMR has reviewed insurers' and mutual funds' processes when designing and developing new products, with the goal of ensuring that the interests of different types of consumers are taken into consideration. Insurance industry associations have</p>

		<p>also taken initiatives to ensure their members act with due skill, care and diligence including voluntary codes of conduct. There is a nation-wide Complaint Reporting System accessible by all provincial supervisors (except British Columbia).</p> <p>The IA, DA and related regulations as well as AMF guidelines provide for fair treatment of policyholders and disclosure requirements for insurers and intermediaries in Québec. These include promoting a culture of fair treatment of customers, product development and promotion, timely and equitable handling of claims and complaints and policy servicing obligations. The privacy of customers has statutory protection.</p> <p>FSCO and RIBO have established CoB requirements through to the point all obligations under a contract have been satisfied. Due to resource constraints, FSCO and RIBO have limited ability to consistently monitor the timing, delivery, and content of point of sale material. They have issued limited supervisory guidance (except for motor insurance) and leverage stakeholder associations to develop their own codes of conduct. As the vast majority of insurers operating in Ontario are FRIs, FSCO relies heavily on OSFI's due diligence with respect to corporate governance and background checks on directors and senior management of FRIs.</p>
20 - Public Disclosure	PO	<p>At the group consolidated level, disclosure requirements are extensive, but these are not fully matched by comprehensive requirements applying to regulated legal entities at the solo level, especially with respect to disclosure of information on the capital of FRIs. The application of the IFRS framework to all FRIs and not only to public companies has ensured that consistent standards are applied across firms. However, reliance on IFRS also risks there being some gaps between the disclosure requirements of the standard-setters and the requirements applicable to FRIs to meet regulatory objectives, including making information available to policyholders. OSFI and the Actuarial Standards Board have filled these gaps to a large extent through their guidelines and the Standards of Practice, but the reliance on IFRS creates risk of divergence which requires careful monitoring.</p>
21 - Countering Fraud in Insurance	O	<p>There is a well-developed framework of legislation at federal and provincial levels enabling criminal and regulatory authorities to detect, investigate and apply sanctions in cases of insurance fraud. Cooperation has been evident, especially in the area of motor fraud in Ontario, which has also been the subject of an initiative by the provincial government (an Anti-Fraud Task Force) to address the issues. Regulatory requirements on insurers are set out clearly in relevant laws and guidelines. Fraud controls are included in supervisory work by OSFI, AMF and FSCO, where considered material under the risk-based approach taken by the three supervisors. FSCO is appropriately making motor fraud controls a high priority. Enforcement action has been taken in practice.</p>

22 - Anti-Money Laundering and Combating the Financing of Terrorism	O	<p>OSFI, AMF and FSCO are not designated competent authorities for AML/CFT. However, all three supervisors have arrangements in place to communicate with FINTRAC, the Financial Intelligence Unit for Canada and competent authority for AML/CFT regulation, in relation to AML/CFT arrangements that encompass all L&amp;H insurers, whether incorporated by OSFI or a provincial authority; and intermediaries. Information exchange takes place in practice and there is an awareness of ML/FT risks and vulnerabilities and of the importance of securing a high degree of compliance by regulated entities.</p> <p>Information exchange with foreign authorities is dealt with mainly by and through FINTRAC, but OSFI may also exchange information directly in connection with its work on the overseas operations of Canadian L&amp;H FRIs. OSFI and AMF go beyond the requirements of ICP22 by establishing specific guidelines setting out their expectations of insurers (there is no similar guidance for intermediaries); and by building AML/CFT compliance into their supervisory work. OSFI has a particularly extensive program of supervision work and a specialist unit to support it. AMF and FSCO take a risk-based and proportionate approach to the supervision of L&amp;H insurers, reflecting both international standards and the work of OFSI on FRIs and overall responsibilities of FINTRAC.</p>
23 - Group-wide Supervision	PO	<p>The ICA, IA and OIA do not have an explicit definition of insurance group nor the scope of an insurance group for the purpose of group-wide supervision. Nonetheless, the three supervisors address certain elements of group-wide supervision within the parameters of their legal authority.</p> <p>OSFI adopts different approaches to group-wide supervision within the parameters of its legal authority. A consolidated supervision approach is applied to L&amp;H FRIs headed by a regulated entity in accordance with the statutory basis of the ICA. A L&amp;H holding company can be established under the ICA although no such holding company has been established. For groups headed by non-regulated entities, OSFI's supervision may be applied indirectly through unpublished contracts or letters of undertaking on a case-by-case basis. Currently, only five of the 17 groups headed by unregulated holding companies have executed such undertaking and the terms vary, based on negotiation with the unregulated entity. OSFI has no legal authority over the non-regulated holding company and can only use indirect means such as an increase in capital in a FRI. Further, the OSFI capital adequacy framework for holding companies (the A2 Guideline: Capital Regime for Regulated Insurance Holding Companies and Non-Operating Life Companies) does not apply to holding companies regulated indirectly via a contract or undertaking (ICP 17).</p> <p>OSFI therefore applies both an indirect approach to consolidated</p>



		<p>supervision, having no general powers in respect of holding companies, and also a direct approach, in the case of two of the three major groups, where the holding company is also a (non-operating) insurance company. OSFI's indirect approach differs in outcome from both the direct approach in the case of the two large groups headed by non-operating insurance companies. For example, the holding company of one large L&amp;H group is not directly subject to the same capital adequacy requirements as the other two large L&amp;H groups. In addition, the indirect approach for the other groups varies depending on the terms of the undertaking negotiated with the unregulated holding companies. In addition, as it takes time to negotiate an undertaking, this approach would not be effective, especially with an entity that is reluctant to provide information to OSFI.</p> <p>AMF has recently extended its Sound Commercial Practices Guidelines to cover financial groups and exercises consolidated supervision of insurance groups. FSCO has not established group-wide market conduct requirements and supervises insurers' CoB on a legal entity basis.</p>
24 - Macroprudential Surveillance and Insurance Supervision	○	OSFI has a well-developed framework of macroprudential surveillance that seeks to integrate the supervisory framework for individual FRIs with a market wide view of key risks and a capacity to respond to emerging issues, through supervisory action and by escalation for discussion with other federal agencies.
25 - Supervisory Cooperation and Coordination	○	OSFI has in place coordination arrangements with other domestic and foreign supervisors that facilitate effective supervision. Domestically, OSFI (the Superintendent) chairs the FISC and collaborates closely with FISC members at the federal level while the CCIR facilitates the coordination amongst OSFI and provincial supervisors. At the international level, OSFI is the GWS for all the large Canadian, internationally-active life insurers and has initiated a variety of supervisory colleges. OSFI also contributes actively to relevant supervisory colleges as a host supervisor.
26 - Cross-border Cooperation and Coordination on Crisis Management	○	While OSFI's approach to management of a cross-border crisis is untested in practice, it has put in place a network of information-sharing arrangements (in addition to its commitments under the IAIS MMOU) as well as mechanisms for cooperation in practice, including supervisory colleges that provide a basis for effective coordination in a crisis. OSFI is well-advanced, by comparison with other jurisdictions internationally, in applying the framework for recovery planning for banks to its major insurance groups, although it has not shared these plans with foreign supervisors as yet.

## E. Recommendations and Authorities' Response

**Table 10. Summary of Observance Level**

Observed (O)	14
Largely observed (LO)	8
Partly observed (PO)	4
Not observed (NO)	0
<b>Total</b>	<b>26</b>

**Table 11. Recommendations to Improve Observance of the ICPs**

<b>Insurance Core Principle</b>	<b>Recommendations</b>
1 - Objectives, Powers and Responsibilities of the Supervisor	<ul style="list-style-type: none"> <li>a) Consider the scope to strengthen regulation by providing delegated powers, as are available to many regulatory authorities internationally, to issue enforceable rules by administrative means rather than through legislation;</li> <li>b) Establish explicit supervisory objectives for group-wide supervision under the relevant primary legislation, supported by adequate legal powers to conduct group-wide supervision.</li> </ul>
2 - Supervisor	<ul style="list-style-type: none"> <li>a) Update the relevant primary legislations to adopt separate legal processes for the prudential decisions of OSFI and AMF from the approval from the executive branch to address national policy objectives and specify the circumstances for the issuance of policy statements to FSCO;</li> <li>b) Consider exempting the supervisors from the government's fiscal controls and administrative guidance, as in the case of the BoC, to strengthen their financial autonomy;</li> <li>c) Review the adequacy of supervisory resources of FSCO and whether FSCO should continue to be subject to the hiring controls set by the Ontario Public Service;</li> <li>d) Enhance the transparency of OSFI's different approaches to supervising insurance groups;</li> <li>e) Establish explicit provisions on public disclosure of the reasons for removal of the President and CEO of AMF and the Superintendent of FSCO.</li> </ul>
6 - Changes in Control and Portfolio Transfers	Require FRIs to notify OSFI of a significant decrease in the ownership by a person(s) below the pre-determined control level.
7 - Corporate Governance	Set out more extensive guidance on FSCO's own expectations in relation to corporate governance and market conduct.
9 - Supervisory Review and	Enhance and standardize regulatory reporting of intra-group transactions, supported by a clear definition of the scope of intra-group

Reporting	<p>transactions. OSFI should also review the level of detail of its reporting requirements applying to solo FRIs.</p> <p>Equip FSCO with adequate supervisory resources to deal with the size and diversity of the Ontario marketplace.</p>
10 - Preventive and Corrective Measures	Strike a good balance between timely staging as a result of persistent concerns, and the need to maintain pressure on the institution to make meaningful progress over a credible and situation-specific appropriate timeline in order to exit staging.
12 - Winding-up and Exit from the Market	<p>a) Examine whether the designation of PACICC by approval of the Minister under the ICA in the same way as Assuris would help promote increased cooperation and early exchange of information between OSFI and the PACICC.</p> <p>b) Continue to test procedures for handling a failure of a FRI by further simulation exercises and the development of recovery plans that is already underway for the large L&amp;H companies.</p>
13 - Reinsurance and Other Forms of Risk Transfer	<p>a) Consider adding material on the importance of FRIs assessing and managing liquidity risks arising from reinsurance cessions when revising OSFI guidelines; and</p> <p>b) Enhance OSFI's process for evaluating the supervisory regimes applying to major unregistered foreign reinsurers so that it explicitly addresses the supervision of reinsurance in their home jurisdictions.</p>
14 - Valuation	Strengthen the valuation standards on credit spreads and non-fixed income investments, recognizing that the current ASB review of reinvestment assumptions for life insurance valuation is already addressing the issues.
15 - Investment	Undertake a review of OSFI's Prudent Person Approach Guideline, to strengthen the requirements on investments and in particular to add explicit requirements that FRI invest only in assets whose risks it can properly assess and manage and on investments in complex or less transparent forms of instruments.
16 - Enterprise Risk Management for Solvency Purposes	Finalise OSFI guideline on ORSA requirements, which is currently a draft, and set expectations for the early phase of implementation work as soon as possible.
17 - Capital Adequacy	<p>a) Set out details of OSFI's approach to groups headed by holding companies in the interests of transparency, till such time as OSFI obtains full powers to apply its regulatory framework to holding companies.</p> <p>b) Consider aligning OSFI's requirements for regulated holding companies more closely to those for regulated operating companies.</p> <p>c) Finalise OSFI's proposed standard for the application of the capital framework on a solo legal entity level and develop a plan for publication of the full approach in due course. OSFI should also establish policy requirements to address, and review its reporting requirements on intra-group transactions for capital management purposes (for example, capital transferability within the group).</p>
18 - Intermediaries	a) Maintain the positive momentum in promoting appropriate harmonisation of the regulatory regimes and supervisory practices

	<p>with respect to intermediaries across provinces, e.g., regulatory treatment of client monies;</p> <p>b) Consider establishing proportionate expectation tailored for intermediaries, focussing on achieving fair treatment outcome for policyholders;</p> <p>c) Implement the recommendations of the CCIR related to the regulatory treatment of MGAs across provinces; and</p> <p>d) Ensure that FSCO has adequate resources for effective supervision of intermediaries.</p>
19 - Conduct of Business	<p>Strengthen the current CoB regimes by:</p> <p>a) Continuing the proactive initiatives by CCIR and JFFMR to enhance consistency of CoB regulatory regimes across provinces;</p> <p>b) Empowering FSCO to issue enforceable rules on product development and promotion as well as require insurers and intermediaries to conduct needs analysis before providing advice and meet policy servicing obligations; and</p> <p>c) Reviewing the adequacy of supervisory resources of FSCO for regulatory policy formulation and conduct more proactive CoB supervision.</p>
20 - Public Disclosure	<p>a) the authorities ensure that FRIs publish (in a format readily available to policyholders as well as market participants generally) both the information on the financial position of the individual legal entities at the solo level in addition to group consolidated requirements, and information about the FRI's capital; and that the application of OSFI's guidelines clearly extends to cover FRIs on an individual as well as a consolidated basis; and</p> <p>b) Maintain the existing process for monitoring IFRS developments to ensure a timely and appropriate response to these developments and determine whether new standards or changes to existing standards have the required impact on disclosure as well as financial soundness requirements.</p>
21 - Countering Fraud in Insurance	<p>While their enforcement work has included action against intermediaries in relation to misrepresentation of insurance cover to a customer, consider the merits of setting out both AMF and FSCO expectations of intermediaries in the area of fraud controls more clearly.</p>
22 - Anti-Money Laundering and Combating the Financing of Terrorism	<p>In relation to intermediaries, consider how best AMF and FSCO should set out their AML/CFT expectations in more detail, drawing on their supervisory work and experience.</p>
23 - Group-wide Supervision	<p>Formulate and implement a clear and consistent regulatory regime for group-wide supervision under the relevant insurance laws. Key elements of the regime should cover the scope of group-wide supervision, including material non-regulated entities; prudential and market conduct requirements at the group level.</p> <p>Going forward, supervisors be empowered to take necessary remedial and enforcement measures at the level of the holding company, in line with emerging international best practices.</p>
24 - Macroprudential	<p>Priorities which OSFI may want to consider for the future, in addition to</p>

Surveillance and Insurance Supervision	<p>finalizing its approach to potentially systemically important FRIs, include:</p> <ul style="list-style-type: none"> <li>a) Ensuring that it has access to data sources and continuing to develop the international dimension of its macroprudential work through liaison with other regulators.</li> <li>b) Considering whether its mainly sector-based approach is adequately complemented by consideration of linkages between banks and insurers; and</li> <li>c) Extending its consideration of risks arising from system-wide market conduct issues, including reputational risks from non-compliance by FRIs and potential conflict between prudential and market conduct regulation.</li> </ul>
26 - Cross-border Cooperation and Coordination on Crisis Management	<p>In developing its approach OSFI should:</p> <ul style="list-style-type: none"> <li>a) Continue to carry out crisis management testing and simulations: extending this to an international group would be an appropriate next stage;</li> <li>b) Ensure that it considers the potential needs in a crisis of supervisors in jurisdictions where the Canadian company is material and anticipates these as far as possible;</li> <li>c) Review the need for supplementing its existing requirements in relation to stress testing by explicitly requiring FRIs to establish and maintain contingency plans and procedures for use in a going- and gone- concern situation as set out in the ICP.</li> </ul>

### ***Authorities' responses to the assessment***

**44. The Canadian authorities wish to express their appreciation to the IMF and its assessment team for their assessment of the Canadian insurance sector. The Canadian authorities share the view that Canada has a high level of observance with the Insurance Core Principles (ICPs).**

**45. Canada is highly committed to the FSAP process and the insights that the IMF can provide with respect to a country's financial sector through this process.** Canada fully agrees that it is important to continually review and seek to improve the regulatory framework and supervision practices.

**46. The IMF has made a number of observations and recommendations, which could further enhance the high degree of compliance with the ICPs.**

**47. These recommendations will be given consideration by the relevant federal and provincial authorities,** having due regard to the various initiatives currently planned or underway, and taking into account the features of the Canadian regime that contributed to the performance of the Canadian insurance system during and post-crisis. It is noted that some recommendations are within the scope and mandate of regulators and others are subject to decisions by different levels of government.

**48. Of note, are the recommendations from the IMF on Principle 23 (but carried throughout the assessment) related to group-wide supervision, which advises that there be a legislated definition of the scope of group-wide supervision, and that authorities empower supervisors to take necessary remedial and enforcement measures at the level of the holding company, in line with emerging best practices.** For future assessments, the IMF may wish to consider bringing more clarity to the basis on which this principle is assessed, given that the ICP and the related standards appear to accept indirect authority over insurance groups, as opposed to direct legislated authority, as the current international standard. We also note that the principle itself is under review internationally.

**49. The introduction of ICPs dealing with market conduct issues is relatively new.** As a result there is a learning curve to understand how the IMF contemplates that specific standards should be implemented. As the ICPs and assessment techniques evolve, it will be important to balance consideration of process with consideration of outcomes achieved. Past experience has not demonstrated a history of significant unaddressed market conduct problems in Canada.

## DETAILED ASSESSMENT

**Table 12. Detailed Assessment of Observance of the ICPs**

<b>ICP 1</b>	<b>Objectives, Powers and Responsibilities of the Supervisor</b> The authority (or authorities) responsible for insurance supervision and the objectives of insurance supervision are clearly defined.
Description	<p>The division of responsibilities for prudential and CoB regulation and supervision at the federal and provincial levels is outlined under Section C of this report.</p> <p><b>Prudential regulation and supervision</b></p> <p>The primary legislation that defines OSFI’s authority and responsibility in the area of insurance supervision is the Insurance Companies Act (ICA) and the Office of the Superintendent of Financial Institutions Act (OSFI Act).</p> <p>OSFI was established in 1987 pursuant to the OSFI Act as an independent agency of the Government of Canada (Government). OSFI’s primary objective is to contribute to the safety and soundness of the Canadian financial system, while having due regard to the need to allow FRIs to compete effectively and take reasonable risks. Its objectives with respect to the insurance sector are to:</p> <ol style="list-style-type: none"> <li>a) Supervise FRIs to determine whether they are in sound financial condition and are complying with their governing law and supervisory requirements;</li> <li>b) Promptly advise FRIs in the event of material deficiencies; and take, or require management or boards to take, necessary corrective measures expeditiously;</li> <li>c) Promote the adoption of policies and procedures by FRIs to control and manage risk;</li> <li>d) Monitor and evaluate system-wide or sectoral issues that may impact FRIs negatively.</li> </ol> <p>In pursuing its objectives, OSFI shall strive to protect the rights and interests of policyholders and creditors of FRIs, having due regard to the need to allow FRIs to compete effectively and take reasonable risks. The law recognizes that, notwithstanding OSFI’s supervision, management and boards of directors are ultimately responsible and that FRIs can fail notwithstanding OSFI’s supervision. (<i>s 4(2) and s4(3) of OSFI Act</i>)</p> <p>Since 1999, the need to increase the degree of competition in the Canadian financial sector has been one of the key principles guiding the government financial services sector policy<sup>31</sup> while acknowledging the need to ensure the continued safety and</p>

<sup>31</sup> “Strong competition is essential to quality, price and innovation in the marketplace. It is also necessary if financial institutions are to serve Canadians well and succeed in the international marketplace. And while Canada’s financial services sector is already quite competitive, there is still more that can be done to promote new entry and foster a stronger second tier of institutions”. Reforming Canada’s Financial Services Sector: A Framework for the Future released on June 25, 1999 by DoF.

soundness of the financial sector. In this regard, OSFI has the scope within its mandate to decide whether to make a recommendation to the Minister on the admission of a FRI or foreign branch.

Since 1992, the ICA has been subject to a sunset clause that requires a review every five years to ensure that it remains current and effective. The five-year legislative review process provides a statutorily mandated window for OSFI to recommend amendments to address conflicts with its supervisory objectives, such as evolving industry or supervisory practices. OSFI maintains a list of legislative and regulatory issues submitted to the Minister for consideration. (*s21 of ICA*)

The Governor in Council is authorized to make regulations specified under various provisions of the ICA.

As a complement to the legislative framework, OSFI is administratively empowered to issue policy guidance to articulate its regulatory and supervisory expectations, which include:

- Guidelines establishing best or prudent practices, such as solvency standards (e.g., capital adequacy), prudential standards (e.g., large exposure limits), accounting standards (e.g., impaired loans), and sound business and financial practices (e.g., corporate governance);
- Advisories clarifying OSFI's position regarding certain policy issues or describe how OSFI generally administers and interprets the ICA, regulations or guidelines, which are not case-specific;
- Rulings describing how OSFI has applied or interpreted provisions of the ICA, regulations or guidelines in specific cases; and
- Discussion papers articulating OSFI's general policy direction in a specific area.

OSFI's guidance does not have the force of law. Nonetheless, it sets out OSFI's supervisory expectations and FRIs are expected to consider the guidance in taking appropriate action and voluntarily to comply with the expectations. The authorities explained that OSFI could use other intervention powers, such as putting a FRI under a staged status (ICP 10) or issuing an order to force compliance. The ICA explicitly empowers the Superintendent to issue an Order, notwithstanding that a FRI is complying with the capital adequacy requirement under the ICA or regulation. (*s515(3) of ICA*)

OSFI is of the view that the use of guidelines is an advantage, given that the process to pass regulations is less swift and responsive to new developments. Nonetheless, current international best practice is for supervisors to be empowered to issue directly legally enforceable rules/standards via administrative means without going through the parliamentary process, in accordance with the parameters specified in the primary legislation. This allows the supervisor to respond in a timely manner to emerging developments and risks while retaining the capacity to articulate its supervisory expectation on issues that are difficult to be hardwired in law via guidance. In addition, the power of OSFI to issue an order beyond capital adequacy and liquidity requirements (e.g., corporate governance) has not been tested, in the absence of similar specific provision to issue an Order. There is a risk that a non-cooperative FRI will challenge OSFI



on the basis that the ICA clearly provides a specific means for imposing mandatory requirements via regulations and OSFI's guidance has not gone through the due process and is not legally binding. Going forward, it is preferable that OSFI be explicitly empowered to issue directly legally enforceable rules.

The ICA and the OSFI Act authorize OSFI to take immediate critical supervisory measures to protect policyholders' interests, which will not be suspended by an appeal from a FRI or affected person (ICP 2). However, as CMHC is a Crown corporation, OSFI does not have legal authorities to take enforcement actions in the case of CMHC.

### **CoB regulation and supervision**

#### **AMF**

AMF is an integrated supervisor established in 2004 under An Act respecting the Autorité des marchés financiers (AMF Act), with the responsibility to regulate and supervise all insurers operating in Québec (including FRIs who are subject to prudential supervision by OSFI). The legal framework for the insurance industry in Québec is principally established under the following legislations:<sup>32</sup>

- a) The Civil Code of Québec (Civil Code)—governs, inter alia, the contractual relationship between an insurer and an insured;
- b) An Act respecting Insurance (IA) —governs principally the corporate existence, powers and functions of insurers and sets the supervisory parameters. The Regulation Under the Act Respecting Insurance (IA-Reg) set out more detailed rules;
- c) An Act respecting the Distribution of Financial Products and Services (DA) and its related regulations (DA-Reg) —sets out the obligations and responsibilities of insurance intermediaries; and
- d) The AMF Act—sets out the powers and responsibilities of AMF.

AMF's mission with respect to the CoB supervision of insurers is to: a) provide assistance to consumers of financial products and services including financial literacy initiatives, processing complaints and providing access to dispute resolution mechanisms; b) supervise the activities connected with the distribution of financial products and services; and c) see to the implementation of protection and compensation programs for consumers of financial products and services, and administer the compensation funds. (*s4 of AMF Act*)

AMF has adequate legal authority to conduct CoB supervision of insurers as well as take the necessary corrective, preventive and enforcement measures (ICP 9, 10, 11, 18 and 19). AMF does not have power to issue enforceable rules but it may enforce established regulatory requirements via written instructions. AMF's guidelines are not legally

<sup>32</sup> Other statutes not administered by AMF that are applicable to insurers and intermediaries, which play a complementary role in ensuring their sound commercial practices are: the Consumer Protection Act (except Titles I and III) and An Act respecting the Protection of Personal Information in the Private Sector.

binding. The Québec's Ministère des Finances et de l'Économie (MFEQ) has proposed that the adoption of most regulations be entrusted to AMF<sup>33</sup>. It is preferable that AMF be empowered to issue enforceable rules/standards, in line with international best practice.

AMF works closely with the MFEQ to constantly improve and update the legislation and related regulations applicable to the insurance market. As part of its Strategic Plan, AMF identifies changes needed to the laws and regulations under its administration. The list of proposed legislative changes is submitted to the MFEQ for discussion. AMF has recently proposed significant changes to the IA to improve its powers and tools for supervising the insurance market, which was tabled at the National Assembly on April 30, 2013. AMF also participates actively in the CCIR subcommittees dealing with regulatory changes needed on a national level to maintain the harmonized framework, e.g., disclosure, forms, etc.

### **FSCO**

FSCO is an agency of the Ministry of Finance, established under the Financial Services Commission of Ontario Act, 1997 (FSCO Act). The vast majority of FRIs are based in Ontario and subject to the CoB supervision by FSCO<sup>34</sup>. The primary legislation<sup>35</sup> that governs the insurance sector in Ontario is:

- a) The Insurance Act (OIA) – clearly defines that the Superintendent of Financial Services is responsible for supervising insurers and agents in Ontario.
- b) The Registered Insurance Brokers Act (RIB Act) - the Registered Insurance Brokers of Ontario (RIBO) is responsible for supervising general insurance brokers while FSCO has certain authority. RIBO is the SRO of P&C insurance brokers in Ontario.
- c) The FSCO Act - provides for the appointment of the Superintendent of Financial Services and confers powers on or assigns duties to the Commission or Superintendent.

FSCO's legislative mandate is to provide regulatory services that protect the public interest and enhance public confidence in the regulated sectors, including the insurance sector.

While FSCO does not have general administrative rule making authority, it has authority to make rules or issue guidelines in limited areas: for example, rules for practice and procedure in matters before the Superintendent or guidelines regarding the Statutory Accident Benefits Schedule incorporated by reference into regulations. The Lieutenant Governor in Council is vested with the authority to issue regulations under the OIA.

<sup>33</sup> These regulations would be approved by the Minister with or without modifications. Regulations concerning duties and rates as well as those having an impact on the scope of application of the laws would remain subject to government approval.

<sup>34</sup> FSCO is responsible for the solvency oversight of less than ten provincially incorporated insurers and 45 farm mutual insurers.

<sup>35</sup> Other relevant Acts are: Compulsory Automobile Insurance Act; Automobile Insurance Rate Stabilization Act, 2003; and Prepaid Hospital and Medical Services Act.

	<p>Similarly, it is advisable that FSCO be empowered to issue enforceable rules by administrative means. (s16(3), s268.3, s121, s28 and s15 of OIA)</p> <p>Where FSCO identifies conflicts or gaps between the legislation and supervisory objectives, it proposes amendments to legislation and regulations to the Ministry of Finance. For example, in response to the introduction of new and more complex life insurance products, FSCO worked with CCIR and CISRO to develop a new Life Insurance Replacement Declaration, which was implemented by regulation.</p> <p>While the tension between prudential and CoB objectives is inherent and not unique to Canada, the division of prudential and CoB supervisory responsibilities between and federal and provincial supervisors pose unique challenges. One example relates to the automobile insurance premium rates that are subject to approval by the provincial supervisor in some provinces including Ontario, which may have prudential implications. Close coordination between supervisors is critical to achieving the overall objective of insurance supervision of promoting a fair, safe and stable insurance sector for the benefit and protection of policyholders.</p> <p><b>Group-wide supervision</b></p> <p>The objectives as well as the legal authorities for group supervision for all three supervisors are not explicitly provided under the applicable primary legislation.</p>
Assessment	Largely observed.
Comments	<p>The responsibilities for the regulation and supervision of the insurance sector are shared between the federal and provincial authorities, each with a clearly defined mandate and objectives under the relevant primary legislation. OSFI, AMF and FSCO have taken action to recommend amendments to the relevant legislation when they identified conflicts between legislation and supervisory objectives. While the supervisors are authorized to issue guidance on their supervisory expectations, they are not empowered to issue directly legally enforceable rules. OSFI has not been delegated powers to make binding rules. The insurance legislation also does not explicitly address the objectives and authority for the supervision of insurance groups. Close coordination between the prudential and CoB supervisors is critical to achieving the overall objectives of insurance supervision, including striking an appropriate balance between the supervisory objectives of prudential and CoB supervision.</p> <p>The authorities are advised to:</p> <ol style="list-style-type: none"> <li>a) Consider how best to empower the supervisors to issue enforceable rules by administrative means, in accordance with specified legal parameters in the primary legislation; and</li> <li>b) Establish explicit supervisory objectives for group-wide supervision under the relevant primary legislation, supported by adequate legal powers to conduct group-wide supervision.</li> </ol>
<b>ICP 2</b>	<p><b>Supervisor</b></p> <p>The supervisor, in the exercise of its functions and powers:</p> <ul style="list-style-type: none"> <li>• is operationally independent, accountable and transparent;</li> </ul>

	<ul style="list-style-type: none"> <li>• protects confidential information;</li> <li>• has appropriate legal protection;</li> <li>• has adequate resources; and</li> <li>• meets high professional standards.</li> </ul>
Description	<p><b>OSFI</b>  <u>Governance, accountability and independence</u></p> <p>The OSFI Act provides that the Minister is responsible for OSFI. The Superintendent of OSFI is solely responsible for exercising the authorities provided to OSFI under the financial legislation and is accountable to the Minister on the administration of the legislation. (<i>s4 and s6 of OSFI Act</i>)</p> <p>The Superintendent of OSFI is appointed by the Governor General as the deputy head of OSFI (the Minister is the head), for a term of seven years and eligible for re-appointment for a further term. The appointment is made “during good behavior” i.e. the Superintendent can only be removed for cause (as opposed to “during pleasure”, where the incumbent can be replaced at any time mid-term without the specification of reasons). The order providing for the removal and related documents must be tabled at Parliament within 15 days. This process holds the government publicly accountable for its decision to remove the Superintendent. A Superintendent has never been removed from office since OSFI was established in 1987. (<i>s5 of OSFI Act</i>)</p> <p>OSFI does not have a board of directors. It has established an Executive Committee, comprising the Superintendent (Chair), and all three Assistant Superintendents. This Committee meets regularly to address key policy, regulatory and management issues, including setting and approval of OSFI’s annual strategic, operational and financial plans; setting priority of projects; allocation of resources; and monitoring and reporting of financial results and performance.</p> <p>Internally, OSFI has developed a Framework for Exercising the Superintendent’s Powers (FESP), which outlines the powers that are retained by the Superintendent and those that are assigned to specific positions within the organization. This delegation establishes clear lines of communication and accountability. It also ensures that timely supervisory decisions can be taken at the level appropriate to the significance of the issue. The FESP contains provisions for exercising certain emergency powers, powers that are normally exercised only by the Superintendent. OSFI has also developed a Business Recovery Plan that covers all aspects of business interruption, including decision making in emergencies. The Plan was last tested via a table-top exercise in October 2009, based on a scenario of an explosion in Toronto resulting in extensive property damage.</p> <p>In 2005–2006, OSFI introduced its Enterprise Risk Management (ERM) process to facilitate greater understanding and ownership of risks at the working levels, to provide a consistent approach to risk management across the organization. The ERM framework divides risks into: a) external risks - economic and financial conditions, the financial industry’s environment, OSFI’s legal environment and catastrophic events, e.g., a key risk noted for 2011/12 was the persistent low interest rate level; and b) internal risks—risks within OSFI’s control that can broadly be categorized as people, processes, systems and</p>

	<p>culture.</p> <p>OSFI’s accountability framework comprises a variety of elements:</p> <ol style="list-style-type: none"> <li>a) Submission and publication of its Annual Reports, which are publicly available (<i>s40 of OSFI Act</i>);</li> <li>b) Annual reporting to Parliament—through the <i>Report on Plans and Priorities</i><sup>36</sup> and a <i>Departmental Performance Report</i><sup>37</sup> (DPR); (<i>s 40 of OSFI Act</i>)</li> <li>c) Reporting to the Minister on OSFI’s operations and periodical report to various House of Commons and Senate Committees by the Superintendent;</li> <li>d) Consultations with financial institutions, other government agencies and subject-matter experts (see below);</li> <li>e) Independent oversight by the Audit Committee regarding the sufficiency, quality and results of assurance on the adequacy of OSFI’s risk management, governance framework and processes, including reviewing and approving OSFI’s financial statements. The Audit Committee comprises a majority of independent members who serve a three-year term, with a maximum of two terms.</li> <li>f) Internal assurance audits based on a comprehensive risk-based audit plan. Audit reports, which include management’s response to any identified issues, are posted on OSFI’s website.</li> <li>g) Annual external audits by the Auditor General of Canada, whose reports are published.</li> <li>h) Regular anonymous surveys of knowledgeable observers to assess OSFI’s performance and effectiveness as a regulator. This includes OSFI’s contribution to public confidence and how OSFI compares to other regulators. Survey results are published on OSFI’s web site.</li> </ol> <p>OSFI is subject to the Canadian Government’s “Policy on Service Standards for External Fees”, which requires the development of service standards that are measurable and relevant for paying stakeholders. For example, OSFI is expected to process 90 percent of “Superintendent deemed approvals” with 30 days of receipt. The standards and a summary of stakeholder feedback must be published in OSFI’s annual DPR. Consistent with the principles set out in the Government’s Red Tape Reduction Initiatives, OSFI has also developed a process to deal with complaints arising from its failure to meet the service standards.</p> <p>All supervisory decisions may be challenged pursuant to a number of distinct processes available under the OSFI Act, the ICA and/or general Canadian rules of law, including administrative law. Under the ICA, certain appeals to the Federal Court are subject to procedural restrictions in order not to unduly impede the Superintendent’s ability to make a timely intervention. For example, the removal order of a director or senior officer from office will not be stayed by an appeal if the Superintendent is of the opinion that</p>
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<sup>36</sup> Provides detail over a three-year period on OSFI’s main priorities by strategic outcomes, program activities and planned /expected results.

<sup>37</sup> Outlines results achieved against planned performance expectations as set out in the Report on Plans and Priorities.

the interests of the policyholders and creditors have been or are likely to be prejudiced (ICP 5). In addition, a regulated entity or any person affected by a decision made by OSFI has the right to a judicial review under the Federal Courts Act. Similarly, in order not to impede timely intervention, the administrative decision stands during the review process.

The ICA and OSFI Act do not provide for executive overrides with respect to decisions made by the Superintendent. However, the ICA stipulates that some institution-specific transactions require approval by the Minister. These transactions include:

- a) Approving the incorporation of an insurer and an insurance holding company, which can only commence business after OSFI has issued an Order (ICP 4);
- b) Approving: the acquisition of significant interest in or de facto control of an insurer; mutualization of insurance companies and conversion of mutual insurers; amalgamations of insurers; and substantial portfolio transfers (ICP 6);
- c) Limiting the average total asset of a FRI;
- d) public interest veto over OSFI's taking control of a FRI for more than 16 days; (ICP 11) and
- e) Approving voluntary liquidation and dissolution (ICP12);

In practice, all ministerial approvals are processed by OSFI; and the Superintendent provides a recommendation to the Minister based on prudential considerations. While the considerations to which the Minister must have regard are mainly public interest grounds or the best interests of the financial system, the criteria for approval by Minister are broad and include prudential factors such as soundness and feasibility of business plans. Although the law is silent as to whether OSFI is required to submit a negative recommendation to the Minister, OSFI's policy is that a recommendation would not be presented to the Minister unless OSFI is satisfied on prudential grounds. In cases where OSFI provides a recommendation for the Minister to approve, OSFI only presents the arguments for approval. OSFI does not provide the underlying information that would enable the Minister to second guess the prudential determination. The authorities argue that this "dual key" approval approach minimizes the possibility that the Minister takes a different view from OSFI. (*e.g., s420 of ICA*)

OSFI has explained that the current arrangement in implementing the Ministerial approval under the ICA has not posed practical constraints in relation to OSFI's prudential mandate. Nonetheless, there is scope for the law to be updated to reflect the actual practice and to more clearly distinguish the separation of OSFI's prudential decisions from the Minister's decision-making responsibilities based on national policy objectives in institution-specific transactions.

#### Funding and supervisory resources

The ICA authorizes the Superintendent to act independently in order to meet staffing and other resource requirements in pursuing OSFI's statutory objects. OSFI's budget is not dependent on government appropriations. It is funded mainly through assessments on FRFIs and a user-pay program for selected services. OSFI allocates its costs of operations based on the approximate amount of time spent supervising each industry, based on the applicable formula, with a minimum assessment for smaller institutions. (*s13 and s23 of OSFI Act*)

	<p>Base assessments for each industry represent the costs allocated less user fees and charges and cost-recovered services revenues. Staged institutions (ICP 9) are assessed a surcharge on their base assessment, to reflect the extra supervision required. As a result, well-managed, lower-risk institutions bear a smaller share of OSFI's costs. OSFI also receives revenues for cost-recovered services. Base assessments for both the P&amp;C and L&amp;H industries have increased by about 65 percent and 50 percent, respectively, since 2007.</p> <p>The federal government can impose government-wide fiscal restraints such as wage freezes, normally in extraordinary circumstances, which would also be applicable to OSFI. For example, the <i>Expenditure Restraint Act</i> in 2009 had the effect of constraining OSFI's overall budget through operational fiscal controls (e.g., constraining growth in staff salaries, restraining travel expenses, cuts in non-core activities, etc.). Although there are no such restraints at this time, there is a potential risk that future constraints may impede OSFI's efforts to meet its mandate.</p> <p>The Treasury Board of Canada<sup>38</sup> also issues administrative guidance applicable to all federal departments and agencies, including OSFI. Current guidance includes, e.g., a requirement to obtain approval of the Minister for single events (including international meetings such as supervisory colleges) involving hospitality over Can\$10,000 or when costs associated with activities not directly related to the delivery of OSFI's core mandate exceed Can\$25,000 on a per event basis. In March 2013, OSFI sought and obtained certain increased delegations with respect to hospitality and had some events pre-approved by the Minister. The need for approval at the operational level has implications for OSFI's discretion to allocate its resources in accordance with its mandate and objectives and the risks it perceives.</p> <p>OSFI has discretion to determine the compensation regime for executive<sup>39</sup> staff members, who are appointed in accordance with the Public Service Employment Act. It maintains a philosophy of targeting the 75<sup>th</sup> percentile of base salary of the financial services market. This has allowed OSFI to attract staff with specialized skills from the private sector as needed. OSFI has been able maintain a low rate of turnover.<sup>40</sup> OSFI reviews its executive compensation structure annually with a view to ensuring that this target is met. (<i>s13 and s15 of OSFI Act</i>)</p> <p>Between 2008 and 2012, OSFI's staff complement increased by approximately 120 persons or 24 per cent to meet its need to increase risk assessment and supervisory resources. In 2012, 164 staff (full-time equivalent basis) were allocated for the</p>
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<sup>38</sup> The Treasury Board is broadly responsible for accountability and ethics, financial, personnel and administrative management and comptrollership in the federal government.

<sup>39</sup> OSFI's non-executive workforce is unionized, and the terms and conditions of employment, including rates of pay, are subject to collective bargaining.

<sup>40</sup> In 2007, the annualized voluntary turnover rate of supervisory staff was 7.1 percent compared to 2.4 percent for regulatory staff. In 2012, the annualized voluntary turnover rate of supervisory staff decreased to 3.8 percent, while the rate remained fairly steady for regulatory staff at 2.3 percent.

supervision of 248 FRIs, of which about 90 supervisors have supervisory experience of 10 years or more. OSFI reviews its supervisory plan on an ongoing basis to make appropriate adjustments in response to evolving issues or changes in supervisory risk assessments. Since 2007, it has increased direct supervisory staff allocated to the large conglomerates by 36 percent, supplemented by increased resources from the specialist groups (e.g., actuarial, credit, operational risks corporate governance, etc).

To demonstrate its commitment to professional development and training, OSFI allocates about two per cent of its human resources budget towards training (\$1.5 million in 2011-12), and targets an average of five days of training per year per employee. Learning Plans are a required element of employees' annual Goal Commitment Documents. These Learning Plans ensure adequate and practical training is identified on an on-going basis. OSFI offers both internal and external training, consisting both formal training and on-the-job development. It maintains a large inventory of external training providers and supports training towards professional designations.

OSFI does not outsource any of its core supervisory functions. It has the legal authority and the budget to commission outside experts as appropriate and regularly draws on such experts (e.g., winding-up expertise). It has policies and procedures to check that all external experts have the necessary skills and independence. All external experts are subject to the same confidentiality rules that apply to OSFI staff. External experts are closely monitored to assess the quality work and to ensure compliance with confidentiality rules and professional standards.

#### Transparency and Review of Requirements and Procedures

The ICA and associated regulations establish a clear and transparent legislative framework for FRIs, supplemented by OSFI's supervisory guidance. OSFI's risk-based supervision framework (ICP 9) promotes consistent and equitable application of supervisory measures, taking into account the nature, scale and complexity of FRIs. However, OSFI's regulatory requirements with respect to a number of insurance groups supervised indirectly based letters of undertaking are not published (ICP 23).

Statutes applicable to FRIs are each subject to the sunset clause that requires a review every five years to ensure that they remain current and effective. The federal DoF leads a broad public consultation process during legislative reviews and OSFI is integral to this process and often consults directly with stakeholders. Amendments to the ICA can also be made on a more regular basis through other vehicles, such as the federal government's annual budget implementation legislation, which implements various fiscal, tax and other policy measures. Regulations made under the ICA may be amended through a Governor in Council process that does not require the approval of Parliament but is also subject to public consultation.

When developing its guidance, OSFI carries out formal public consultations. To facilitate transparency, a summary of industry's comments and OSFI's responses is published on OSFI's website. To ensure that the guidance remains current and effective, OSFI has created a Guideline Review Committee to monitor and oversee the reviews of the guidelines. Recent examples of public consultations include OSFI's Assessment Criteria



as part of the Supervisory Framework, and guidelines issued on capital adequacy requirements.

The ICA requires OSFI to disclose certain regulatory information to the public for the purposes of assessing the financial condition of FRIs. The information published on OSFI's website includes balance sheet and income statement, capital adequacy, impaired assets, and a summary of off-balance sheet items, on a quarterly or yearly basis. OSFI also provides a summary update on the insurance industry in its Annual Reports. (*s22(3) of OSFI Act and s673 of ICA*).

OSFI has been fully transparent about its role, responsibilities, and how it performs its duties either on its website or through the various accountability mechanisms mentioned above. In addition, OSFI's speeches and media interviews disseminate information on the insurance sector and its role, policy positions etc. OSFI is also subject to the Access to Information Act under which the public can request specific information (ICP3).

#### Confidentiality, supervisory integrity and legal protection

All information obtained by OSFI, or by any person acting under the direction of the Superintendent in the course of supervision is confidential. OSFI and its employees (past and present) are legally bound to take all reasonable measures to ensure the confidentiality of information. Legal gateways and safeguards for the disclosures of such information are outlined in ICP 3. (*Section 22 of OSFI Act and section 672 of ICA*)

OSFI staff members are required to observe its operational standards and guidelines for information security and confidentiality. OSFI employs multiple physical layers of controlled access at its office locations. Its computer systems are also protected by high levels of access controls, including sophisticated smartcard technology and password protection. Wrongful disclosure is a punishable offence under the ICA (ICP 11).

The Superintendent, Deputy and Assistant Superintendent, and members of FISC are bound by the requirements on integrity, professionalism, and conflicts of interest under the OSFI Act. Each OSFI employee, including OSFI's governing executive, must abide by OSFI's Statement of Values and Code of Conduct, which sets out the organization's core values of professionalism, integrity and respect for people. This is complemented by the Conflict of Interest Policy. (*s19 to s21 of OSFI Act*)

The Conflict of Interest Policy is designed, *inter alia*, to prevent undue influence from industry, such as a prohibition on owning shares of FRFIs, disclosure with respect to borrowings from FRFIs, and the acceptance of any grant or gratuity. In addition, former executive level employees shall not accept employment or appointment to the board of directors of FRFIs or to make representation on behalf of FRFIs to OSFI, within one year after leaving office. Failure to comply with the Policy is subject to disciplinary measures, including discharge or termination.

The Government, the Minister, the Superintendent, Assistant Superintendents, officers/ employees of OSFI or any person acting under the direction of the Superintendent are protected against legal liabilities for anything done or omitted in good faith in the

course of official duties. The Government, through the Treasury Board, covers the costs of an employee's defense if the employee acted within the scope of his/her duties. ( s39 of OSFI Act)

### **AMF**

AMF is headed by a President and Chief Executive Officer (CEO) appointed by the government of Québec. The terms of his appointments are published and he remains in office until replaced. He may not be removed without a valid reason, e.g., breach of the rules of ethics or professional conduct, as determined by the prescribed disciplinary procedure.<sup>41</sup> However, there is no explicit requirement for the reasons of dismissal to be publicly disclosed.

The President and CEO is responsible for the administration and direction of AMF. AMF does not have a board of directors and several committees have been formed to assist the President and CEO, i.e., Executive Committee, Ethics and Professional Conduct Committee, Information Protection and Security Committee, Decision Coordinating Committee, Policy Development Committee, Compliance Committee and Governance Committee. An advisory board, the *Conseil consultatif de régie administrative* (CCRA) has also been established; whose members are appointed by the MFEQ.

AMF is subject to various accountability mechanisms, including approval of its activity plan and budget estimates by the Québec government, audits by the Auditor General of Québec, presenting its annual reports at the National Assembly, and publication of weekly Bulletins. The AMF's management framework provides for close monitoring of its activities and quarterly reporting to the CCRA and the Steering Committee, which also incorporate a risk management approach and an internal audit function.

AMF's decisions under the DA and the IA as well as BDR's decisions under the DA may be reviewed by the Superior Court, for jurisdictional matters only. An appeal against BDR's decision may be brought before the Court of Québec (Court of Québec's decisions may be appealed before the Court of appeal). AMF's administrative sanctions under IA and certain licensing decisions may also be appealed before the Tribunal administratif du Québec, which is limited to confirming or infirming the decision. An appeal does not suspend the execution of the contested decision, unless the BDR, the Tribunal administratif du Québec, the Court of Québec or the Court of appeal decides otherwise. (s34.1 & s104.1 of AMF Act, s33 of the Code of Civil Procedure, s115 and 220 of DA and s366 & s367 of IA, s115.19 to s115.22 of AMF Act and s107 of Administrative Justice Act)

The various committees of AMF hold meetings weekly or monthly, with the objective of facilitating internal communication and prompt escalation of significant issues to appropriate levels within AMF. Urgent matters may be discussed at specially convened meetings in a timely manner. The delegation of powers by the President and CEO is published in the *Gazette officielle du Québec* and in AMF's Bulletin and matters are

<sup>41</sup> Regulation respecting the Ethics and Professional Conduct of Public Office Holders or the Code of Ethics and Professional Conduct - President and CEO.

<p>reported upwards in accordance with the instrument of delegation as well as the sub-delegation authorized by the President and CEO. (<i>s24 of AMF Act</i>)</p> <p>The institutional relationships between AMF and the executive and judicial authorities are clearly defined. AMF has specific and transparent obligations to inform, consult or obtain consent from the MFEQ or the government of Québec, for example:</p> <ul style="list-style-type: none"> <li>• AMF’s plan of activities and budget estimates require the approval of the government (<i>s. s46 &amp; 47 of AMF Act</i>);</li> <li>• The compensation of the President and CEO is determined by the government and the overall level of compensation of AMF staff is defined by AMF and approved by the Conseil du trésor in accordance with the Public Administration Act (<i>s20 and s26 of AMF Act</i>).</li> <li>• AMF may issue guidelines only after consultation with the MFEQ (<i>s. 325.0.1 of IA</i>);</li> <li>• The IA provides that certain institution-specific matters require approval by the MFEQ, on the recommendation of AMF, e.g., incorporation of an insurer, mutual insurance association or a federation of mutual insurance associations; allotment of the voting shares of an insurers; and amalgamation of insurers.</li> <li>• At the request of the MFEQ, AMF must forward any document/information concerning its administration of the DA (<i>s244 of DA</i>).</li> <li>• The CCRA advises AMF on its corporate governance, in particular its budget estimates, staffing plan and activity plan. It reports to the MFEQ on any matter requested by the MFEQ and makes recommendations concerning the administration of AMF (<i>s57, s57.1, s57.2 and s58 of AMF Act</i>).</li> </ul> <p>There is scope for strengthening AMF’s operational autonomy in the area of issuance of guidelines and greater clarity on the division of responsibilities between AMF and the MFEQ on institution-specific decisions with the objective of ensuring that AMF has sole discretion on prudential matters. (Please refer to similar comments on OSFI above.)</p> <p>AMF is financially self-sufficient, funded by the fees and dues paid by regulated entities. It can adjust the level of its fees with government approval. Half the sums collected by AMF from fines or administrative sanctions are paid into the Education and Good Governance Fund, while sums collected from sanctions under the IA and the DA are paid in full into this Fund. Finally, AMF may, as needed, ask Government for financial assistance. AMF sets its budget annually based on its staffing and activity plan and the estimates are submitted to the CCRA for advice and then to the government for approval. (<i>s38.2, s40 and s57of AMF Act</i>)</p> <p>AMF has sufficient and well-diversified staff resources (actuarial, accounting, legal, IT) to conduct effective supervision. In 2012, AMF allocated 30 full-time-equivalent supervisory resources for CoB supervision of 285 insurers and 30,839 certified representatives. AMF completed all its planned supervisory activities in the last two years.<sup>42</sup></p>
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<sup>42</sup> In 2011, AMF performed 96 supervisory activities, including 17 onsite inspections of Québec chartered insurers. In 2012, AMF performed 105 supervisory activities, including 21 onsite inspections.

The terms and conditions of employment of AMF staff are defined by AMF and approved by the *Conseil du trésor* in accordance with the Public Administration Act. AMF considers its overall remuneration as competitive vis-à-vis the industry and other government bodies. AMF has a staff development policy that includes formal mechanisms to identify training needs and assessment of whether such needs are met. At least one percent of AMF's payroll is invested on staff training annually. It can hire or contract the services of outside experts who are subject to the same confidentiality requirements as staff.

AMF may delegate some of its regulatory powers to SROs. The *Chambre de l'assurance de dommages* (CAD) and the *Chambre de la sécurité financière* have been recognized under the AMF Act and all insurance intermediaries in Québec are members of at least one of these two Chambers. The Chambers are supervised by the AMF and supported by three Codes of Ethics.<sup>43</sup>

The President and CEO, members of the CCRA as well as staff of AMF are subject to codes of ethics and professional conduct specifically applicable to them, including clear policy on managing potential conflict of interests. The codes also provides for disciplinary process and measures. AMF, the President and CEO as well as AMF staff members are protected from legal liabilities for acts performed in good faith in the course of their official duties (*s28 s32 & 32.1 of AMF Act*).

Information obtained by AMF in the course of its duties is confidential. The President and CEO and staff members of AMF and other persons authorized by AMF may not testify in relation to or produce information or a document obtained under an investigation except for a proceeding to which AMF is a party. AMF's Information Protection and Security Policy sets out its approach to information security. A breach of professional secrecy may be sanctioned under disciplinary, civil and penal law. The legal gateways for disclosure of confidential information are outlined in ICP 3. (*s16 of IA; s16 and s15.2 to s15.5 of AMF Act, s6 of Regulation on Conduct of Public Office Holders and s159 of Access Act*)

AMF has been transparent about its supervisory activities and must comply with the Access Act, which allows public access to information by government bodies. It has issued various guidelines, which are subject to public consultation, to articulate its supervisory expectations. The role, mission and structure of AMF as well as all relevant legislation, regulation and guidelines, including its Supervisory Framework, are published on its website. AMF publishes the annual reports required by the laws it administers. (*s34 of AMF Act*)

#### **FSCO**

The governance structure of FSCO is as follows:

- a) The Commission, comprising five members appointed by the Lieutenant Governor in Council: the Chair, two Vice-Chairs, Director of Arbitrations and the

<sup>43</sup> Code of Ethics of Damage Insurance Representatives, Code of Ethics of Claims Adjusters and Codes of Ethics of the *Chambre de la sécurité financière*.

	<p>Superintendent. It is responsible for reviewing and approving key planning, and strategic and accountability documents including various internal documents, the Statement of Priorities, and the Annual Report.</p> <p>b) The Superintendent of Financial Services (also the CEO), who may delegate his powers and duties to FSCO staff. A number of internal committees have been established to deal with policy and operational issues e.g., Executive<sup>44</sup> and Corporate Policy Coordination Committees etc.; and</p> <p>c) The Financial Services Tribunal (FST), an adjudicative body comprising nine to 15 members appointed by the Lieutenant Governor in Council. The FST holds hearings about decisions proposed or made by the Superintendent.</p> <p>FSCO's accountability framework comprises:</p> <p>a) The Commission and the Superintendent are accountable to the Minister. A MOU between the Minister, FSCO's Chair, and the Superintendent clarifies the roles, relationships, and mutual expectations of the Minister and FSCO.</p> <p>b) Accountability framework under the government's Agency Establishment and Accountability Directive;</p> <p>c) Annual audits by the Ministry of Finance and the Auditor General of Ontario.</p> <p>d) FSCO's Audit and Risk Committee oversees the quality of FSCO's internal controls to ensure compliance with policies and procedures, risk management, accounting policies, and financial reporting. The internal audit function of the public service of Ontario audits FSCO's activities on a consulting basis.</p> <p>e) FSCO delivers a Statement of Priorities and a report to the Minister annually. The Statement of Priorities sets out FSCO's strategic priorities and initiatives for the current year, together with the reasons for their adoption and a report on key accomplishments in the previous year. (<i>s11 of FSCO Act</i>)</p> <p>FSCO has a written delegation framework for accountability with structured decision-making lines to help ensure that appropriate staff members have the authority to take immediate action in urgent situations.</p> <p>The Superintendent is appointed under the Public Service of Ontario Act, 2006 (PSOA), which requires the Public Service Commission (PSC) to ensure the non-partisan recruiting and employing of the public servants. Under the PSOA, a public servant may be dismissed for cause or the PSC may dismiss without cause a public servant by giving reasonable notice or compensation in lieu of notice. There is no requirement that the reasons for removal are publicly disclosed.</p> <p>The Minister has a broad scope in issuing policy statements on matters related to the FSCO Act or any other Act that confers powers on or assigns duties to FSCO or the Superintendent. The Commission, the Superintendent and the Tribunal shall have regard to the policy statements in making decisions. The circumstances under which such policy statements may be issued are not specified. In 2003, the Minister issued a policy</p>
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<sup>44</sup> Provides strategic leadership and direction and makes recommendations and decisions on organizational matters including financial and human resource issues.

statement to “provide guidance and direction” concerning automobile insurance rates, including the policy to bring rising auto insurance rates under control by “reducing costs to auto insurers by 10 percent”. The Minister’s power to issue policy statement raises a concern on the autonomy of FSCO in making operational supervisory decisions. (*s12 of FSCO Act*)

Clear regulatory requirements are set out in the legislation and regulations that FSCO administers and in the published bulletins and advisories that FSCO issues. Legislation, regulations and updates are published promptly on a Government website and also in the Ontario Gazette. As FSCO is in the process of updating/documenting its supervisory practices, it has not published all its supervisory procedures. FSCO adopts a risk-based approach to supervision that takes account of the nature, scale and complexities of regulated entities.

FSCO reviews and updates regulatory requirements and supervisory procedures regularly in order to respond effectively to the changing financial services marketplace. In particular, the OIA requires the review of parts of the Act that deals with automobile insurance, including the Statutory Accident Benefits Schedule, at least every five years. It has a centralized database, the Legislative Amendments Tracking System to track proposed amendments to legislation and regulations. FSCO consults extensively with stakeholders prior to making or recommending material changes to regulatory requirements. Proposed changes to regulations must be posted on the Regulatory Registry, a Government website, for consultation purposes.

FSCO may publish any information that it considers in the public interest. In this regard, FSCO publishes comprehensive information on the insurance sector, its role and how it performs its duties in its Annual Report and website. (*s11(3) of FSCO Act*).

Appeals against the decision of the Superintendent may be made to the FST. The OIA also provides for the Superintendent to establish Advisory Boards to hold hearings on the granting/refusal of a new license or revocation/suspension of an existing license for insurance agents and adjusters. An Advisory Board consists of a representative of insurers, a representative of agents and a representative of the Superintendent who acts as chair of the Advisory Board. The Superintendent considers the Advisory Board’s report and recommendation before making a decision.

FSCO, its staff and any individuals acting on FSCO’s behalf, are required by the Freedom of Information and Protection of Privacy Act (FIPPA) to protect the confidentiality of information in their possession. In addition, they observe the Ontario Regulator’s Code of Practice on the preserving the confidentiality of information. The legal gateways for disclosure of confidential information are outlined in ICP 3.

FSCO has established conflict of interest guidelines for members of the Commission, FST members and FSCO employees. The Guidelines are in addition to provisions in the PSOA dealing with conflicts of interest. The Superintendent, members of the Commission and FST and employees of FSCO have adequate legal protection for any act done in good faith in the course of their duties. However, the legal protection does not relieve the Crown of any liability to which it would otherwise be subject. (*s9 and s10 of FSCO Act*)

	<p>FSCO is primarily funded through assessments on regulated entities<sup>45</sup>. It is also granted an annual spending authority through the government planning process, based on organizational needs and government priorities. FSCO files quarterly reports with the government on its spending. FSCO is subject to the hiring controls set by the Ontario Public Service. Where expert or specific skills and qualifications are required and not available, FSCO has the ability to hire resources through consulting services agreements. The FSCO Act provides that the Superintendent or the FST may hire or contract the services of outside experts when necessary. FSCO screens third parties and monitors their performance.</p> <p>FSCO does not have adequate resources to undertake proactive CoB supervision of insurers and intermediaries. In 2012, FSCO allocated 22.5 full-time-equivalent supervisory resources to supervise a large population of the regulated entities in the insurance sector: 350 insurers (mainly FRIs); 46,222 insurance agents; 4,632 corporate insurance agencies; 1,657 insurance adjusters, as at June 8, 2012. Its planned supervisory activities were constrained by the availability of resources and supervisory activities had to be reduced in 2012-11 due to increased regulatory policy review, re-organization and the need to train new recruits. Government-wide and commission-specific issues are affecting FSCO, these include fiscal and staffing constraints; increased competition in attracting specialized and/or qualified staff; succession planning; career management; and employee recognition. Limits on resources will continue to put pressure on FSCO's supervisory activities and adversely affect FSCO's capacity to deal with emerging issues.</p> <p>FSCO recognizes the value and benefits of training and developmental opportunities and is dedicated to supporting on-going learning for all staff. Its training policy is committed to continuous investment in the training and development and in providing the tools and guidance necessary to achieve the learning goals of staff.</p>
Assessment	Partly observed.
Comments	<p>OSFI, AMF and FSCO have robust accountability framework and are generally transparent in how they discharge their supervisory responsibilities. While the supervisors have adequate delegated authority to conduct supervision within the parameters set out in the relevant legislations, their operational autonomy is affected by the statutory roles of the Minister (OSFI) and MFEQ (AMF) in institution-specific supervisory decisions or to take account of policy statements issued by the Minister (FSCO). The legal framework and operational safeguards for the protection of confidential information are strong. The heads of the supervisory agencies and their staff members are required to observe high ethical standards including effective management of conflict of interests and they have adequate legal protection.</p> <p>OSFI and FSCO are subject to government-wide fiscal restraints and guidelines on their discretion to allocate financial resources and the AMF's budget and fees are subject to</p>

<sup>45</sup> FSCO, with the approval of the Minister, can set fees for the purposes of the FSCO Act and fees can be established by the Minister under the IA.

	<p>government approval. While the removal of the Superintendent of OSFI is subject to a parliamentary process that ensures accountability, there is no requirement for the reasons for the removal of the President and CEO of AMF and the Superintendent of FSCO to be published. There is scope for OSFI to enhance the transparency of its different approaches to supervising insurance groups.</p> <p>The authorities are advised to:</p> <ol style="list-style-type: none"> <li>a) Update the relevant primary legislations to adopt separate legal processes for the prudential decisions of OSFI and AMF from the approval from the executive branch to address national policy objectives and specify the circumstances for the issuance of policy statement to FSCO;</li> <li>b) Consider exempting the supervisors from the government’s fiscal controls and administrative guidance, as in the case of the BoC, to strengthen their financial autonomy;</li> <li>c) Review the adequacy of supervisory resources of FSCO and whether FSCO should continue to be subject to the hiring controls set by the Ontario Public Service;</li> <li>d) Enhance the transparency of OSFI’s different approaches to supervising insurance groups; and</li> <li>e) Establish explicit provisions on public disclosure of the reasons for removal of the President and CEO of AMF and the Superintendent of FSCO.</li> </ol>
<b>ICP 3</b>	<p><b>Information Exchange and Confidentiality Requirements</b></p> <p>The supervisor exchanges information with other relevant supervisors and authorities subject to confidentiality, purpose and use requirements.</p>
Description	<p>OSFI, AMF and FSCO have the legal authority, when needed, to obtain any information that is relevant to their supervisory function or that of a foreign supervisor, including from unregulated persons and entities (ICP 9). All three supervisors adopt strict policies and operational requirements to safeguard confidentiality of supervisory information (ICP2).</p> <p>In Canada, the public can request specific information from federal government agencies under the Access to Information Act (AI Act) subject to certain statutory exclusions, such as trade secrets, information treated as confidential by a third party or prejudicial to the competitive position of a third party, etc. The agencies shall give written notice why such information should not be disclosed to a third party, who is given the opportunity to make representations. Similar legislation applies to the AMF (Access Act) and FSCO (FIPPA).</p> <p>The Intergovernmental Agreement on Information Sharing on Financial Institutions executed in 1989 does not cover OSFI as the scope of the agreement is limited to the administration and enforcement of provincial statutes. Under this agreement, provincial supervisors shall, to the greatest extent possible, consult each other before taking substantive regulations actions.</p> <p>The CCIR proposed, in April 2013, the establishment of a supervisory college of Canadian supervisors, supported by a protocol on cooperation and exchange of information. In addition, AMF, OSFI and other Canadian regulators are working on a</p>



draft MoU for information sharing and preservation of financial stability, expected to be signed by end-2013.

In June 2005, OSFI and AMF signed an agreement, mainly to prepare and share analysis reports related to ceded reinsurance. At least once a year, both organizations meet to discuss the result of their analysis of FRIs. AMF also shares with OSFI its "Watch list" on insurers. On an informal basis, OSFI and AMF discuss issues on P&C insurers, if necessary. AMF is currently exploring the possibility of extending the discussions to L&H FRIs. A formal agreement is being developed between all relevant supervisors of Desjardins Group to formalize the coordination process.

### **OSFI**

The OSFI Act sets out the legal gateway for disclosure of confidential information to: a) any government or other agencies that regulate or supervise FIs for supervisory purposes; b) CDIC or any compensation association designated by the Minister; and c) Deputy Minister or any authorized DoF officer and the Governor of the BoC or any authorized BoC officer for the purposes of policy analysis. The disclosure is subject to the Superintendent of OSFI being satisfied that the confidentiality of information will be safeguarded. Information in regulatory returns filed with OSFI or obtained via industry survey, except for customer-specific information, may also be disclosed for the purpose of financial analysis. (*s 22(2) of OSFI Act*)

The ICA contains similar provisions. In addition, the Minister may determine that OSFI ought to disclose information obtained in the course of supervision for the analysis of the financial condition of a FRI. The Minister shall consult OSFI before making such a determination. (*s672(2) and s673 of ICA*)

OSFI has established over 30 MoUs with foreign counterparts and is a signatory to the IAIS Multilateral MoU. These arrangements allow OSFI to share confidential supervisory information under assurance of confidentiality. As part of its MoU negotiation process, OSFI undertakes a thorough legal due diligence review of the counterpart's legal regime to ensure that there are adequate confidentiality safeguards.

OSFI assesses requests for information on a case by case basis, in line with its Information Sharing Policy. While the existence of a formal MoU is not a prerequisite for information sharing, OSFI's policy is to limit the sharing of written confidential information, particularly with respect to a parent entity, unless a formal arrangement is in place (e.g., MoU). Based on OSFI's experience, this is not a practical impediment as it has MoUs in place with almost all relevant authorities. It would proactively initiate MoU discussion when it receives a request from a supervisor who does not have a MoU with OSFI. If time is of the essence, OSFI allows verbal information request to be followed up in writing. OSFI does not require strict reciprocity in information exchange. Its policy is to respond in a timely and comprehensive manner, generally within two weeks.

Participants of supervisory colleges hosted by OSFI are requested to sign college-specific confidentiality agreements, even if they have bilateral MoUs with OSFI, to ensure a candid exchange of views/information. OSFI also agrees to sign similar confidentiality agreements for colleges hosted by other supervisors. More information on the

arrangements for supervisory colleges under ICP 25.

OSFI's MoUs outline the types of information expected to be shared for the on-going supervision of cross-border establishments. For example: a) material developments or supervisory concerns; b) information on the regulatory regime and major changes with significant impact on cross-border activities; c) material administrative penalties imposed or enforcement action taken with prior notification as far as practicable; and d) any other relevant information useful for supervision. The most frequent types of information sharing are a), c) and d). The Assessors were shown concrete examples of information sharing with both foreign and domestic counterparts.

OSFI seeks information from another supervisor only when it has a legitimate interest and for supervisory purposes, as evidenced by its bilateral and multilateral MoUs. It uses information obtained from another supervisor only for the purposes specified in the request. If OSFI wishes to use the information for another purpose, including exchanging with other parties, it will obtain prior agreement from the originating supervisor.

OSFI expects to be consulted if the information it has shared is to be forwarded another supervisor, as stated explicitly in its MoUs. The CDIC must consult the Superintendent before it can share information it had received from OSFI with other supervisory or government bodies. OSFI will generally permit the information to be passed on where there is a legitimate need and the information will be kept confidential by the recipient and used solely for lawful supervisory purposes. (*s45.2(2) of the Canada Deposit Insurance Corporation Act*)

If OSFI is legally compelled to disclose information (e.g., court subpoena), it will promptly notify the originating supervisor and use all reasonable means to resist the demand, if required to do so. All of OSFI's bilateral MoU and the IAIS Multilateral MoU explicitly reference this matter. To date, OSFI has never been legally compelled to release confidential information received from another regulator.

#### **AMF**

The Access Act empowers AMF to disclose information to: a) to a body responsible for the prevention, detection or repression of crime or statutory offences, if the information is necessary to prosecute an offence under an Act applicable in Québec; or b) to a person/body if the information is necessary for the application of an Act in Québec whether or not the law explicitly provides for the release of the information. In this regard, AMF may share information with: the police force in Québec, a Canadian securities authority for the purposes of investigation or prosecution; other regulatory bodies which are signatories to the IOSCO Multilateral MoU for the purposes of investigation or prosecution; and *the Ordre des comptables professionnels agréés du Québec*. (*s41.2 & s67 of Access Act and s9 of Chartered Professional Accountants Act*).

AMF has concluded more than 30 MoUs on supervision and exchange of information. It has full discretion to decide if it is appropriate to communicate information regardless of the existence of an agreement or MOU. AMF has expressed its willingness to complete all the steps to become signatory of the IAIS Multilateral MoU. (*s16 of AMF*

*Act; s. 16 of IA).*

AMF uses information provided by other supervisors for the purpose stated in its request and for supervisory purposes. AMF imposes appropriate conditions or restrictions to safeguard the information that it intends to communicate to another supervisor. When AMF determines that there is a risk that information could be compelled by the courts, it consults with the originating supervisor and will invoke the necessary privileges to ensure confidentiality.

AMF proactively exchanges material and relevant information with other supervisors, including other provincial and federal supervisors. Agreements concluded by AMF also allow for the provision of unsolicited assistance. AMF's policy is to inform its counterparts if its actions are likely to affect entities of any insurance group, as far as practicable.

In 1990, the Government of Québec and Assuris signed an agreement to cover Québec policyholders under a compensation plan in the event of insolvency of a Québec-chartered L&H insurer. Under the agreement, AMF and Assuris shall exchange information on an insurer with Stage 2 intervention rating onwards and for any subsequent changes of intervention stages (ICP 10). If the insurer conducts activities outside Québec or belongs to a financial group, AMF should also notify the other relevant supervisor. AMF and Assuris meet formally on a semi-annual basis and more often if needed. In April 2013, AMF published its Intervention Guidelines for Québec-Chartered Life Insurers and Assuris Member Companies on its website.

AMF is obliged to designate a person responsible for protecting personal information (currently AMF's General Secretary). This helps to ensure that any request received by AMF will be dealt with in a timely and comprehensive manner. The internal Information Access Policy and Delegation of Powers provide a basic framework through which information requests are assessed and decided. (*s8 of Access Act*).

There is no reciprocity requirement with respect to information exchange. AMF must ensure that information exchanged receives protection equivalent to that in Québec. It will also do its utmost to preserve the confidentiality of any information received from a foreign supervisor. It is AMF's practice to request permission from a foreign supervisor for sharing information received with other relevant supervisors in Québec, which is also a term in the MOUs executed by AMF. (*s7 of Access Act*)

### **FSCO**

The legal authority of FSCO to share information is implied from the FSCO Act and OIA, subject to the access and confidentiality provisions, as well as purpose and use constraints in the FIPPA. FSCO may refuse disclosure where it could reasonably be expected to reveal confidential information received from another government/agencies or international organizations; or prejudice the conduct of intergovernmental relations by the Ontario Government or an institution. The exemptions to disclose information may be overridden on the ground of compelling public interest. All requests under FIPPA must come through the Ministry of Finance. FSCO has a Freedom of Information and Protection of Privacy Protocol and appointed a Coordinator for FIPPA requests. (*s15,*

	<p><i>s23 and Part II and III of FIPPA)</i></p> <p>FSCO has a number of MoUs with other regulators or government entities including RIBO, AMF, Statistics Canada and the Ontario Minister of Revenue and OSFI. Information sharing amongst Canadian supervisors is coordinated through CCIR<sup>46</sup>, CISRO and JFFMR.</p> <p>While many CCIR and CISRO members publish information on disciplinary decisions taken against intermediaries, such information is not centralized. On a weekly basis, FSCO emails a list of the agents whose licenses have been revoked, suspended or surrendered to insurers and other supervisors. In Fall 2012 CCIR and CISRO agreed in principle to establish a working group, co-chaired by FSCO and RIBO, to develop a common platform for accessing disciplinary actions.</p> <p>Information exchange is normally in relation to supervisory issues. While the Intergovernmental Agreement provides that the supervisor receiving the request for information may require that such a request be made in writing, FSCO does not always insist on written requests. FSCO responds to information requests in a timely manner consistent with the nature, urgency and risk of the issue. Strict reciprocity is not a required basis for sharing information.</p> <p>The exchange of confidential information has been generally with domestic supervisors e.g., CCIR members<sup>47</sup>. If FSCO received a request to share information from an unfamiliar supervisor, it would undertake the appropriate legal and operational due diligence to determine the degree to which it was subject to confidentiality requirements.</p> <p>FSCO only uses information requested for the purpose it was intended and would inform the originating supervisor in advance of any other use of that information. The Intergovernmental Agreement provides that if the information shared will be disclosed by legal process, the supervisor intending to release the information must get the consent from the supervisor that provided the information.</p>
Assessment	Observed.
Comments	<p>All three supervisors are empowered to obtain and exchange information with relevant supervisors and authorities subject to confidentiality, purpose and use requirements. They have a wide network of bilateral MoUs and OSFI is a signatory to the IAIS Multilateral MoU. The existence of a MoU is not a prerequisite for information exchange and strict reciprocity is not required. OSFI's policy is to limit the sharing of written confidential information unless a formal arrangement is in place and this has not posed</p>

<sup>46</sup> For example, in a recent market conduct issue related to the policy administration of a segregated fund offered by an insurer across several provinces, FSCO and the other involved provincial supervisors, conducted investigations and provided relevant reports to CCIR.

<sup>47</sup> CCIR members are subject to the Principles of Communication agreement that provides, *inter alia*, that the exchange of information between CCIR members must be held in the strictest confidence.

	practical issues as it has a wide network of MoUs and proactively initiate MoU discussion with relevant supervisors.
<b>ICP 4</b>	<p><b>Licensing</b></p> <p>A legal entity which intends to engage in insurance activities must be licensed before it can operate within a jurisdiction. The requirements and procedures for licensing must be clear, objective and public, and be consistently applied.</p>
Description	<p>In Canada, the entities that are permitted to conduct insurance activities are controlled through a combination of federal and provincial/territorial approval and licensing and regimes. Insurers may be incorporated or continued federally under the ICA or relevant provincial legislation. A FRI may be established as a company, society or mutual.</p> <p><b>Incorporation and continuance of a FRI</b></p> <p>The authority to issue the letters patent of incorporation of a FRI is vested with the Minister, based on the recommendation of OSFI. Upon the Minister's approval, OSFI issues an authorizing Order to Commence and Carry on Business. A new insurer must also be licensed in each province and territory in which it intends to carry on insurance business. (<i>Instruction Guide for Incorporating Federal Insurance Companies</i>).</p> <p>Before making a formal application, an applicant must give notice of the intention to apply for incorporation. Draft notices should be provided to OSFI for review prior to publication. The notice of intent allows for public comment/ objection and is to be placed in the Canada Gazette and a relevant newspaper. A person may object to the proposed incorporation to the Superintendent within 30 days of the publication of the Notice.</p> <p>OSFI's guidance sets out the broad considerations in making a recommendation to the Minister. An application must be supported by all relevant information required by OSFI, including: ownership and financial strength; three-year business plan including pro-forma financial statements; management team as well as the proposed appointed actuary and external auditor; description of the major risk management and control processes and policies and capital management policy; composition of the Board and its committees; corporate governance framework and conflict of interest policy; role and responsibility of the internal audit function; internal policies and controls for compliance management; information technology governance structure; and systems and business continuity plan.</p> <p>Any person who intends to own more than 10 percent of any class of shares of a FRI must seek approval of the Minister. A controlling shareholder is required to provide the Superintendent with a Support Principle acknowledgement that entails commitment to provide the FRI with ongoing financial, managerial and operational support including the provision of additional capital in the future where necessary. Where a financial services group wishes to establish a FRI, OSFI expects the group to select as the applicant the entity through which most of the group's insurance business or financial activities is conducted.</p> <p>An application from a foreign-owned FI must furnish additional information such as</p>

whether it is subject to comprehensive consolidated supervision and regulation; a report of the examination issued by its home regulator, if available, or confirmation from the home regulator that it reports favorably on the applicant; and confirmation that the home supervisor is aware of the application.

In considering an application for incorporation, the Minister takes into account all relevant factors, including: a) the financial resources of the applicant as a source of continuing financial support; b) the soundness and feasibility of the business plan; c) the business record and experience of the applicant; d) the character and integrity of the applicant or the reputation of an applicant who is a body corporate; e) competence, experience and suitability of management; f) the impact of any integration issues; and g) the best interests of the financial system in Canada. The Minister may also consider any concern relating to Canada's national security, international relations and international legal obligations. The Minister may set out in the letters patent restrictions on the FRI's business to address supervisory and regulatory concerns. (*s27 and s1016.1 and s28 of ICA*).

The criteria and information requirements related to applications by existing insurers to continue operations under the ICA as a FRI are substantially the same as that for a new application for incorporation. (*A No. 13 – Continuation of a Body Corporate*)

#### **Order to commence and carry on business by FRI**

The application for an Order should be supported by: a) minutes of the first meeting of the board; b) confirmation on meeting the required paid-in capital; c) minutes of the first meeting of the shareholders; d) incorporation and organization expenses and a statement that the amounts are reasonable; e) a letter of commitment to provide OSFI with adequate advance notice of any proposed material changes to the business plan; and f) confirmation on membership in the applicable policyholders' compensation fund. The Superintendent may not make an Order more than one year after the letters patent is issued. OSFI may impose additional requirements or restrictions on the activities of the FRI in the Order. (*s57 and s58 of ICA*).

#### **Licensing of a FRI**

As the definition of "insurance" is generally a matter of contract law, the power to govern insurance contracts under the Canadian Constitution Act, 1867, is ascribed to the provinces. Any insurer doing business in a particular province/territory must be licensed by the relevant provincial supervisor. Applicants must complete the standardized Application for Insurer's License form developed by CCIR. This form is harmonized for all provinces and territories in Canada and contains specific requirements for each province. Consistent classes of insurance across Canada were developed through the CCIR.

#### AMF

Only legal persons authorized and holding licenses issued by AMF shall act as insurers in Québec. AMF is required to maintain the register of authorized insurers, including the kind of classes of insurance which it is authorized to transact in Québec, which is published on its website. The IA and IA-Reg specify the licensing criteria and conditions. (*s201, s19(a), s205, s207, s210 and s211 of IA and s30 to s33 of IA-Reg*).

<p>AMF has issued guides on the licensing process in Québec, detailing the assessment criteria as well as the information and documentation required. (<i>Guide for Initial Licence Application by an Insurer not Incorporated in Québec, Guide for Insurer's Licence Amendment Application and the Guide for the presentation of an application for the constitution of an insurance company with a Québec charter.</i>)</p> <p>Insurers that do not have their head offices in Québec must appoint a chief representative in Québec. P&amp;C insurers having no establishment in Québec may issue certain insurance contracts without a license (except automobile and surety insurance<sup>48</sup>) provided such contracts are issued through a firm acting through a special broker and they may not advertise or publicize their business in Québec. This exemption applies to specific products that are not available in Québec and the broker must obtain the names of three insurers indicating that they are unable to write the business. (s206, s207, s204 of IA and s42 of DA).</p> <p><u>FSCO</u></p> <p>The OIA prohibits unlicensed insurance activities and every insurer undertaking insurance or carrying on business in Ontario must be licensed by FSCO. Most insurers in Ontario are FRIs subject to prudential regulation by OSFI. The number of Ontario-incorporated insurers has been steadily declining. FSCO has issued a consultation paper proposing to cease incorporation of new insurers in Ontario but would continue to license insurers incorporated in a jurisdiction that meets international solvency standards<sup>49</sup>.</p> <p>For FRIs or extra-provincial companies, FSCO ensures that the insurer is licensed by the primary supervisor for the classes (or the comparable classes) they are applying to write in Ontario. For those conducting L&amp;H business, a proof of ability to provide for maturity of contracts is required and FSCO may accept the fact that it is licensed by any government of Canada as acceptable. Motor insurance policies, including basic coverage and limits are prescribed in law in Ontario. Branches are also required to appoint a Chief Agent before conducting business in Ontario.</p> <p>Ontario licensing requirements for insurers are substantively aligned with federal requirements. FSCO has published "Notes concerning the Incorporation and Licensing of an insurance Company in Ontario" to guide prospective applicants. A list of the insurers licensed by FSCO is published on its website.</p> <p>Under the OIA, FSCO can refuse to issue a license where the licensing requirements have not been met, as well as having the authority to impose conditions or limitations that FSCO considers appropriate. All licenses issued by FSCO clearly state the classes of insurance that the insurer is allowed to undertake. Any limitations or restrictions are also clearly stated on the license. FSCO may amend or revoke a licensing condition or</p>
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<sup>48</sup> A foreign insurer that intends to act only in surety insurance in Québec may be exempted from the licensing requirement, if AMF considers the exemption does not undermine the protection of the insured. This decision must be published in AMF's Bulletin and in the *Gazette officielle du Québec*. (s. 211.1 of IA)

<sup>49</sup> Source: "Improving Solvency Supervision of Insurance in Ontario: a proposal to upgrade solvency standards for the benefit and protection of Ontario policyholders", May 2012.

limitation but cannot amend restrictions imposed on an insurer's license in its home jurisdiction or permit a FRI to have greater powers in Ontario than its home jurisdiction. An approval with conditions is not provided until the applicant has been given notice of intention and the opportunity to make written submissions.

#### **Branches of foreign insurers**

A foreign insurer must apply to OSFI for an Order approving the "insuring in Canada of risks,"<sup>50</sup> subject to the approval of the Minister. OSFI has issued detailed guidance on the information required to assess an application for an Order. Foreign insurers who intend to "insure in Canada risks" are required to maintain assets in Canada to support their liabilities incurred in respect of insurance business in Canada. These assets are under OSFI's oversight and will be made available to satisfy the claims arising from their insurance business in Canada, in the event of insolvency. (*s573 and s581 of ICA and A No. 4 – Establishment of Branch by Foreign Insurer Order to Insure in Canada Risks*)

While a foreign insurer may not be carrying on sufficient activities in Canada to constitute "insuring in Canada of risks" under the ICA, its activities may need to be licensed by the relevant provinces. For example, some provinces require a foreign insurer to obtain a license merely to promote its products in, insure a person domiciled or resident in, or provide insurance coverage on a property situated in the province/territory. (*Advisory 2007-01-R1 – Insurance in Canada of Risks*)

Before making an Order, OSFI must be satisfied that all relevant requirements of the ICA have been complied with and that the applicant has: a) vested at least Can\$5 million in trust in a Canadian FI, securities of or guaranteed by Canada/province or other admissible assets; b) appointed an actuary and an auditor; and c) appointed a resident in Canada to be its chief agent under a power of attorney to receive notices from OSFI or the Minister. OSFI may also impose conditions or limitations on the Order. All foreign insurers (except reinsurers) must also be members of the relevant compensation association designated by the Minister. (*s574, s579, s581 to 583, s591, s611 and 612 of ICA*)

An applicant is generally required to have consolidated assets of at least Can\$1 billion in the case of a L&H insurer or Can\$200 million for P&C insurer; with a capital and surplus of between 5 to 10 percent of liabilities for L&H insurer, or at least 20 percent of assets in the case of a P&C insurer. (*Index A No. 4 – Establishment of a Branch by a Foreign Insurer (Order to Insure in Canada Risks)*)

For policyholders to be protected under the Canadian regime, they should require the foreign insurer to insure them in Canada. As from January 1, 2010, foreign insurers are required to include a statement in all documents related to their insuring in Canada of risks (i.e., premium notices, applications for policies and policies), that the document was issued or made in the course of their insurance business in Canada. (*s578(5) of ICA*)

<sup>50</sup> This concept does not refer to the location of the risk (e.g., a person or a house) being insured, which can be located inside or outside of Canada.



	<p><b>Cross-border insurance activities without a physical presence</b></p> <p>A determination that an insurance entity is “insuring in Canada risks” would not necessarily entail a “physical presence” in Canada by that entity (e.g., an entity could insure in Canada risks via its agent). In such cases, the ICA and the federal regulatory regime would apply. If, however, an entity is not carrying on sufficient business activities in Canada (such that it would not be considered to be “insuring in Canada risks”), the ICA and federal supervisory and regulatory regime would not apply.</p> <p><b>Permitted activities</b></p> <p>An Order to commence and carry on business/approving the insuring in Canada of risks must specify the classes of insurance risks<sup>51</sup> that the FRI or branch is permitted to insure and may contain conditions or limitations, e.g., the insurance of risks in Canada may be limited to reinsurance. (<i>s58 and s583 of ICA</i>).</p> <p>The ICA prohibits the authorization of any new composite FRI/branch (i.e. writes both L&amp;H and P&amp;C businesses). Unless a foreign insurer is permitted to write direct insurance in its home jurisdiction, its Canadian branch will be restricted to the business of reinsurance.. Societies are prohibited from being commercial or for-profit enterprises and their property must be under the control of persons elected by its members. (<i>s445 and s589, s443 and s23(2) of ICA</i>)</p> <p>A FRI is generally restricted to the provision of financial services or such business that generally appertains to the provision of financial services, is not permitted to deal in goods, wares or merchandise or engage in any trade or other business. Nonetheless, a FRI may undertake certain ancillary services e.g., appraisal services for real estate, as specified in the ICA. (<i>s440 of ICA</i>)</p> <p><b>Supervisory practices</b></p> <p>OSFI publishes detailed administrative guidance on the various filings, documentation and other requirements associated with the application for establishment of FRIs and branch operations. Entry into the federal insurance regime is a carefully vetted process either for domestically or foreign owned entities. OSFI’s risk tolerance around new entrants is focused on prudential and national security considerations as required by law. OSFI’s analysis is guided by its Internal Risk Tolerance Framework for New Entrants, which considers that OSFI should have a low risk tolerance for loss to policyholders, depositors and other creditors. This means that an applicant’s initial base case business plan must demonstrate that capital (in the case of an FRI), or assets vested in trust in Canada (in the case of a branch), is sufficient to cover any losses expected during either the first three years of operation of the new FRI or branch, or until the FRI or branch begins generating a profit, whichever comes later. To this end, OSFI has enhanced the due diligence and conducts a full risk analysis that is commensurate to that carried out on existing FRIs and branches.</p>
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<sup>51</sup> The classes of insurance are: accident and sickness, aircraft, automobile; boiler and machinery, credit, credit protection, fidelity, fire, hail, legal expenses, liability, life, marine, mortgage, other approved products, property, surety and title. (*Schedule to the ICA*).

OSFI officers from the Legislation and Approvals Division and Supervision Sector jointly review and assess each application for the incorporation of a FRI or establishment of a branch. Prior to filing an application, prospective applicants are strongly encouraged to have an initial discussion with OSFI. The review of “fitness and propriety” of the applicants has been applied more rigorously since legislative changes were introduced making national security an explicit consideration. OSFI has a “no tolerance” approach in evaluating potential national security information from Canadian law enforcement agencies.

While there is no specific time limit to make a decision on an application, applicants are made aware that applications typically take 12 to 18 months to complete, depending on the complexity of each case. OSFI communicates regularly with the applicant throughout this process. OSFI’s Service Standard 4 provides that 80 percent of applications for letters patent of incorporation and applications for Orders approving the insuring in Canada of risks will be processed in less than 90 days after receipt of a complete application.

OSFI examines the proposed corporate structure to assess its ability to supervise, examine and regulate the proposed FRI effectively. Generally, the factors considered include: a) the proposed activities; b) potential systemic importance, e.g., the size or intended role relative to the Canadian financial sector; c) the applicant’s group-wide financial activities, e.g., complexity of the group structure, strategic direction, potential contagion risks, size of the FRI relative to the group, financial activities in other jurisdictions etc.; d) the independence and self-sufficiency of the FRI, e.g., independence of the FRI’s directors from the boards of the other entities in the group and the extent of the FRI’s involvement in the business of affiliated entities; and e) the extent to which affiliates are supervised by other regulatory agencies with whom OSFI has concluded a MoU.

Where appropriate, the Superintendent may take measures to address concerns that the proposed structure would hinder effective implementation of corrective measures. For example, an applicant may have to restructure or provide an undertaking to OSFI to provide information and/or restrict certain activities of the group. (*Instruction Guide for Incorporating Federal Insurance Companies*)

Before issuing an Order to Commence and Carry on Business or an Order to Insure in Canada Risks, OSFI must be satisfied that the FRI or branch has the necessary systems, management structure, control processes and compliance management systems in place. An on-site pre-commencement review is usually arranged prior to the issuance of either Order, to assess whether the applicant is capable of producing the required statutory and supervisory information in an accurate and timely manner at the commencement of operations.

Any license denials or proposed conditions and/or restrictions are discussed, at the earliest possible stage, with applicants. If an application is denied, made conditional or restricted, the applicant would be informed with a written explanation.

Before issuing a license, AMF communicates with OSFI on the provision of a Letter of

	<p>Good Standing. AMF is in constant communication with the applicant during its analysis of the application and informs the applicant of its decision typically within 90 of receipt of an application that is complete. FSCO's assessment of license applications relies on audits, actuarial reports and the work of other supervisors, supported by its professional judgment. During the licensing process, FSCO communicates with the applicants regularly. FSCO's practice is to decide on an application that is complete within 30 to 60 business days. The OIA required FSCO to give written notice of its decision.</p>
Assessment	Observed.
Comments	<p>The licensing process for FRIs involves a three-stage process: a) approval by the Minister to incorporate or continue operations under the ICA; b) Order to commence and carry on business by OSFI; and c) licensing by the relevant provincial supervisors in all the provinces that it intends to conduct insurance business. Foreign insurers intending to establish branches must obtain an Order from OSFI if they intend to "insure in Canada a risk", along with provincial license(s), and they are required to include a statement in all policy documents that the policy was issued in the course of their insurance business in Canada. The criteria and procedures for the approval by the Minister and OSFI are clear and transparent. The process involves significant interaction with the applicants and the relevant home supervisors (if applicable) and OSFI typically conducts a pre-commencement on-site review before issuing the Order to Commence and Carry on Business or an Order to Insure in Canada Risks. Licensing criteria and processes adopted by AMF and FSCO are in line with international best practices, supported by harmonised application form developed by the CCIR.</p>
<b>ICP 5</b>	<p><b>Suitability of Persons</b></p> <p>The supervisor requires Board Members, Senior Management, Key Persons in Control Functions and Significant Owners of an insurer to be and remain suitable to fulfil their respective roles.</p>
Description	<p>The ICA, in conjunction with the OSFI guidance, set out requirements for the following categories of persons.</p> <p><b>Significant owner</b></p> <p>The financial soundness and integrity of significant owners are assessed during licensing (ICP 4) and when there are changes in significant interest or control (ICP 6).</p> <p><b>Directors, senior management and chief agent (Responsible Persons)</b></p> <p>The ICA provides for the eligibility of Responsible Persons, both individually and collectively, including:</p> <ul style="list-style-type: none"> <li>• At least half the directors of an FRI<sup>52</sup> or a majority of the supreme governing body of a society must be residents in Canada (<i>s167 and s543 of ICA</i>);</li> <li>• Persons that are disqualified from being directors e.g., bankrupts, insurance agents or brokers of the FRI, a minister etc. (<i>s168 of ICA</i>);</li> </ul>

<sup>52</sup> Please note that the term "FRI" used in ICP 5 does not include branches of foreign insurers, unless otherwise noted.

- No more than two thirds of the directors are affiliated with the FRI and no more than 15 percent of the directors may be employees of the FRI or its subsidiary (*s171 and s172 of ICA*);
- Directors who failed to abstain at meetings due to conflict of interests are ineligible to serve as director in any FRI for a period of five years thereafter (*s212(2) of ICA*);
- The majority of the members of the audit committee and the conduct review committee must not be affiliated with the FRI or employees of the FRI or its subsidiary (*s203 and s204 of ICA*); and,
- The chief executive officer (CEO) and, in the case of a branch, the chief agent must be resident in Canada (*s205 and s579 of ICA*).

OSFI expects every FRI and branch to have a written policy regarding the performance of assessments of the suitability and integrity of its Responsible Persons. Responsible Persons are defined to include directors, senior management and chief agent. The policy includes obtaining evidence that Responsible persons possess the required education, skills, professional qualifications and experience. A financial group may adopt one umbrella policy for the entire group. The policy should address: a) Identification of the Responsible Persons subject to assessments; b) timing of the initial and update assessments; c) key practices, e.g., decision making process; and d) assessment procedures, e.g., who conducts the assessment, information to be obtained. The assessment policy and information should be retained for a reasonable period of time and made available to OSFI on request. (*Guideline E-17 – Background Checks on Directors and Senior Management of FRIEs*)

Directors and senior management, or in the case of a branch, the chief agent, must complete the Security Information Form to facilitate Canadian law enforcement and intelligence agencies in conducting the requisite security assessments. FRIEs and branches are expected to independently verify Responsible Persons' criminal records at least every seven years.

OSFI's Corporate Governance Guideline (CGG) expects FRIEs' boards to collectively bring a balance of expertise, skills, experience and perspectives taking into consideration the FRIE's strategy, risk profile and overall operations. OSFI has been tracking the composition of the large L&H FRIEs' boards against its expectation for relevant financial industry and risk management expertise. As part of its corporate governance horizontal review, the competency evaluation process and board succession processes of FRIEs were assessed. This included discussions with the Board Chair, and Chairs of other committees as appropriate, and review of independence policies for board members .

#### **Appointed actuaries (AA)**

The AA must be a Fellow of the Canadian Institute of Actuaries (CIA) and are subject to the CIA's Rules of Professional Conduct. OSFI expects all FRIEs and branches to implement an independent peer review processes on the work of their AAs, which is conducted at least once every three years. *Guideline E-15 – Appointed Actuary: Legal Requirements, Qualifications and Peer Review*).

The CEO, chief operating officer or chief financial officer of a FRIE as well as the chief agent of a branch may not be appointed or hold the position of actuary unless

	<p>authorized by OSFI. (<i>s359.1 and s 624.1 of ICA</i>)</p> <p><b>Key persons in Control Functions</b></p> <p>While there is no explicit suitability criteria of key persons in risk management, compliance and internal audit functions, OSFI considers that Key Persons in Control Functions are covered in its definition of senior management (Responsible Persons above) i.e., the chief agent of a branch, and the CEO, chief financial officer and any other officer of a FRI who has a functional reporting line directly to the board of directors or CEO.</p> <p>FRI and branches are required to file an annual return listing board members, senior management and certain key persons in control functions (chief compliance officer, chief anti-money laundering officer, chief financial officer, business continuity/disaster recovery coordinator, appointed actuary, chief agent). They must also file the Notice on Change of Corporate Information within 15 days of any change, which include changes: in particulars of directors, resignation/retirement, new appointments; vacancy in or change of auditor or the designated member of the audit firm; and a vacancy in or change in any of the Functional Appointments.</p> <p>A FRI or a branch that is subject to supervisory measures to improve its financial safety and soundness is required to furnish information on its directors, chief agent (branch) and senior officers<sup>53</sup>, prior to the appointment. OSFI may disqualify the appointment on the basis of competence, business record, experience, conduct or character of a person. (<i>s678.1 and s678.3 of ICA</i>)</p> <p>OSFI may also order the removal of a person from office as a director, senior officer or chief agent if the person is not suitable to hold that office: a) on the basis of competence, business record, experience, conduct or character; or b) because the person has contravened or has contributed to the contravention of the ICA; an order, direction, condition or, limitation has been imposed by OSFI; or a prudential agreement with OSFI (ICP 11). Where the interests of policyholders or the public may be compromised, OSFI may suspend the appointment for 10 days pending representation by the person concerned. The person may appeal against OSFI's decision to the Federal Court. A removal order is not stayed by an appeal. (<i>s678.2 of ICA</i>)</p> <p>Where OSFI becomes aware, through its supervisory processes, that a significant owner's financial condition is having, or may have, negative implications for a FRI's financial condition, the FRI will be staged or monitored more closely and its capital requirements may be adjusted, if deemed necessary to account for the risk. In addition, the Minister may require a holder of a significant interest to dispose of any number of shares specified (ICP 11).</p>
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<sup>53</sup> A senior officer means the CEO, secretary, treasurer, controller or actuary or any other officer reporting directly to the board of directors or CEO.

	<p><b>Supervisory practices</b></p> <p>While OSFI assesses the competence and experience of directors, senior officers and key persons and verifies the existence of any criminal records at incorporation and as part of its supervisory process, it generally relies on FRI's or branches' internal processes for assessing the ongoing suitability and integrity of these individuals post authorization. Where warranted, OSFI applies a risk-based approach and may exercise its general power to obtain information, requiring a FRI/branch to demonstrate the suitability of persons. It may exchange information on suitability of persons, where necessary. (s674 of ICA)</p>
Assessment	Observed.
Comments	The ICA provides for the eligibility of Responsible Persons, which is supplemented by OSFI's guidelines on its expectation for FRI's/branches to establish and implement assessment policies and procedures to assess suitability of persons, including the scope of persons to be assessed. OSFI generally relies on the internal processes of FRI's/branches and may require a FRI/branch to demonstrate the suitability of persons where warranted. Change in Responsible Persons (defined as a member of the Board or a Senior Officer) must be notified to OSFI. OSFI is empowered to disqualify or remove persons found not suitable to hold the relevant positions.
<b>ICP 6</b>	<p><b>Changes in Control and Portfolio Transfers</b></p> <p>Supervisory approval is required for proposals to acquire significant ownership or an interest in an insurer that results in that person (legal or natural), directly or indirectly, alone or with an associate, exercising control over the insurer. The same applies to portfolio transfers or mergers of insurers.</p>
Description	<p><b>Changes in control</b></p> <p>Control is defined as follows:</p> <ul style="list-style-type: none"> <li>a) Control in law: more than 50 percent of the votes and sufficient to elect the majority of the directors on the board of an incorporated entity (including a FRI); more than 50 percent of the ownership interests, and the ability to direct the business and affairs of an unincorporated entity; general partner of a limited partnership; (s3(1)(a), s3(1)(b) and s3(1)(c) of ICA);</li> <li>b) Control in fact:<sup>54</sup> through direct or indirect influence. (s3(1)(c) of ICA); and</li> <li>c) Deemed control—A person who controls an entity is also deemed to control any entity that is controlled, or deemed to be controlled, by the entity. In addition, in relation to voting shares and other ownership interests, one must consider securities beneficially owned by entities controlled by the person in the consideration of that person's control. (s3(2) and s3(3) of ICA)</li> </ul> <p>Except in the case of increases in significant interests, which are addressed further below, approvals by the Minister (and therefore notifications to the Superintendent, who</p>

<sup>54</sup> OSFI has issued guidance on the control in fact concept. (*Advisory 2007-02—Control in fact, Ruling 2008-03 - Control in fact—Major shareholder and service provider. See also the Guidelines Respecting Control in Fact for the Purpose of Subsection 407.2(1) of the Insurance Companies Act.*)

receives the requests for such approval and makes recommendations to the Minister) are generally required in respect of:

- a) an acquisition by a person (legal or natural, whenever this term is used) of shares of a FRI that will cause the person to have a significant interest in a class of shares in a FRI. (*s407(1) of ICA*);
- b) an acquisition of control of an entity that will cause a person to have a significant interest (*s407(1) of ICA*);
- c) an acquisition of control in fact of a FRI (*s407.1(1) of ICA*); and
- d) a deemed acquisition of a) to c) where an entity that would result from an amalgamation, a merger or a reorganization would have a significant interest in or control in fact of an insurer (*s407(2) and 407.1(2) of ICA*).

Significant interest is defined as owning, directly or indirectly, more than 10 percent of the total outstanding shares of a class of shares. (*s8 of ICA*)

Subject to 3 a) below, in the case of increases in significant interests, approvals by the Minister are required in respect of:

1. An acquisition of shares that will increase, by at least 5 percent in a significant interest in a FRI (*s407(1) and s409 of ICA*);
2. An acquisition of control of an entity that will increase, by at least 5 percent a significant interest in a FRI (*s407(1) and s409 of ICA*); and
3. An acquisition of control in fact of a FRI by acquiring additional shares (*s407.1(1) of ICA*).

a) Increases when control in law

Where a person has control in law over a FRI, acquisitions of additional shares of the FRI by that person are not subject to any further approval or notification (*s410(1)(b) of ICA*).

b) Decreases

While there is no explicit requirement for notification, FRIs are required to file annual returns which include information regarding their shareholders. For L&H insurers, the information required covers persons with significant interests and their shareholdings. For P&C insurers, the information required regarding shareholders is not limited to persons with significant interests. In addition, OSFI supervisors request FRIs to notify it of any material changes in their businesses and affairs. In all cases of significant decreases below the predetermined control levels, the insurers have notified OSFI either in advance or forthwith after learning of the decreases. (*s665(1) of ICA*)

All the approval requirements mentioned above apply regardless of the jurisdiction of the prospective or actual owner. OSFI has issued guidance on the information to be submitted in an application for the above approvals, including information on the intended beneficial owners. Where the acquirer is subject to supervision, the following information must be provided to facilitate coordination with relevant supervisors: the name, address and telephone number of the foreign regulatory contact; and confirmation that the home supervisor is aware its intention acquire or increase a significant interest in, and/or to acquire control of a FRI and confirmation that approval from home supervisor has been obtained (if required). (*Transaction Instruction A No. 23 – Acquisition of a Significant Interest and/or Acquisition of Legal Control of a Federally Regulated Entity*)

Factors considered by the Minister in approving an application for control in law, which are essentially the same as those applicable for incorporation of FRIs, include: the nature and sufficiency of the financial resources of the applicant(s); the soundness and feasibility of the business plans; the business record and experience of the applicant(s); the character and integrity of the applicant (s); whether the management team comprises persons with suitable competence and experience; integration of the operations of the applicant(s) with the insurer's businesses; whether the resulting corporate structure hinders supervision; the best interests of the financial system in Canada; national security; and Canada's international relations and its international legal obligations. (Section 420, paragraph 1016.1(1)(a) and paragraph 1016.1(1)(b) of ICA).

No person can exercise *de facto* control over the widely-held<sup>55</sup> FRI holding companies of the demutualized FRIs. In this regard, restrictions apply in respect of Manulife and Sun Life: a) other than their current widely-held holding companies, , no person may exercise *de facto* control over these demutualized FRIs and they cannot have a major shareholder; and b) their widely-held holding companies cannot be subject to *de facto* control or have a major shareholder. The Minister has the discretion to remove these restrictions. (s407(4) to (9) and s407.2 of ICA).

Unless exempted by the Minister, a FRI that has more than Can\$2 billion in equity must have at least 35 percent of its voting shares listed on a recognized Canadian stock exchange; and those listed share must not be beneficially owned by a person who holds beneficial ownership of 20 percent or more of a class of the FRIs voting shares. If the FRI fails to comply, the Minister may issue an order to limit its average total asset. (s411, s2(3), s412 and s414 of ICA).

Where it can be reasonably deduced that a proposed controlling shareholder would be prejudicial to policyholders, the Superintendent would not recommend that the Minister approve the application. Where it is proposed that an insurer become part of a group structure that may affect effective supervision by OSFI, the Superintendent has routinely obtained a legally binding undertaking from a controlling shareholder to addresses this concern (e.g., providing the Superintendent with notices of prospective acquisitions by the shareholder). Where a controlling shareholder is an unregulated entity, the Superintendent has obtained an undertaking to comply with certain capital/leverage ratios. In addition, OSFI expects the ultimate owner to provide a support principle letter to acknowledge the responsibility to support the operations and capital needs of the FRI.

#### **Mutualization and conversion of companies**

The Minister may approve a mutualization proposal from an insurance company. Before applying to the Minister, the mutualization proposal must be approved by shareholders and policyholders entitled to vote via a special resolution. In determining whether to approve a mutualization proposal, the Minister must be satisfied that: a) the proposal

<sup>55</sup> A company is deemed as widely held if it has no major shareholder. A major shareholder is a person who holds beneficial ownership of 20 percent or more of a class of a FRI's voting shares or 30 percent or more of a class of a FRI's non-voting shares. (s2(3) and s2(4) of ICA).



	<p>was approved by the shareholders and policyholders; b) the conversion may reasonably expected to be achieved; c) there are no reasonable grounds for believing that the conversion would cause contravention of capital adequacy and liquidity requirements; d) the stated capital of the company has ceased to be an important factor in safeguarding the interests of the policyholders; e) the purchase price for the shares is fair and reasonable; and f) the proposal is in the best interests of the financial system in Canada. The purchase of shares is subject to the approval of the Superintendent on the conditions that: a) the purchase would not cause contravention of capital adequacy and liquidity requirements; and b) the stated capital of the shares has ceased to be an important factor in safeguarding the interests of the policyholders. (<i>s226 to s236 of ICA</i>).</p> <p>The Minister may, on the recommendation of the Superintendent, approve a conversion proposal from a mutual company that has been approved by its eligible policyholders. The mutual company must have sent to each eligible policyholder a notice of the meeting to approve the special resolution of the conversion; describing the conversion proposal in sufficient detail that policyholders can form a reasoned judgment about the terms of the proposal and its impact on the company and policyholders. (<i>s237 of ICA and Mutual Company (Life Insurance) Conversion Regulations</i>).</p> <p>On June 30, 2011, the Minister launched public consultations aimed at developing a framework for the demutualization of Canadian P&amp;C insurers. The Minister will wait until this framework is in place before making any decision to approve or deny such a demutualization request.</p> <p>The Minister issues letter patent which effect the amalgamations of insurers. Before submitting their amalgamation proposal to the Minister, the applicants must enter into an amalgamation agreement approved by the Superintendent and accompanied by a report from an Independent Actuary (see below). The agreement must also be approved by eligible shareholders and policyholders via a special resolution. The criteria used by the Minister in deciding whether to issue the letter patent are essentially the same as those applicable for incorporation of FRIs. (<i>s245 to s248 and s250 of ICA</i>)</p> <p>Special considerations apply if one of the applicants for amalgamation involve a converted company that has an aggregate of surplus and minority interests of Can\$5 billion or more; or a widely-held FRI; or an insurance holding company that controls such a converted company. The Minister may not issue the letters patent unless the amalgamated company is: a) widely held; or b) controlled by a widely-held company or widely-held insurance holding company. (<i>s250(6) of ICA</i>)</p> <p><b>Portfolio Transfer</b></p> <p>A proposed transfer agreement must be available for inspection by policyholders, shareholders and members, who, in the case of a transfer of all or substantially all assets or policies/liabilities<sup>56</sup> must approve the proposal by a special resolution. An insurer must submit an application to the Minister within three months of the passing of the special</p>
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<sup>56</sup> OSFI would generally consider the term “substantially all” to mean 75 percent or more of assets, liabilities or policies.

	<p>resolution. At least 30 days before the application, an insurer must publish a notice of the proposed transfer in the <i>Canada Gazette</i> and in a newspaper. A transfer of all or substantially all of the risks undertaken by an insurer or the sale of all or substantially all of an insurer's assets is subject to the approval of the Minister. Less substantial portfolio transfers are approved by the Superintendent. In both cases, a report by an Independent Actuary may be required. The Superintendent and the Minister are to be satisfied that the interests of the policyholders of the transferor and transferee will be protected. (<i>s254 and s257 of ICA and OSFI Transaction Instruction A No. 10—Transfer or Reinsurance of Business, Sale of All or Substantially All Assets, Transfer of All of Substantially All Liabilities</i>)</p> <p>Where the insurer is insolvent, approval from a court is required to effect a portfolio transfer either in whole or in part (<i>s162 of WURA</i>).</p> <p><b>Report by an Independent Actuary</b></p> <p>The purpose of the report is to ensure that an independent party<sup>57</sup> assesses the effects of the proposed transaction on policyholders' interests. The report should identify the effects on policyholders and opine on the fairness of the transaction to the policyholders. OSFI has issued guidelines on the scope and content of the report. In particular, the report should address the overall assessment of the effect of the transaction on the reasonable expectations of policyholders and whether the transaction is equitable to all classes and existing generations of policyholders. (<i>OSFI Guideline E-14: Role of the Independent Actuary</i>).</p>
Assessment	Observed.
Comments	<p>The ICA sets clear ownership and control thresholds above which approval is required. The Minister is vested with the authority to approve proposals to acquire or increase significant ownership or interest in a FRI, based on essentially the same criteria as those for the incorporation of FRIs. While FRIs are not explicitly required to notify OSFI in the case of a significant decrease in the ownership by a person(s) below the pre-determined control level, such cases may be identified through OSFI's supervisory process. FRIs need to obtain approvals from the Minister to transfer all or substantially all of their business to another insurer while the Superintendent approves less substantial portfolio transfers.</p> <p>It is recommended that OSFI requires FRIs to notify OSFI of a significant decrease in the ownership by a person(s) below the pre-determined control level.</p>
<b>ICP 7</b>	<p><b>Corporate Governance</b></p> <p>The supervisor requires insurers to establish and implement a corporate governance framework which provides for sound and prudent management and oversight of the insurer's business and adequately recognizes and protects the interests of policyholders.</p>
Description	Because they are incorporated under the ICA, FRIs are not subject to the requirements

<sup>57</sup> The Independent Actuary should not have done any work for the companies involved and does not work for a company that provided services to these companies, over the past two years.

<p>on corporate governance in general company law, although some are bound by the provisions of securities laws in relation to issuance of securities and listing requirements.</p> <p>The framework for FRI corporate governance is set out in both the ICA and OSFI guidelines. The ICA requires that:</p> <ul style="list-style-type: none"> <li>• the directors of a company shall manage or supervise the management of the business and affairs of the company; (<i>s165(2) of ICA</i>)</li> <li>• every director and officer of a company in exercising any of their powers and discharging any of their duties shall: <ul style="list-style-type: none"> <li>○ act honestly and in good faith with a view to the best interests of the company; and</li> <li>○ exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances. (<i>s166(1) of ICA</i>)</li> </ul> </li> <li>• the directors of a company establish an audit committee with specific responsibilities in relation to financial reporting and control; and a conduct review committee to manage conflicts of interest in relation to dealings with related parties (<i>s165(2) of ICA</i>).</li> </ul> <p>OSFI's Corporate Governance Guideline applies to all FRIs, except the branches of foreign insurers, because they do not have boards of directors (although OSFI explicitly looks to the Chief Agent to oversee the management of the branch, including corporate governance; its expectations of the Chief Agent generally are set out in Guideline E-4A).</p> <p>OSFI's Supervisory Framework, supported by the Ratings Assessment Criteria (ICP9), notes that a FRI's board is responsible for providing stewardship, including direction-setting and general oversight of the management and operations of the FRI and that senior management is accountable for implementing the board's decisions, and is responsible for directing and overseeing the operations of the FRI. Boards are also responsible for approving the FRI's overall strategy and risk appetite and for reviewing and discussing the business and financial performance relative to the strategy and risk appetite.</p> <p>OSFI's supervisory work on FRIs includes reviews of board processes to oversee the implementation of the business objectives and strategies and risk appetite. In addition, OSFI undertakes cross-firm work, including a review in 2010–2011 of the three large L&amp;H FRIs' corporate governance. Feedback was provided directly to members of the boards, including Chairs. The review included a particular focus on the work of audit committees, reflecting their central role and responsibilities in financial reporting and control (see below). OSFI noted that they take a proportionate approach to setting expectations for individual FRIs.</p> <p>OSFI supervisors are supported by internal supervisory guides covering aspects of corporate governance requirements; and by risk and governance specialists (credit, market, operational, corporate governance) in the Supervision Support Group.</p> <p>The Corporate Governance Guideline also requires that FRIs establish oversight functions</p>
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	<p>that are independent from operational management and these oversight functions are responsible for providing enterprise-wide oversight of operational management.</p> <p>In relation to board composition and skills, the ICA outlines requirements with respect to a minimum number of directors (at least seven), residency (at least one-half resident Canadians), disqualified persons, and affiliated persons. Requirements for Committees of the board are also outlined in the ICA. (s165, 202 and 265 of the ICA).</p> <p>OSFI's Corporate Governance Guideline notes that:</p> <ul style="list-style-type: none"> <li>• the board should collectively bring a balance of expertise, skills, experience and perspectives, taking into consideration the FRI's strategy, risk profile and overall operations;</li> <li>• relevant financial industry and risk management expertise are key competencies for the board;</li> <li>• boards should have an evaluation process, which should be reviewed annually and updated by the appropriate board committee, to assess the skills and competencies required to oversee the FRI's strategy, products and risk.</li> </ul> <p>The Guideline includes a requirement that the board put in place succession plans with respect to the board, CEO and, where appropriate, other members of senior management, including the heads of the oversight functions. <i>(Page 4 of Corporate Governance Guideline)</i>.</p> <p>The board should be independent from senior management and the Guideline gives guidance that the board's ability to act independently can be demonstrated through practices such as having regularly scheduled board and board committee meetings that include sessions without senior management present. The recruitment process for new directors and the development of a director profile (both responsibilities of the board) should emphasize the independence of board members from senior management. The board should document and approve a director independence policy that takes into consideration the specific shareholder/ownership structure of the FRI. Where appropriate, director tenure should also be factored into the independence policy.</p> <p>OSFI regards the separation of the roles of Chair and CEO as critical to maintaining the board's independence as well as its ability to execute its mandate effectively and has set out a clear message to this effect in the Guideline. <i>(Page 6 of Corporate Governance Guideline)</i></p> <p>OSFI consider an FRI's internal control framework to encompass all the personnel, policies, processes, limits, culture and other aspects of a FRI that support the achievement of the FRI's objectives. It facilitates the efficiency of operations, contributes to effective risk management, assists compliance with applicable laws and regulations, and strengthens the FRI's capacity to respond appropriately to business opportunities and challenges. <i>(Page 6 of Corporate Governance Guideline)</i></p> <p>In relation to the design and implementation of a sound risk management and internal controls, the Corporate Governance Guideline sets out expectations, including that the</p>
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	<p>board should:</p> <ul style="list-style-type: none"> <li>• establish an appropriate risk governance framework, including provision for a risk appetite and, depending on the nature, size, complexity and risk profile of the FRI, a dedicated Board Risk Committee to oversee risk management on an enterprise-wide basis;</li> <li>• appoint a senior officer with sufficient stature and authority within the organization who has responsibility for the oversight of all relevant risks (CRO or equivalent); the CRO should have unfettered access to the board; and</li> <li>• approve the overall internal control framework and monitor its effectiveness by receiving regular reports on the performance of risk management and other control systems, and on any ineffectiveness or significant breaches of controls, code of conduct, or laws and regulation.</li> </ul> <p>In relation to remuneration policy, the Guideline sets out an expectation that all FRIs implement the Financial Stability Board (FSB)'s Principles for Sound Compensation Practices. The three largest L&amp;H FRIs are also required to meet the related FSB Implementation Standards. The board is to approve the compensation of the CEO and, where appropriate, other members of senior management, including the heads of the oversight functions and to review compensation policy generally to be consistent with the FSB Principles. <i>(page 4 of Corporate Governance Guideline)</i></p> <p>In 2009-2010, OSFI undertook a cross-firm review of compensation practices to assess the gaps between current compensation practices and the FSB Principles for Sound Compensation Practices and Implementation Standards.</p> <p>In relation to the board's role in establishing reliable financial reporting processes, while the obligation to approve annual financial statements falls on the board as a whole, the ICA puts particular expectations on the Audit Committee, which has to be comprised of independent directors. The duties of the Audit Committee include:</p> <ul style="list-style-type: none"> <li>• reviewing the annual financial statements of the FRI;</li> <li>• evaluating and approving internal control procedures of the FRI;</li> <li>• meeting with the Chief Internal Auditor and/or the Appointed Actuary to discuss the effectiveness of internal controls and the adequacy of reserving and reporting practices;</li> <li>• approving audit plans (internal and external) and discussing with management and the external auditor the results of the audit.</li> </ul> <p><b>AMF</b></p> <p>AMF sets its expectations on corporate governance in its 2009 Governance Guideline, which amplifies requirements in the Insurance Act and applies to FRIs licensed in the province as well as to insurance companies incorporated there. The key requirement is that insurers follow sound and prudent management practices. Other requirements are framed as broad principles for insurers to adopt, providing scope for companies to apply the framework as appropriate to the nature and scale of their business. The Guideline calls in particular for senior management to ensure the implementation of a "culture of governance" and the adoption of "organizational behaviour based on ethics and professional conduct". AMF addresses the effectiveness of corporate governance in its</p>
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	<p>supervision and has taken enforcement action on the basis of inadequate governance. The Supervisory Framework (ICP9) covers insurers' governance programs, including an assessment of the board's oversight of controls and compliance with AMF's requirements.</p> <p><b>FSCO</b></p> <p>FSCO has not issued its own requirements on corporate governance and those in OIA and related regulations apply mainly to insurers incorporated in Ontario. FSCO will assess corporate governance issues as part of its supervision work and looks to the guidelines issued by OSFI for FRIs as the basis for its expectations. However, in line with its general approach to supervision and enforcement, FSCO will only focus closely on corporate governance as part of its industry-wide conduct reviews of targeted risk areas.</p>
Assessment	Observed.
Comments	<p>The ICA and OSFI Corporate Governance Guideline provide for an extensive framework of standards on corporate governance of FRIs. While certain requirements are set out in law and apply to all FRIs, including a requirement to establish an audit committee with prescribed responsibilities, the Guideline recognizes the need for corporate governance arrangements to reflect the circumstances of individual FRIs. OSFI monitors and assesses corporate governance as part of its supervisory approach, looking both at compliance with minimum standards (including Chair/CEO separation as well as the role of the audit committee) and at the effectiveness of corporate governance in practice. OSFI's expectations of the larger FRIs are in line with international practice in areas such as the need for a board Risk Committee and CRO; and OSFI also devotes resources and specialist expertise to oversight of governance at the large insurance groups.</p> <p>AMF has published guidelines in this area and assesses governance in its supervisory work. FSCO's oversight work in this area primarily makes use of monitoring tools such as industry wide assessment questionnaires followed by selected field examinations in targeted risk areas. While FSCO has not published guidelines on governance, it is able to rely on OSFI and AMF Guidelines to set general expectations since the majority of insurance business in Ontario is transacted by companies subject to solvency regulation by OSFI or AMF.</p> <p>It is recommended that the FSCO set out more extensive guidance on its own expectations in relation to corporate governance and market conduct.</p>
<b>ICP 8</b>	<p><b>Risk Management and Internal Controls</b></p> <p>The supervisor requires an insurer to have, as part of its overall corporate governance framework, effective systems of risk management and internal controls, including effective functions for risk management, compliance, actuarial matters, and internal audit.</p>
Description	OSFI's approach to risk management and controls is closely aligned with its overall approach to corporate governance. It relies on its general powers to regulate FRIs in the ICA as the basis for issuing guidelines that set out its detailed expectations. It covers risk management when it assesses risks in individual institutions and develops supervisory plans under its Supervisory Framework (through the Quality of Risk Management

component – see ICP 9); and it carries out supervisory work on the risk management and controls of individual FRIs, focusing more closely on the larger institutions, for example through quarterly meetings with senior management. OSFI also carries out regular cross-firm work; and presents findings to the industry at quarterly risk management seminars.

As a result, OSFI's expectations are transparent (including extensive material in the Corporate Governance Guidelines and Supervisory Framework documents). It also recognizes that effective supervision is necessary to ensure that firms comply in practice.

### **Systems for Risk Management and Internal Controls**

Overall requirements are set out in the Corporate Governance Guideline. Rather than listing the detailed attributes of required risk management and control frameworks, the Guideline places the onus on senior management and on boards of directors respectively to establish frameworks and to oversee their effectiveness. The Guideline defines at a high level what such frameworks should entail, setting out, for example, that an FRI's internal controls encompass all the personnel, policies, processes, limits, culture and other aspects of an FRI that support the achievement of its objectives.

Under OSFI's Supervisory Framework, risk management is assessed at both the operational management level and the oversight functions. The approach makes clear that OSFI holds management of frontline business units primarily responsible for the controls used to manage all of the activity's inherent risks on a day-to-day basis. The role of oversight functions is to provide independent, enterprise-wide oversight of operational management. OSFI identifies seven oversight functions that may be required depending on the nature, size and complexity of the FRI and its inherent risks: financial; compliance; actuarial; risk management; internal audit; senior management; and the board (*OSFI's Supervisory Framework, pages 5 to 6*)

OSFI does not generally set explicit standards or attributes which oversight functions have to meet in order to be considered effective. However, for the CRO, OSFI sets expectations as to the stature and authority of the holder of the role; and there are detailed requirements relating to the role of the AA (see below). It is the role of OSFI's supervisors to assess the effectiveness of oversight functions in practice. This is undertaken through reviews of reports, including management information; through meetings and onsite reviews; and by holding oversight functions responsible where specific control weaknesses are identified. OSFI notes that its supervisors test specifically for evidence that CFOs have been involved in key decisions (by examining board papers, interviewing staff etc). Where hedging programs have been shown to be ineffective, it has reviewed the quality of the contribution of the actuarial function to the relevant decisions.

Where necessary, OSFI has on occasions required FRIs to remove holders of oversight functions from their positions. It has done so invariably through informal means (requests to senior management) rather than through the exercise of formal powers.

For the largest insurance groups, OSFI also assesses effectiveness through its quarterly meetings with key group oversight functions, for example with the CRO and Head of Internal Audit.

### **Risk Management Function**

The Corporate Governance Guideline requires that FRIs have a senior officer who has responsibility for the oversight of all relevant risks across the firm (CRO or equivalent). For small, less complex firms, the CRO role may be held by another executive. All FRIs must, at minimum, have identified an individual within the firm who is accountable to the board and senior management for risk. The CRO should have sufficient stature and authority within the organization and be independent from operational management. The CRO should have unfettered access and a reporting line to the board or the Risk Committee. The Guideline also sets out broad requirements of the risk management function in relation to identifying, measuring, monitoring and reporting on the risks independently of the business lines and operational management.

### **Compliance Function**

The role of the compliance function is set out in the Supervisory Framework and includes setting the policies and procedures for adherence to regulatory requirements in all jurisdictions where the FRFI operates; monitoring the FRFI's compliance with these policies and procedures; and reporting on compliance matters to Senior Management and the Board. OSFI's E-13 Legislative Compliance Management (LCM) Guideline sets out an expectation that the function ensures that key day-to-day LCM controls throughout the enterprise are sufficiently robust to control compliance with legislation and, where significant issues arise, escalate them to senior management and the board as appropriate.

### **Actuarial Function**

There is an extensive framework of requirements relating to the role of the AA (see also ICP14) and also the need for an actuarial function. OSFI Guidelines are clear that the AA and actuarial function are responsible to the board in the same way as other control functions.

The AA has specific responsibilities as set out in the ICA. OSFI's Appointed Actuary: Legal Requirements, Qualifications and External Review Guideline provides that the AA is required to value the actuarial and other policy liabilities as at the end of a financial year. The AA is required to be a Fellow of the CIA. The AA is therefore subject to the CIA's Rules of Professional Conduct. The appointed actuary cannot also be a member of the board. The CEO, COO, or chief agent of a foreign company may not be appointed as AA unless authorized in writing by OSFI. (*s359.1(1), 624.1(1) of ICA*)

The actuarial function is expected to provide not only actuarial input (e.g., on pricing and product development) but also challenge to operational management (i.e., to ensure that business decisions reflect sound actuarial analysis). Detailed expectations of the actuarial function are set out in OSFI's Supervisory Framework, which identifies the role of the function as including:

- an evaluation of the design, pricing and valuation of the insurance products offered by the FRI;
- assessing the reasonableness of provisions set for policy liabilities, and the appropriateness of the process followed;
- reviewing models used to determine exposures, and the adequacy of reinsurance programs to mitigate these exposures;



	<ul style="list-style-type: none"> <li>• analyzing stress testing results, and the process used, to establish the adequacy of capital and capital planning for the FRFI under adverse conditions; and</li> <li>• reporting on the results of its work to Senior Management and the Board.</li> </ul> <p>OSFI meets with the head of actuarial function at the major L&amp;H insurance groups as part of its cycle of quarterly meetings.</p> <p>The emphasis on the actuarial function, which does not have to be headed by the AA, creates some risk that the role and importance of the AA will be diminished within individual FRIs, resulting in reduced focus on the AAR and other responsibilities of the AA. OSFI's oversight of the AAR process, including peer review, and its supervisory assessment of the overall adequacy of actuarial work should identify concerns in practice.</p> <p><b>Internal audit function</b></p> <p>OSFI does not require FRIs to have an internal audit function. Instead, OSFI relies on setting expectations on the internal control framework through the Corporate Governance Guideline in addition to the requirements in the ICA (ICP7) and assessing compliance with these requirements in a manner which takes into account the circumstances of individual institutions. The Corporate Governance Guideline notes that OSFI expects FRIs to establish oversight functions, defined for these purposes to include internal audit, that are independent from operational management. (<i>Corporate Governance Guideline, page 7</i>)</p> <p>The Audit Committee of the Board has a particular responsibility to oversee the effectiveness of controls and to agree on the audit plan of the FRI, both external and internal.</p> <p>In addition, OSFI assesses the adequacy of internal audit as part of its supervisory work. The Supervisory Framework defines the internal audit function as an independent function with responsibilities that include assessing adherence to, and the effectiveness of, operational controls and oversight, including corporate governance processes; and reporting on the results of its work on a regular basis to Senior Management and the Board.</p> <p><b>Outsourcing</b></p> <p>OSFI's B-10 Outsourcing of Business Activities, Functions and Processes Guideline sets out the general approach to outsourcing, including of control functions. It notes that FRIs retain ultimate accountability for all outsourced activities. The Corporate Governance Guideline notes that in small, less complex FRIs, in place of establishing specific oversight functions, OSFI expects that the board and senior management will ensure that other functions or processes within or external to the FRI provide the level of compensating controls or independent enterprise-wide oversight required.</p>
Assessment	Observed.
Comments	OSFI has an extensive framework of requirements for risk management and control functions at FRIs and oversees the effectiveness of the arrangements as part of its

	<p>supervision program. A particular emphasis of the approach is on ensuring that there is a Chief Risk Officer at the major institutions with appropriate stature and authority, including a reporting line to the board. OSFI's approach also provides for a balance between ensuring appropriate stature and significance for actuarial work, supported by the key role of the AA, and fully embedding actuarial work and decisions within the overall corporate governance framework.</p>
<b>ICP 9</b>	<p><b>Supervisory Review and Reporting</b></p> <p>The supervisor takes a risk-based approach to supervision that uses both off-site monitoring and on-site inspections to examine the business of each insurer, evaluate its condition, risk profile and conduct, the quality and effectiveness of its corporate governance and its compliance with relevant legislation and supervisory requirements. The supervisor obtains the necessary information to conduct effective supervision of insurers and evaluate the insurance market.</p>
Description	<p><b>Prudential Supervision by OSFI</b></p> <p>The ICA empowers OSFI to conduct prudential supervision of FRI's through information requirements, regulatory reporting, on-site examinations and inquiries. (<i>Part XV, s664,s 671,s 674 and s675_of ICA</i>)</p> <p><u>Supervisory approach</u></p> <p>OSFI supervises FRI's on a consolidated basis and assess all their material entities (including subsidiaries, branches and joint ventures) both in Canada and internationally. Supervision is principles-based, i.e. supervisors exercise discretion in determining the most appropriate supervisory and regulatory options that are commensurate with the supervisory risk assessments. The intensity of supervision depends on the nature, scale, complexity and risk profiles of FRI's and the potential impact of failure.</p> <p>OSFI has developed a risk-based Supervisory Framework that facilitates timely supervisory intervention to increase the likelihood that corrective measures will be effective in maintaining the safety and stability of FRI's and the financial sector. Under the Supervisory Framework methodology, supervisors are required to:</p> <ol style="list-style-type: none"> <li>a) Understand a FRI's environment, industry and business profile to ascertain its <i>Significant Activities</i> and the materiality/importance of each activity. This covers the business focus, group structure, risk profile and internal control environment. Both qualitative and quantitative factors are used to assess the materiality/importance of an activity;</li> <li>b) Assess the level of risk inherent in these activities and the quality of risk management to determine the <i>Net Risk</i> and the <i>Direction of Risk</i> for each activity. The quality of risk management considers both the operational management and the independent oversight functions<sup>58</sup>;</li> <li>c) Determine a FRI's <i>Overall Net Risk</i> rating, i.e., the weighted aggregation of Significant Activities, taking into account the importance of each activity; and</li> </ol>

<sup>58</sup> OSFI has identified seven Oversight Functions: board of directors, senior management, internal audit, risk management, actuarial, compliance, and financial analysis.

d) Decide on the *Composite Risk Rating* (CRR), which is the overall assessment of a FRI's safety and soundness, combining the Overall Net Risk with explicit consideration of the adequacy of earnings, liquidity and capital.

As at end-March 2012, OSFI had assigned a low or moderate CRR to 92 percent of all rated FRFIs, while the remaining 8 percent were rated as either above average or high risk. (March 2011: 90 percent and 10 percent, respectively).

The methodology also requires an assessment of the overall effectiveness (based on characteristics and performance indicators) of an FRI's oversight functions, at each activity and the FRI level. The objective is to determine the extent to which OSFI can use their work, to minimize duplication of effort and enhance supervisory efficiency and effectiveness. OSFI relies upon FRFIs' external auditors for the fairness of the financial statements. OSFI's assessment of a FRFI's overall financial performance depends upon the FRFI's audited financial statements. OSFI generally found that the quality of external audit is acceptable. While it is reasonable to leverage on the work of external auditors, there are merits for OSFI to assess the quality of their work independently e.g., verification on a sampling basis, so that efficiency is not compromised.

#### Supervisory Process

a) *Planning* - A supervisory strategy for each FRI is prepared annually, which outlines the supervisory work planned for the next three years, with a fuller plan for the upcoming year. Supervisory work for each significant activity is prioritized based on the net risk assessment and the need to update the assessment due to information decay. Similarly, supervisory work for each relevant oversight function is prioritized. The plan includes a process to compare activities across FRIs to ensure that the assessments of individual FRIs are subject to a broader standard, and that supervisory resources are allocated effectively. Work priorities set out in the supervisory strategy and annual plan may be adjusted in response to emerging issues or changes in risk assessments.

b) *Execution and updating risk profiles* - there is a wide range of supervisory activities:

- Monitoring - regular review of information on the FRI and its industry and environment (ICP 24), to keep abreast of changes and identify emerging issues. FRI-specific monitoring may extend to gathering information on material non-regulated entities, such as a holding company or foreign parent company and usually includes discussions with senior management and oversight functions. OSFI periodically requires FRIs to perform specific stress tests.
- Reviews - more extensive supervisory work than monitoring, such as reviews of business processes. The nature and scope of information reviewed, and the location of the review (off-site or on-site), are determined during the planning process. OSFI frequently undertakes comparative or benchmarking reviews to identify standard and best industry practices.
- Updating risk profiles of FRIs - by the relevant relationship manager (RM) designated as the main point of contact. RMs are supported by specialists and other staff. Supervisory assessments are summarized and reported in Section Notes, Risk Assessment Document and Risk Matrix. Key documents are subject to sign-off protocols within OSFI.

OSFI is empowered to require a FRI/branch to provide both regular and *ad-hoc*

information for supervision purposes. Details including the frequency of submission of financial and non-financial regulatory reporting for FRIs are published on OSFI's website. FRIs are subject to penalties for late or erroneous filings. FRIs are required to submit a report by the Conduct Review Committee that includes work done to ensure that transactions with related parties that may have a material effect on the stability or solvency of the insurer are identified. (*s204, s331(4) and s664 to s669 and s671 of ICA*)

FRIs are required to report their off-balance sheet transactions and exposures, including their securities lending and derivatives activities. OSFI's Outsourcing of Business Activities, Functions and Processes Guideline sets out reporting requirements on FRIs' outsourced activities or functions. In particular, OSFI's supervisory powers should not be constrained, irrespective of whether an activity is conducted in-house or outsourced.

OSFI is required to conduct an examination or risk assessment of FRIs/branches (except fraternal benefit societies) at least once every three years. Scoping documents are prepared for on-site reviews based on the risk profile of the significant activity, business unit, or oversight functions being reviewed. (*section 674 of ICA*)

*c) Reporting and intervention* involves various mechanisms:

- Supervisory Letter is the primary written communication to an FRI, written by the RM annually or as appropriate. It summarizes the key supervisory findings and recommendations and/or requirements during the year and indicates the FRI's current CRR.
- Interim Letters may be issued during the year to provide a FRI with timely feedback on issues arising from supervisory activities.

Findings and recommendations are discussed with a FRI before the above letters are issued. Recommendations and responses from the FRI are recorded in a Follow-up Document maintained by the RM, which is reviewed and updated regularly as part of the monitoring process. This document helps to ensure that supervisory concerns are followed through appropriately on a timely basis. OSFI shares the letters with provincial supervisors with whom it has agency agreements. In addition, OSFI shares information, as appropriate, with foreign supervisors (ICP 3 and ICP 25).

Supervisors assign *intervention ratings* to FRIs, which determines the degree of supervisory attention they receive. Broadly, these ratings are categorized as: normal (stage 0); early warning (stage 1); risk to financial viability or solvency (stage 2); future financial viability in serious doubt (stage 3); and non-viable/insolvency imminent (stage 4). As at March 31, 2012, there were 38 staged institutions. With a few exceptions, the majority of the staged institutions were in stage 1. OSFI's Guides to Intervention (ICP 10) summarizes the various supervisory measures and the circumstances under which measures may be expected and escalated.

#### Review of report

OSFI chairs the CCIR Forms Committee, with the mandate to: coordinate the information requirements of OSFI and the provincial supervisors; harmonize the regulatory returns and instructions; and coordinate the consultation with and communication to the

	<p>industry associations.<sup>59</sup> The Committee meets quarterly to effect its mandate.</p> <p><u>Group-wide supervision</u></p> <p>Under OSFI's consolidated supervision, it has authority to inspect regulated entities and regulated head of group both domestically and overseas and has done so regularly for the large life insurance groups (ICP 23). Off-site monitoring of non-regulated entities is largely based on information requests through the FRFIs; public information such as published financial statements or information exchange with other supervisors. OSFI has established dedicated supervisory teams for the three large conglomerate insurance groups.</p> <p><u>Quality assurance of the supervisory process</u></p> <p>The quality and effectiveness of supervisory assessments are supported by extensive supervisory guidance (e.g., guides, and templates for documentation). There are various guides and templates for Significant Activities and the oversight functions for the full spectrum of supervisory review. Supervisory work is reviewed by line management, for consistency and accountability. There is a process to monitor and follow up on prudential issues reported to FRFIs until a satisfactory conclusion is reached.</p> <p>OSFI's planning process includes determining adequate resourcing based on the size, nature, complexity and risk profile of each FRI. Supervisory staff is supported by risk and governance specialists (e.g., credit, market, actuarial, corporate governance) as well as an efficient IT system including OSFI intranet, electronic data management systems,<sup>60</sup> business intelligence tools, etc.</p> <p>Regulatory returns are submitted electronically by FRFIs using the Automated Data Transfer application. The regulatory return processing system incorporates validation rules to check the regulatory return data sent by the FRFIs, prior to the data being accepted and loaded. There are also data validation routines in the OSFI Business Intelligence data warehouse.</p> <p>OSFI's supervisory activities are subject to internal auditing. For example, in 2012, the Internal Audit examined OSFI's supervision of L&amp;H conglomerate groups and assessed the supervisory team's application of OSFI's Supervisory Framework and Guides. In response to the audit findings, OSFI Management has: a) initiated an internal training program in 2012 to discuss how the supervisory methodology is applied in each conglomerate supervisory team through the various stages of the supervisory process; b) strengthened sign-offs on the documentation of supervisory work; and c) formalized processes to ensure appropriate oversight. The Internal Audit planned to review the progress of implementation of these measures in August 2013.</p>
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<sup>59</sup> Currently there is representation from British Columbia, Alberta, Québec, and New Brunswick as well as OSFI.

<sup>60</sup> The Tri-Agency Database System is shared with the BoC and Canada Deposit Insurance Corporation, supporting all three organizations in collecting, validating, managing and maintaining financial returns.

## **B. CoB Supervision**

While the CCIR has formulated a risk-based approach for CoB supervision<sup>61</sup>, each provincial supervisor has the discretion to implement the risk-based approach. CCIR defines risk-based market conduct regulation as “directing regulatory efforts to the most significant issues that either have the greatest potential for consumer harm or that could weaken public confidence if left unchecked. In a risk-based approach, regulators prioritize issues based on their potential impact (risk) to the achievement of desired regulatory outcomes.” FSCO adopted the CCIR’s risk-based approach and the AMF used the risk-based approach in the development of their framework.

### **AMF**

AMF is empowered to require insurers to submit regulatory information, conduct on-site examinations, including delegating this authority to any person it may designate. (*s9 & s10 of AMF Act and Chapter V, s10 & s317 of IA*).

AMF has adopted a risk-based Supervisory Framework in March 2009, which is updated at least every three years; and was last revised in October 2011. The Supervisory Framework is built on three phases:

- a) *Phase A—Risk profile.* AMF identifies the Significant Activities for each insurer through the analysis of business plans and strategies. This is followed by an analysis of inherent risks for each significant activity and an evaluation of the quality of risk management and financial condition to determine an insurer’s risk profile.
- b) *Phase B—Supervisory plan.* AMF develops a three-year supervisory plan based on each insurer’s risk profile and allocates resources accordingly. The plan is updated as necessary and at least annually. Supervisors work together with the RM appointed for each insurer, who assesses the extent of reliance on third parties such as external auditor, appointed actuary and where applicable, another supervisor.
- c) *Phase C—Supervision activities.* AMF uses the CCH TeamMate software to record off-site and on-site supervision activities. Supervisory programs are standardized and automated, covering the supervisory process, scope and key elements. Follow-up activities are monitored via the TeamCentral to ensure satisfactory resolution.

AMF conducts on-site examinations of insurers to assess their market conduct either on a thematic basis either as part of its routine supervisory activities or to address specific emerging supervisory concerns.

AMF holds insurers responsible for complying with the regulatory requirements applicable to outsourced activities. As part of its supervision, AMF examines their outsourcing strategies, policies and procedures as well as the quality of oversight exercised by their boards and senior management. AMF has inspected service providers of functions outsourced by insurers e.g., MGAs. (*Outsourcing Risk Management Guideline*)

The CAD has been authorized by AMF to carry out inspections of small-scale P&C

<sup>61</sup> CCIR: An Approach to Risk-Based Market Conduct Regulation, October 2008.

intermediaries and claims adjustment firms consisting of 24 representatives or less, in accordance with the inspection program approved by AMF. AMF verifies that the CAD complies with the provisions of the cooperation agreement and that it has adequate and competent resources to conduct effective inspections.

### **FSCO**

FSCO has the authority to require insurers and intermediaries to provide relevant information relating to insurance business and conduct on-site inspections of insurers and intermediaries. However, FSCO has no explicit authority to supervise insurance groups/non-regulated entities or service providers for activities that are outsourced by an insurer. Nonetheless, FSCO may employ indirect means, e.g., through outsourcing agreements of insurers. (*s30 to s32 and s102 of OIA*)

FSCO's risk-based approach to CoB supervision is supported by documented supervisory procedures and established performance standards, including standard criteria, assessments, communications with licensees, escalation of compliance issues and timely conclusion of reviews. It also relies on other supervisors and industry associations for practices and guidelines, e.g., CCIR's Best Practices for Regulatory Surveys.

Insurers' statutory filings to FSCO are largely confined to solvency information. Typically, they are requested to complete surveys and self-assessment questionnaires regarding their business practices. FSCO also analyzes consumer complaints as an indication of insurers' market conduct. It has conducted several market conduct assessments of L&H and auto insurers to ensure that agents are well supervised, that only approved auto rates are used and that claims and complaints are handled in a reasonable manner.

Constrained by its limited resources, FSCO's supervisory activities are typically triggered by industry intelligence, complaints, or reports of contraventions. Under either its industry-wide targeted or reactive supervisory approaches, FSCO has adopted a risk-based approach to the scope, nature, form and frequency of information requests as well as a risk-based approach with respect to the degree of review of material received. This is compounded by the large number of insurers and intermediaries under FSCO's purview; and the various products and distribution channels involved. For example, while FSCO assesses governance related to its industry-wide assessment of targeted market conduct risks, FSCO lacks resources to undertake across the board proactive assessments of insurers' governance relating to CoB issues.

Over the past few years, FSCO has undertaken a number of industry-wide market conduct reviews: a) surveys, e.g., on insurance agents' observance with the CCIR Principles of Managing Conflict of Interest; b) on-site reviews to determine if FSCO could rely solely on the questionnaire responses or to assess the controls described in the questionnaires, e.g., supervision of agents selling segregated funds; and c) on-site market conduct reviews of the six insurers dominant in the title insurance market. For thematic reviews, such as controls related to claims handling, antifraud measures and using approved premium rates, FSCO sets a multi-year program, adjusting the work to reflect changes in legislation or regulations and the marketplace. For 2012, FSCO conducted a total of 8 examinations of insurers, six of which were related to anti-fraud measures in 14 insurers. Going forward, FSCO plans to conduct assurance examinations

	<p>on a four-year cycle.</p> <p>At the end of an inspection, FSCO meets with the insurer's management to discuss the findings and recommendations. A post examination letter will be sent confirming the findings and recommendations and indicating the timeframes for implementation or submit a plan to address the issues. FSCO also conducts examinations where the Superintendent has issued a compliance order and the insurer has signed an undertaking to confirm implementation of the order. If there is a failure to comply, FSCO will take further regulatory action.</p>
Assessment	Largely observed.
Comments	<p>OSFI's risk-based Supervisory Framework facilitates structured and comprehensive supervisory risk assessment as well as prompt and consistent supervisory actions. While OSFI collects extensive regulatory, statistical, and capital related information at the consolidated level and the solo FRI level, some of the information collected is less granular on a non-consolidated basis. There is no standardized reporting of intra-group transactions. In addition, the current scope of related party transactions for the purposes of reporting to OSFI by FRIs' Conduct Committees is narrower than intra-group transactions with broad exemptions including reinsurance transactions (ICP 23). There are clear scoping statements and processes for onsite reviews. OSFI issues annual Supervisory Letters on its key findings and recommendations and Interim letters, as appropriate. The Supervisory Framework helps to ensure that supervisory activities are documented and followed through in a timely manner. OSFI is empowered to inspect service providers of outsourced functions and has conducted such inspections.</p> <p>Both AMF and FSCO adopt a risk-based approach to CoB supervision. AMF's Supervisory Framework is closely aligned with international best practices. AMF has authorized the CAD to conduct inspections of small-scale P&amp;C intermediaries and claims adjustment firms, subject to its oversight. Constrained by limited resources, FSCO adopts both reactive and industry-wide targeted risk-based approaches to CoB supervision.</p> <p>There is scope to enhance and standardize regulatory reporting of intra-group transactions, supported by a clear definition of the scope of intra-group transactions. OSFI should also review the level of detail of its reporting requirements applying to solo FRIs. It is also important to equip FSCO with adequate supervisory resources to deal with the size and diversity of the Ontario marketplace.</p>
<b>ICP 10</b>	<p><b>Preventive and Corrective Measures</b></p> <p>The supervisor takes preventive and corrective measures that are timely, suitable and necessary to achieve the objectives of insurance supervision.</p>
Description	<p><b>OSFI</b></p> <p>The ICA prohibits a company or society from carrying on insurance business without obtaining an Order to commence and carry on business from the Superintendent. The provincial supervisors are the licensing authorities in Canada and the licensing regime is described in ICP 4. (<i>s52(1) of ICA</i>)</p>



	<p>If OSFI suspects that an entity is conducting business in Canada without an Order, OSFI will write to the entity requesting its business model to determine if it is conducting business in Canada. If the response is unsatisfactory (or no response is obtained), OSFI would contact the home supervisor of that entity (if applicable). If OSFI determines that the entity is conducting insurance business in Canada, it would encourage such persons to cease and desist from their activities but would pursue judicial action, if necessary. When a provincial supervisor determines that an entity is conducting insurance business in that province/territory without a license, it has the authority to apply for a judicial order directing the entity to obtain a license or restraining the entity from conducting the business. OSFI uses public warning notices posted on its website to advise the public of individuals or entities that may be conducting insurance activities without the necessary license.</p> <p>The Superintendent has a wide range of corrective and preventive measures, which may be administrative in nature or supported by statutory powers. Administrative measures include: moral suasion; notifying management, board of directors and/or external auditor by way of a Supervisory Letter; meetings with management, board of directors, chief agent and/or external auditor to express concerns and discuss measures to improve the situation; meetings with parent board of directors; increasing the frequency and intensity of monitoring and reporting requirements; conducting enhanced and more frequent supervisory reviews; establishing an on-going presence at the insurer; directing external specialists to assess certain areas of risk; and requiring an insurer to develop specific and detailed contingency plans.</p> <p>The intervention process is designed to identify concerns at an early stage to minimize losses to policyholders and other creditors. OSFI's Guide to Intervention for Federally Regulated Life Insurance Companies sets out the primary interventions that OSFI might use and various intervention ratings with progressive escalation of the measures as the ratings worsen. The Guide also outlines inter-agency and Assuris protocol, and the role of Assuris at each stage. The Guide to Intervention for Federally Regulated Property and Casualty Companies set out the primary interventions at various stages. A fundamental tenet of the intervention process is that intervention actions are commensurate with the severity of the FRI's problems.</p> <p>OSFI is empowered to take the following supervisory interventions:</p> <ol style="list-style-type: none"> <li>a) Execute a prudential agreement<sup>62</sup> with an insurer on implementing measures designed to maintain or improve its safety and soundness or to protect the interests of policyholders and creditors. (<i>s675.1 of ICA</i>)</li> <li>b) Amend or revoke an authorization to insure risks, which may be used to prohibit the writing of new business or a class of business (<i>s59 and s586 of ICA</i>);</li> <li>c) Issue a direction of compliance, e.g., to cease activities, where there is a threat to the safety and soundness of the FRI or where the FRI is not being cooperative (<i>s676 of ICA</i>)</li> <li>d) Require an external auditor to enlarge the audit scope and/or to perform other</li> </ol>
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<sup>62</sup> A prudential agreement will generally be used in cases where the threat to safety and soundness is not imminent or well-defined.

	<p>procedures (s348 of ICA);</p> <p>e) Order a FRI to amend its policies regarding the creation of security interests in its property and the acquisition of beneficial interests in a property that is subject to a security interest. (s470 of ICA); and</p> <p>f) Order a FRI or a branch to increase capital or meet liquidity requirements or to increase assets maintained in Canada (s515, s608 and s609 of ICA)</p> <p>A FRI or a branch must comply with an Order issued by OSFI. OSFI may apply for a court order to compel compliance with a prudential agreement or direction or to cease a contravention of the ICA. (s678 of ICA).</p> <p><b>AMF</b></p> <p>In April 2013, AMF published guidelines on its intervention process that details a framework of interventions based on insurers' risk profiles, with intervention stages of 1 to 5. For example, at Stage 3, "Watch Condition", AMF may: demand additional information, request a valuation by an independent actuary or order additional external audit work. (<i>The Intervention Guidelines for Québec-Chartered Life Insurers and Assuris Member Companies</i>)</p> <p>AMF's powers to take corrective and preventive measures is exercised through: a) written instructions to rectify a situation which is confidential; b) a commitment by a FI to file certain documents or information with AMF; c) guidelines which are not prescriptive that a FI generally follows to the letter; d) orders to do or not do something, which may be published in the <i>Bulletin de l'Autorité des marchés financiers</i>; and e) injunction.</p> <p><b>FSCO</b></p> <p>FSCO has sufficient tools available to enforce its preventative or corrective measures. Tools include cease and desist orders, issuing a compliance order for unfair or deceptive acts or practices. Continued failure to address FSCO's concerns may result in enforcement actions.</p>
Assessment	Observed.
Comments	<p>The supervisors are empowered to take action against a person who conducts insurance business without the necessary Order from OSFI or license from AMF or FSCO. OSFI's Supervisory Framework supports early intervention and OSFI has published guidance on its approach to taking progressive escalation of actions or remedial measures at each stage of the intervention ratings assigned to FRIs and severity of the situation. OSFI has adequate powers to initiate timely and proportionate preventive and corrective measures where FRIs are unable or unwilling to adequately address supervisory concerns. Similarly, AMF and FSCO have adequate legal authority to take preventive and corrective measures relating to CoB issues.</p> <p>The staging process is a powerful tool in influencing FRIs' behaviour to achieve the intended supervisory outcome and it is important that OSFI strike a good balance between timely staging as a result of persistent concerns, and the need to maintain pressure on the institution to make meaningful progress over a credible and situation-specific appropriate timeline in order to exit staging.</p>

<b>ICP 11</b>	<p><b>Enforcement</b></p> <p>The supervisor enforces corrective action and, where needed, imposes sanctions based on clear and objective criteria that are publicly disclosed.</p>
Description	<p>The following enforcement powers under the ICA are vested with the Minister:</p> <ul style="list-style-type: none"> <li>a) Impose limit on the assets held by a converted company, on the recommendation of the Superintendent if the Minister is of the opinion that it is in the best interests of the financial system in Canada to do so (<i>s59.1 of ICA</i>); and</li> <li>b) Direct the disposition of shares by any person who hold shares in an FRI in contravention of the relevant provisions of the ICA (<i>s432 of ICA</i>); and</li> <li>c) Where the Superintendent takes control of a FRI itself or of the assets of a FRI for more than 16 days, the Minister has a public interest veto power (<i>s679 of ICA</i>).</li> </ul> <p>OSFI may exercise the following enforcement powers:</p> <ul style="list-style-type: none"> <li>a) Order repatriation of management functions where the outsourcing of all or substantially all of those functions is deemed inappropriate (<i>s528 of ICA</i>);</li> <li>b) Remove a person from office as a director or senior officer (<i>s678.2 of ICA</i>);</li> <li>c) Revoke the appointment of an auditor; (<i>s340 of ICA</i>)</li> <li>d) Order a FRI to divest investments acquired in contravention of the ICA; (<i>s510 of ICA</i>)</li> <li>e) Revoke, suspend, or amend an approval (<i>s1016.4 of ICA</i>)</li> <li>f) Direct a foreign fraternal benefit society to transfer or reinsurer all of a portion of its policies; (<i>s678.5 and s678.6 of ICA</i>)</li> <li>g) Assume control of a FRI's assets and assets under administration (see below);</li> <li>h) Request the Attorney General to apply for a winding-up order under the Winding-up and Restructuring Act (WURA); (<i>s684.1 of ICA</i>)</li> <li>i) Apply for a court order restraining continued breaches of the ICA or related regulations; (<i>s1031 of ICA</i>)</li> </ul> <p>OSFI's intervention framework is not delayed by the process of applying sanctions. As CMHC is a Crown corporation, OSFI does not have legal authorities to take enforcement actions in the case of CMHC.</p> <p>OSFI has rarely used its enforcement powers, as its preference is to resolve issue via moral suasion, which has worked well. For example, OSFI has not removed any Responsible Person as FRIs would take appropriate action voluntarily.</p> <p>OSFI may take control of the assets of a FRI or of the FRI itself under the following circumstances: a) failure to pay its liabilities or will not be able to pay its liabilities as they become due and payable; b) assets are insufficient for adequate protection of policyholders and creditors; c) assets not satisfactorily accounted for; d) regulatory capital has reached a level or is eroding in a manner that may be detrimental to policyholders or creditors; e) failure to comply with a capital/assets order issued by the Superintendent; or f) any other state of affairs that may be materially prejudicial to the interests of policyholders or creditors or the owners of any assets under the insurer's administration. (<i>s679 of ICA</i>)</p>

The ICA provides for various offences that are subject to sanctions:

- a) in the case of a natural person - on summary conviction, a fine of up to Can\$100,000 or to imprisonment for up to 12 months, or to both; or on conviction on indictment, a fine of up to Can\$1,000,000 or to imprisonment for up to five years, or to both; and
- b) in the case of an entity—on summary conviction, a fine of up to Can\$500,000; or on conviction on indictment, to a fine of up to Can\$5,000,000.

The court may, if it is satisfied a convicted person has acquired monetary benefits, impose an additional fine equal to three times the estimated monetary benefits. (*s1023 to s1027 of ICA*).

In addition, the OSFI Act and the Administrative Monetary Penalties (OSFI) Regulations provide for an administrative penalty regime<sup>63</sup>. Penalties are to be imposed in a proportionate manner, taking into account: a) the degree of intention or negligence; b) the harm done by the violation; c) the history of the person who committed the violation in the previous five years; and d) any other prescribed criteria. The maximum penalty for a violation is: a) for a natural person, Can\$10,000 for a minor violation<sup>64</sup>, Can\$50,000 for a serious violation and Can\$100,000 for a very serious violation; and b) for an entity, Can\$25,000 for a minor violation, Can\$100,000 for a serious violation and Can\$500,000 for a very serious violation. The penalties for late or erroneous filings are established at a fixed daily rate based on the value of the total assets of the FRI. (*s25 and s26 of OSFI Act*)

Every person who knowingly provides false or misleading information in relation to any matter under the ICA or its regulations is guilty of an offence. In addition, it is an offence to refuse or fail to comply with the OSFI's requirements to provide information or allow OSFI access to the FRI's records, directors, officers, auditor, and actuary to obtain information and explanations. (*s1023.1 and s1025 of ICA*)

Offences under the ICA and its regulations are prosecuted by the Crown and sanctions are imposed by the Canadian courts. The courts ensure consistency of sanctions across institutions by applying the rule of precedents. To ensure consistent and fair application administrative monetary penalties across FRIs, OSFI has established internal guidelines and an Administrative Monetary Penalties Committee to review violations and propose recommendations.

#### **AMF**

AMF may, on its own initiative or on request, conduct any investigation if it has reasonable grounds to believe there has been contravention of the laws under its purview. The person(s) authorized to conduct an investigation is vested with the powers and immunity of the commissioner in conducting public inquiry, except the power to

<sup>63</sup> All fines payable are recoverable and enforceable, with costs, at the suit of Her Majesty in right of Canada, instituted by the Attorney General of Canada. In respect of fines payable under OSFI's administrative monetary penalties or late and erroneous filings regimes, OSFI monitors and follows up with institutions, as necessary, to ensure debts are paid. A financial penalty constitutes a debt due to the Her Majesty in Right of Canada and may be recovered in court. (*section 1033 of ICA and section 31 of OSFI Act*)

<sup>64</sup> A minor violation that is continued on more than one day constitutes a separate violation for each day during which it is continued.

	<p>order imprisonment. The investigations may result penal, administrative or civil proceedings. (s12 &amp; 13 of AMF Act)</p> <p>Examples of misconduct that AMF has referred to enforcement as a result of its on-site inspections include: appropriation of funds; practicing in a discipline without proper registration; failure to deal fairly, honestly and in good faith with clients; and inadequate compliance structure.</p> <p>AMF's enforcement powers include namely:</p> <p><u>Insurers</u></p> <ul style="list-style-type: none"> <li>a) Impose a monetary penalty to sanction of up to Can\$1 million, e.g., if an insurer does not comply with an Order (s405.1 of IA);</li> <li>b) Impose or vary conditions or restrictions of a license (s219.1 of IA);</li> <li>c) Apply to the Superior Court for an injunction (s174.18 and s325.5 of IA) ;</li> <li>d) Initiate penal proceedings if an offence under the IA is committed (s406, s406.1 s406.2 and s408.1 of IA); and</li> <li>e) Order a legal person or partnership to cease a course of action or to implement specified measures (s325.1 of IA)</li> </ul> <p><u>Intermediaries and Distributors</u></p> <ul style="list-style-type: none"> <li>e) Suspend or cancel a license and/or impose restrictions and conditions on their distribution activities (s218 to s220 of DA);</li> <li>f) Impose administrative sanctions or penalties (s115.2 of DA);</li> <li>g) Request the BDR to impose administrative penalties or specific orders, e.g., prohibition to act as a director or officer, freezing of assets, order a representative or firm to submit a review of practices and procedures, disgorgement order etc. (s115, s115.1, s115.3 and s115.9 of DA);</li> <li>h) Impose an administrative penalty not exceeding Can\$100,000 on an insurer (acting as a distributor) or distributor for non-compliance of the Distribution Act (s419 of DA);</li> <li>i) Order an insurer to cease distributing an insurance product through distributors</li> <li>j) Institute penal proceedings for offence under the Distribution Act (s461 to s483 and s492 of DA);</li> <li>k) Apply to the Québec Superior Court for an order to appoint a receiver on specified grounds (s19.1 of AMF Act).</li> </ul> <p><b>FSCO</b></p> <p>FSCO adopts a progressive enforcement approach, where the penalty is proportionate to the seriousness of the contravention. Its enforcement powers include cease or desist orders, suspension, revocation or imposition of conditions on a license; or administrative monetary penalty. Before taking action, the person affected has an opportunity for a hearing before the Superintendent, an Advisory Board appointed by the Superintendent, or the FST. The Superintendent may also initiate prosecutions of offences under the OIA pursuant to the Provincial Offences Act. FSCO has recently created the Regulatory Discipline Officer role to proactively identify problems and trends in the industry. The Officer initiates and manages the enforcement process leading to regulatory action.</p>
Assessment	Observed.

Comments	<p>All three supervisors have adequate legal authority and tools to take enforcement actions and impose sanctions, in a progressive approach that is commensurate with the severity of the offence. There are established internal guides as well arrangements to ensure consistent and fair application of enforcement actions and sanctions.</p> <p>In practice, OSFI rarely takes enforcement actions as its moral suasion has been effective. FSCO and AMF have taken a number of enforcement actions on market conduct breaches.</p>
<b>ICP 12</b>	<p><b>Winding-up and Exit from the Market</b></p> <p>The legislation defines a range of options for the exit of insurance legal entities from the market. It defines insolvency and establishes the criteria and procedure for dealing with the insolvency of insurance legal entities. In the event of winding-up proceedings of insurance legal entities, the legal framework gives priority to the protection of policyholders and aims at minimizing disruption to provision of benefits to policyholders.</p>
Description	<p>The ICA and the Winding-up and Restructuring Act (WURA) provide for a number of ways in which FRIs incorporated in Canada can exit the market, including arrangements for winding-up on insolvency. There are a number of provisions enabling such companies to exit the market voluntarily in an orderly fashion. These include:</p> <ul style="list-style-type: none"> <li>• “simple liquidation” at the request of a solvent company; and</li> <li>• discontinuance of insurance business at the request of a solvent company, through assumption reinsurance under which the company’s risks are transferred to another insurance company.</li> </ul> <p>Similar arrangements apply to branches of foreign insurers in respect of their operations in Canada. These transactions are subject to approval by OSFI or in some cases by the Minister and it is OSFI policy that, in accordance with its mandate and objectives, approval would be given only once OSFI has established that there would be no detriment to policyholders (or after policyholder liabilities have been discharged). In the case of simple liquidation, OSFI can apply to the court for an order for the liquidation to continue on the basis of court supervision.</p> <p>The legal framework for insolvency is set out in the WURA. An application to wind-up an insurance company (an FRI or a Canadian branch of a foreign insurer) may be brought by the insurer itself, a creditor or the Attorney General of Canada at the Superintendent’s request. Under the WURA, a court may order that an insurer be wound-up, where the insurer is insolvent and where the court holds that it is just and equitable that the insurer be wound-up.</p> <p>The court may issue an order where OSFI has taken control of the assets of the insurer (or the insurer itself). In practice, OSFI would expect, in case of a potential failure of an FRI, to exercise its powers to take control of the company or its assets ahead of seeking a winding-up – so as to secure assets and maximise the chances of an orderly liquidation that safeguards policyholder interests. The court will normally appoint a liquidator, at which point the powers of the company directors are terminated. (<i>s679 of ICA and s31 of WURA</i>)</p> <p>The liquidator has extensive powers to manage the liquidation, taking advantage of the</p>

accompanying stay of execution as necessary. The liquidator may, with court approval, transfer business to another company. The court may also modify the terms and conditions of policies if it is satisfied that the modification will have no adverse material impact on the policyholders; or agree to a plan of arrangement for an insurer to restructure its debt obligations under the protection of the court.

Under the scheme of priorities set out in the legislation, policyholders rank ahead of general creditors. Claims of the Crown and secured creditors as well as claims of employees for some wages take higher priority. The rank of segregated fund policyholders moved up in 2012; in addition to generally having a priority of claim over the segregated fund assets, they now rank ahead of general creditors in respect of guaranteed amounts over non-segregated fund assets, if there are remaining assets after meeting claims from the insurance policyholders. The solvency regime limits encumbrances of assets. (*s161 of the WURA*)

The WURA also provides for a separate regime for liquidating the branch of a foreign insurance company in Canada. The liquidator may take control of the foreign company's assets in Canada, which would include (but not be limited to) the assets vested in trust in Canada (ICPs 14 and 17). Policyholders of branches rank similarly highly as those of Canadian companies in relation to the distribution of branch assets – provided that the insurance relates to “insuring in Canada of risks”, which OSFI interprets as meeting certain business activities in Canada (i.e. the location of the insured risk, e.g., the property is not the test).

The two private Canadian compensation organizations, Assuris and PACICC, also work with liquidators on wind-ups with a view to minimizing losses to policyholders.

- All L&H insurance companies, including Canadian branches of foreign insurers and those incorporated by provincial authorities, have to be members of Assuris as a condition of licensing. Assuris protects a minimum of 85 per cent of all benefits and offers 100 percent protection of smaller sums such as Can\$200,000 for life insurance. Assuris holds a minimum fund of Can\$100 million (Can\$115 million at end-2012) and has the capacity to levy assessments on members. Assuris may also provide financial assistance to a solvent member before a winding-up order is issued or may facilitate the transfer of business from a troubled member to other insurers.
- P&C insurers in Canada, including Canadian branches of foreign insurers, are generally required by provincial regulators to become members of PACICC (unlike Assuris, PACICC is not designated under the ICA as a “compensation association”). PACICC covers claims payments and refunds of unearned premiums. For covered claims, the maximum recovery is Can\$300,000 for personal property and \$250,000 for all other lines. Any unearned premiums will be refunded to a maximum of Can\$700 per policy. PACICC is funded by its members through assessments. The formal trigger for PACICC involvement in a distressed institution is the winding-up order, though PACICC may assist a member insurer prior to a liquidation order.

On the point of winding-up, an insurer has to cease carrying on business. OSFI would expect to have used its intervention powers to prevent the financial condition deteriorating to the extent that liquidation is necessary (ICP10). If insolvency were imminent, then OSFI would seek to use a power to take control of the assets of the

	insurer or of the insurer itself without the need to obtain an order from the court. These powers are exercisable in a range of circumstances, as described under ICP11. (s679 of WURA).
Assessment	Observed
Comments	<p>There are extensive provisions in the legislation for the authorities to manage the exit from the market of an insurance company, including Canadian branches of foreign insurers, in an orderly manner. These also provide for policyholders to rank above general (unsecured) creditors. For L&amp;H insurance, these provisions are substantially untested for many years (notwithstanding the failure of a small provincially-incorporated company in 2012). In P&amp;C insurance, the arrangements have been more often tested, although most failures have been smaller, provincially regulated companies.</p> <p>It is recommended that:</p> <ul style="list-style-type: none"> <li>• The authorities consider whether it would help promote increased cooperation and early exchange of information between OSFI and the PACICC were PACICC to be designated by approval of the Minister under the ICA in the same way as Assuris.</li> <li>• The authorities continue to test procedures for handling a failure of a FRI by further simulation exercises and the development of recovery planning that is already underway for the large L&amp;H companies.</li> </ul>
<b>ICP 13</b>	<p><b>Reinsurance and Other Forms of Risk Transfer</b></p> <p>The supervisor sets standards for the use of reinsurance and other forms of risk transfer, ensuring that insurers adequately control and transparently report their risk transfer programmes. The supervisor takes into account the nature of reinsurance business when supervising reinsurers based in its jurisdiction.</p>
Description	<p>Reinsurance business is covered by the ICA. OSFI regulates and supervises reinsurers and sets specific standards in relation to the reinsurance bought by primary insurers. Many P&amp;C FRIs have reinsurance programs to cover at least part of their catastrophe risk and this is normally obtained in the international market from reinsurers based outside Canada. OSFI's experience is that alternative forms of risk transfer are not used extensively by FRIs.</p> <p>OSFI's guideline Sound Reinsurance Practices and Procedures (B-3), which applies to all FRIs including reinsurers, sets out specific expectations on reinsurance risk management practices and procedures. All ceding companies are required to:</p> <ul style="list-style-type: none"> <li>• have a board-approved Reinsurance Risk Management Policy (RRMP), which documents the FRI's purpose and objectives for seeking reinsurance, risk diversification objectives, risk appetite, risk concentration and ceding limits as well as practices and procedures for controlling reinsurance risk, which must be integrated into the general risk management approach;</li> <li>• have appropriate systems and controls to oversee their reinsurance program as well as individual reinsurance transactions;</li> <li>• provide its RRMP to OSFI on request, together with a complete description of all its reinsurance arrangements, including levels of reinsurance, the due diligence performed on reinsurance counterparties; and the proportion of cessions to</li> </ul>



<p>registered and unregistered reinsurers (see below); and</p> <ul style="list-style-type: none"> <li>• inform OSFI promptly if it becomes aware of any reinsurance issues that could materially impact its financial condition.</li> </ul> <p>OSFI distinguishes in its approach between reinsurance obtained from:</p> <ul style="list-style-type: none"> <li>• “registered” reinsurers (those that are FRIs, including branches in Canada, and provincial reinsurers approved by OSFI—which requires them to show that they provide reinsurance to FRIs and meet certain conditions related to financial strength and good standing with its regulator); and</li> <li>• “unregistered” reinsurers, i.e., all others, including the non-Canadian business of the major global reinsurance groups and the Lloyd’s market.</li> </ul> <p>Where reinsurance is obtained from unregistered reinsurers, the cedant is required to obtain collateral against the credit exposure as a condition of taking credit for reinsurance in calculating the amount of the assets it is required to hold against technical provisions and its capital requirement. These requirements reflect the risks related to the fact that the reinsurer is not regulated by OSFI.</p> <p>OSFI’s general policy in this regard is set out in the Discussion Paper on OSFI’s Regulatory and Supervisory Approach to Reinsurance (December 2008) and a follow-up Response Paper: Reforming OSFI’s Regulatory and Supervisory Regime for Reinsurance (March 2010). OSFI’s position is that it will not review its policy on collateral requirements (e.g., by contemplating reinsurance mutual recognition arrangements with regulators in other countries) until there has been progress on the development of a common international framework of prudential requirements for reinsurers.</p> <p>OSFI has set out guidance on its expectations in regard to such collateral, specifically Reinsurance Security Agreements (RSA Guidance) and Letters of Credit. The RSA Guidance requires the cedant:</p> <ul style="list-style-type: none"> <li>• to have a board-approved policy requiring management to confirm, from time to time, to the board the existence of a valid and enforceable security interest in the collateral taken which has priority over any other security interest to which it may be subject; and</li> <li>• to include in their policy the types of assets it will take and the limits (e.g., credit ratings as outlined in the capital/asset guidelines; counterparty concentrations; foreign denominated securities) as well as the practices and procedures for managing and controlling risks related to the collateral assets.</li> </ul> <p>OSFI takes into account the nature of the supervision of reinsurers used by FRIs – as reflected in its distinction (for determining which arrangements may attract a credit in the asset and capital requirements) between reinsurers regulated by OSFI itself and others.</p> <p>However, because it requires collateral to be held by FRIs in relation to reinsurance with unregistered reinsurers, there is a risk that OSFI will rely on the collateral requirements and not assess the nature of the supervision of the reinsurers as fully as it would in the absence of collateral requirements. OSFI’s experience is that because most of the</p>
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relevant reinsurers are located in jurisdictions with which OSFI has information-sharing agreements and with which it otherwise collaborates closely, the assessment of the nature of reinsurance supervision is captured in its management of the broader regulatory relationship. Guideline B-3 explicitly requires FRIs to conduct a thorough assessment of supervision of their reinsurance counterparty—and OSFI in turn uses this assessment.

A further distinction is between reinsurance obtained from a related reinsurer and that obtained from a third party. Ceding companies are required to obtain OSFI's approval before reinsuring with an unregistered related party and collateral requirements apply to reinsurance obtained from unregistered related party reinsurers. OSFI looks in detail at the terms of the proposed arrangement to ensure it is undertaken on commercial terms. (*s523(2) of ICA*).

OSFI requires ceding companies to have processes to ensure that a comprehensive, written, and binding reinsurance contract is executed prior to the effective date of reinsurance coverage. The requirement is that a reinsurance contract be "unambiguous" with all material terms and conditions of the contract documented in writing by all parties prior to the contract's effective date. In cases where a comprehensive reinsurance contract is executed by all parties only after the effective date, OSFI has set out its expectations of the action which ceding companies should take in order to mitigate the risk of uncertainty in coverage during this interim period. This reflects industry practice in Canada for the reinsurance coverage during this period to be set out in a less formal document (e.g., slip, binding letter of intent, or "summary document"), which OSFI requires FRIs to obtain prior to the effective date of the reinsurance coverage. (*Pages 5 to 6 of the Sound Reinsurance Practices and Procedures Guideline*)

OSFI's guidelines also acknowledge that FRIs may on occasion enter into a supplemental or subordinated reinsurance contract, a side letter, or other types of arrangements ancillary to the main contract. OSFI requires ceding companies to be transparent with stakeholders about these arrangements, that such amendments are appropriately reflected in their financial statements, and that they do not adversely change the terms or conditions of the original contract to the detriment of policyholders. (*Pages 5 to 6 of the Sound Reinsurance Practices and Procedures Guideline*)

OSFI requires FRIs to undertake their own evaluation of reinsurance counterparties and that they should generally not rely solely on third parties, including rating agency assessments or brokers' recommendations. FRIs are required to conduct their own due diligence on the financial strength and capabilities of all reinsurance counterparties, taking into account the materiality of the risk. This requirement was elaborated in the guideline following OSFI's observation in its supervision of FRIs that some companies were relying excessively on third parties for the assessment of reinsurers. (*Page 4 of the Sound Reinsurance Practices and Procedures Guideline*)

FRIs are not subject to overall limits on the amount of their reinsurance business. However, they are required "generally not, in the normal course of business", to cede 100 percent, or substantially all, of their risks in the main areas in which they conduct business. This limit addresses the risk of a weakening of the underwriting discipline at

	<p>the ceding FRI.</p> <p>An FRI may, however, occasionally cede a portion, or even 100 percent, of a specific line of business or type of risk that is ancillary to its core business; and cessions of existing lines of business at 100 percent may, depending on the circumstances, also be acceptable. The wording of this part of the guidelines reflects a concern at OSFI not to detract from the responsibility of FRIs to set their own limits in this area, based on their own due diligence. <i>(Footnote 7, page 3 of the Sound Reinsurance Practices and Procedures Guideline)</i></p> <p>FRIs are permitted to set their own concentration limits as appropriate to the business, based on premiums, expected claims, amount of risk, and possible future exposures (at time of inception or renewal of policy), on a consolidated basis, to individual counterparties or groups of individual counterparties or related entities and counterparties in a specific geography. <i>(Footnote 6, page 3 of the Sound Reinsurance Practices and Procedures Guideline).</i></p> <p>OSFI includes reviews of reinsurance in its supervision of FRIs, taking into account the scale and nature of the risks. It also reviews reinsurance issues on a cross-sector basis. In the P&amp;C sector, a wide-ranging review of the management of earthquake risk has been undertaken, which included an examination of whether FRIs were assessing the adequacy and effectiveness of their reinsurance arrangements in relation to catastrophic losses.</p> <p>In case of concerns in this area, OSFI may require an FRI not to take a capital or asset requirement credit for the reinsurance arrangement, or may use its powers under the ICA to set additional capital or asset requirements or higher target solvency ratios to compensate for reinsurance that may be ineffective or unreliable.</p> <p>It is also in the context of its supervision work that OSFI assesses liquidity risks in reinsurance. It examines the level of the ceding company's liquidity risk and the quality of its liquidity management. If a ceding company is highly exposed to reinsurance, for example, OSFI may discuss liquidity issues. OSFI responded in one case of enhanced liquidity risks (due to unpaid reinsurance recoverables of over 164 percent of capital) by requiring the FRI to obtain increased collateral from the reinsurer. OSFI's guidance on reinsurance acknowledges that reinsurance exposes an insurer liquidity risks but does not set out detailed expectations in this area.</p> <p>OSFI does not have a process to review all risk transfers to capital markets, or special purpose entities (SPEs). However, in the case of P&amp;C FRIs, it requires the reporting in the annual regulatory return of insurance risk transfers to the capital markets (including whether the regulated insurer or its parent has issued insurance-linked securities such as catastrophe bonds, swaps, industry loss warranties etc). OSFI has capacity to review such transactions though specialists in its Supervision Support Group.</p> <p>OSFI will agree to FRIs taking credit in their asset or capital requirements for risk transfers to capital markets via SPEs in cases where collateral is provided in Canada by the SPE or where the FRI is ceding foreign business (i.e., written by the FRI from an operation outside Canada) and the arrangement is recognized by a regulator of an OECD</p>
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	country. If OSFI is not satisfied with the risk transfer arrangement, it may not permit the capital credit.
Assessment	Largely Observed.
Comments	<p>OSFI's guidelines on reinsurance, recently reissued after a full review, set out extensive standards on the management of reinsurance, with an emphasis on management taking responsibility for assessing reinsurance counterparties rather than relying on third parties, setting limits in line with risk appetite and documenting the approach in a board-approved statement. OSFI's policy to require collateral to be posted by foreign reinsurers as a condition of credit being taken for reinsurance enhances the security of these arrangements. However, OSFI should complement these with requirements on FRIs to evaluate the residual risks and by systematic evaluation by OSFI of the supervision arrangements for the foreign reinsurers.</p> <p>It is recommended that OSFI:</p> <ol style="list-style-type: none"> <li>take the opportunity when revising its guidelines to add material on the importance of FRIs assessing and managing liquidity risks arising from reinsurance cessions;</li> <li>enhances its process for evaluating the supervisory regimes applying to unregistered foreign reinsurers so that it explicitly addresses the supervision of reinsurance in their home jurisdictions.</li> </ol>
<b>ICP 14</b>	<p><b>Valuation</b></p> <p>The supervisor establishes requirements for the valuation of assets and liabilities for solvency purposes.</p>
Description	<p>OSFI does not generally set valuation standards itself but works with the accounting and actuarial standard setters to deliver a valuation framework that is appropriate for use as the basis of regulatory solvency calculations.</p> <ul style="list-style-type: none"> <li>The requirements for regulatory purposes, including reporting by FRIs to OSFI, are based closely on IFRS, which were adopted by the Canadian Accounting Standards Board with effect from 2011 for use by "publicly accountable enterprises", which OSFI has defined in a communication in April 2008 to include all FRIs.</li> <li>IFRS standards in turn require that, for the valuation of liabilities arising on insurance contracts, where work on a final version of IFRS 4 is continuing, Canadian insurance companies (including all FRIs) use the Standards of Practice issued by the Actuarial Standards Board.</li> <li>Under the ICA, FRIs are required to prepare financial statements in accordance with generally accepted accounting principles, i.e. as issued by the Accounting Standards Board. (<i>S331(4) of the ICA</i>)</li> <li>The ICA also requires that the valuation of actuarial and policy liabilities that must be undertaken by the appointed actuary (AA) of an FRI shall be in accordance with generally accepted actuarial practice, i.e. the standards issued by the Actuarial Standards Board (ASB). (<i>s365(1) of the ICA</i>)</li> </ul> <p>The effect of these provisions, apart from a particularly close alignment of the financial and regulatory reporting frameworks, is that valuation standards and practices in Canada are driven principally by:</p>

- relevant IFRSs, including IAS 39 covering the recognition and derecognition criteria for financial instruments, IAS 40 on investment properties and IAS 16 for the valuation of property and equipment;
- the Standards of Practice of the Actuarial Standards Board; and
- any variations in these standards that OSFI may require—in practice it has required none.

OSFI's capital framework is also based directly on these financial statements (ICP17).

OSFI's Guideline E-15 Appointed Actuary: Legal Requirements, Qualifications and Peer Review lays out the duties of the AA under the ICA as well as OSFI's expectations for external actuarial peer review of the valuation of policy obligations.

The ASB's Standards of Practice are broadly principles-based. They specify the use of a standard methodology, separately for P&C and L&H insurers, but the approach allows for significant discretion on the part of the AA, for example on the assumptions to be used. Key features of the approach are as follows.

- For L&H insurers, the Canadian Asset Liability Method or CALM is based on the prospective future cash flows of both the policies and their supporting assets.
  - All cash flows are included (e.g., premiums, fees, investment income, defaults, capital gains/losses, mortality, morbidity, surrender, lapse, expenses, taxes, policy dividends, asset maturities, future asset purchases/sales, etc.).
  - For interest rates, the assumptions to be used are prescribed in the Standards of Practice in the form of a set of nine scenarios (the least favorable outcome is to be used).
  - The margins for adverse deviations for future investment income returns on fixed income assets are determined based on a set of scenarios prescribed in the standards. These returns are applied to the future net cash flows that are subject to reinvestment. These margins capture the risks of inappropriate asset/liability management.
  - The CALM methodology is performed by distinct product segments. The objective of the cash flow projection methodology is to ensure that the assets supporting the liabilities at the time of the valuation are sufficient to meet all the future policy cash flow needs.
- For both L&H and P&C, the AA is responsible for the selection of realistic best estimate assumptions and assumptions for margins for adverse deviations. The selection must be appropriate to the company being valued and must be kept under review by the AA for continued applicability.

Because of the significant scope for discretion on the part of the actuary, it is important that the approach is backed up by a framework of effective challenge and oversight of the AA's decisions. This is provided in practice through a number of arrangements:

- The Actuarial Standards Board (ASB) is responsible for the professional standards applying to AA, and the Canadian Institute of Actuaries (CIA) has powers to investigate and to apply sanctions as necessary. The CIA has used these powers.

- Regulatory expectations of the AA set out in OSFI's E-15 Guideline include requirements:
  - that companies have an AA with appropriate qualifications;
  - that the AA make an annual report to OSFI (the Appointed Actuary Report – AAR, see below) describing how the valuation was prepared;
  - that a peer review of the work of the AA be performed periodically and the peer review report on the AA be submitted directly to OSFI as well as to the management of the FRI (OSFI requires the peer reviewer to “ascertain that the work of the AA for the valuation of policy liabilities and ceded reinsurance assets is in compliance with accepted actuarial practice”).
- Effective oversight by the Board and senior management of the FRI, pursuant to standards applying to corporate governance of FRIs (ICP7) and by OSFI's supervision of compliance of FRIs in this area. And OSFI guidelines require the AA meet with and report to the directors (or the chief agent) on the company's financial position annually.
- Supervisory oversight by OSFI on the basis of regulatory reporting: this is undertaken by the supervisors with actuarial support. This Actuarial Division also undertakes cross-firm work, including recently an examination of the actuarial function at a number of FRIs. OSFI's requirement for Dynamic Capital Adequacy Testing (prescribed stress tests) provides further insights into the adequacy of the AA's valuation and the FRI's business, as will the Own Risk and Solvency Assessment (ORSA) to be introduced next year (ICP16).
- The requirements of the Auditing Standards Board and Canadian Institute of Chartered Accountants in relation to audit work undertaken on the financial statements of FRIs. These requirements provide for the auditor to take their own view of the valuation of policy liabilities. The major auditing practices employ actuaries to support the audit work of insurance companies. Audit work is itself overseen by the Canadian Public Accountability Board (CPAB).
- Legal protection for whistleblowing in relation to actuarial work. OSFI has received and acted on occasional whistleblowing, although instances are rare and there has not been a case since the early 1990s.

This is overall a robust framework. (One aspect not covered but in place in some other countries is direct oversight of the actuarial profession by a statutory body). There have been shortcomings in Canadian actuarial work in recent years: some products have been mispriced because of underestimation of the policyholder behavior considerations and there have been instances where flexibility in the language of the Standards of Practice has been exploited to provide for valuations favorable to the company. Such cases appear to have been rare. However, OSFI and the actuarial profession have some concerns over valuation practices in relation to non-fixed interest assets, where firms have greater discretion on assumptions on reinvestment rates of returns than they have in practice on fixed income investments. OSFI has a process for regular dialogue with the CIA and ASB, through which OSFI can raise areas of the standards which it thinks require consideration by ASB for revision, based on its supervisory work. This process has led to one recent clarification of the standards, while the issues with valuation of non-fixed interest assets (including the case for limits on assumed future investment in such assets) are also now being considered by the ASB.

	<p>A key focus of OSFI's supervisory work on the insurer's actuarial financial position is the AAR. The ICA requires the AA to make, and the company to file with its annual return, an AAR and the DCAT on the policy liabilities and on any other matters the Superintendent may specify in a form determined by the Superintendent. The purpose of the AAR is to give OSFI a comprehensive report documenting the work done by the AA to calculate the policy liabilities. The AAR also documents the work the AA does for certain sections of the capital adequacy requirements, including the administration of participating policies for life insurers. OSFI sends annual memorandums to both life and P&amp;C insurers setting out requirements in relation to AARs. <i>(s667(2) of ICA)</i></p> <p>A further feature of the approach in Canada, which is of particular importance to the major L&amp;H insurance groups with their significant overseas operations is that the framework applies to their global insurance business.</p> <p>The approach generally is an economic test, based on current market valuations with projections of future rates that have to be consistent with current rates (i.e., making use of current yield curves). It is consistent in this respect. However, the CALM approach does not currently explicitly require actuaries to consider the impact of credit ratings migration. While valuations must take account of default risk (which has been low in Canada), insurers may benefit from widening credit spreads in their assumptions on future reinvestment rates to the extent that these are not reflected in increased default experience. OSFI noted that firms in practice use spreads which return to long term averages over a set period (typically five years) and that when credit spreads widened in 2008, insurers did not take full credit in their valuations. They also observed that the effect of the prescribed interest rate scenarios is that fixed-income assets transition over time to risk-free rates). The treatment of spreads is also being addressed by the ASB.</p> <p>Where an amortised cost basis is permitted (for certain assets under IFRSs), the relevant standard also requires an economic impairment test to be applied.</p> <p>The standards require the recognition of provisions for adverse deviations in the best estimate valuation of both policy-related cash flows and asset cash flows. The requirements cover all the cash flows (premium payments, lapses, claims, expenses etc.) The standards also require that the provisions for adverse deviation be appropriate in the aggregate. <i>(Standards of Practice 2130.06.1)</i></p> <p>The approach recognises that the FRI may have committed to issue insurance contracts in the future but which are not yet in force; and that in relation to some contracts, there may be cash flows generated after the policy terminates. Contracts have to be valued gross of reinsurance. Best estimates are required to be unbiased, neither conservative nor the reverse. There is no time limitation on cash flows to be included in the valuation – an important consideration in L&amp;H insurance in Canada given the long-dated nature of many insurance contracts. The standards provide explicitly for recognition of the time value of money and for appropriate allowance to be made for embedded options and guarantees. <i>(2310.06 and 2130.05 of the Standards of Practice)</i></p>
Assessment	Largely Observed.

Comments	<p>The requirements on valuation of technical provisions and assets provide a comprehensive framework of standards, including a consistent economic basis for valuation across the balance sheet and margins for adverse deviation. While the approach is principles-based and provides for significant discretion to be exercised by the AA, it is underpinned by professional and regulatory requirements applying to the AA and a framework of oversight, peer review and audit requirements. The approach has been adapted where areas of weakness were highlighted by the financial crisis. Nonetheless, there remain aspects of the approach (allowances for credit spreads and the extent of discretion in relation to non-fixed income investments) where strengthening of the actuarial standards is appropriate. OSFI had identified the need for changes to the Canadian valuation of technical provisions and has supported work by the ASB in this area. It is also important that the oversight, peer review and audit requirements continue to provide a robust challenge to the assumptions and methods used by actuaries.</p> <p>Recognizing that the current ASB review of reinvestment assumptions for life insurance valuation is already addressing the issues, it is recommended that the valuation standards on credit spreads and non-fixed income investments are strengthened.</p>
<b>ICP 15</b>	<p><b>Investment</b></p> <p>The supervisor establishes requirements for solvency purposes on the investment activities of insurers in order to address the risks faced by insurers.</p>
Description	<p>The framework for regulation of investments includes both legislative requirements and guidelines issued by OSFI, reflecting both a rules-based and a principles-based approach to the regulation and supervision of investments.</p> <p>The ICA generally prohibits FRIs from acquiring control of or acquiring or increasing a substantial investment in any entity except:</p> <ul style="list-style-type: none"> <li>• a "permitted entity" (in many cases, a regulated or unregulated financial institution);</li> <li>• an entity held via a regulated financial institution subsidiary of the FRI;</li> <li>• an entity held for a limited period of time; and</li> <li>• an entity held in accordance with the Specialized Financing Regulations, which allow merchant banking / venture capital investments (the specialized financing exception, however, is not available to property and casualty companies or to fraternal benefit societies).</li> </ul> <p>The ICA and Investment Limit Regulations also establish portfolio limits on commercial lending, real property, and equity as summarised below, though with exemptions for the largest companies (<i>Part IX of the ICA</i>)</p>



Type of Institution	Restrictions on Investments in Real Estate	Restrictions on Investments in Equities	Restrictions on Aggregate Investments in Real Estate and Equities	Exemptions from the Limits
Life Insurance (Domestic)	Aggregate of: -70% of regulatory capital -15% of non-par liabilities -25% of par liabilities - 5% of liabilities in respect of prescribed annuities	Aggregate of: -70% of regulatory capital -15% of non-par liabilities -25% of par liabilities - 5% of liabilities in respect of prescribed annuities	Aggregate of: -100% of regulatory capital -20% of non-par liabilities -40% of par liabilities - 5% of liabilities in respect of prescribed annuities	- <i>mutual co.</i> with surplus and minority interests of $\geq$ \$5 billion - <i>large stock co.</i> with equity $\geq$ \$5 billion that is widely held or controlled by a widely-held regulated entity
Life Insurance (Foreign)	15% of assets vested in trust for specified classes of insurance 10% of assets vested in trust for other classes of insurance	25% of assets vested in trust	No limit prescribed	N/A
Property and Casualty (Domestic)	10% of total assets	25% of total assets	35% of total assets	- <i>mutual co.</i> with surplus and minority interests of $\geq$ \$5 billion - <i>large stock co.</i> with equity $\geq$ \$5 billion that is widely held or controlled by a widely-held regulated entity
Property and Casualty (Foreign)	10% of assets vested in trust	25% of assets vested in trust	No limit prescribed	N/A

OSFI guidelines set further requirements on investments:

- The Large Exposure Limits Guideline applying to L&H FRIs limits the aggregate exposure of a consolidated company to any entity, which shall not exceed 25 percent of total capital.
- The Investment Concentration Limit Guideline, which applies to P&C FRIs, limits the aggregate book value of investments in any entity or group of related entities to 5 percent of the company's consolidated assets.

The ICA also requires FRIs to adhere to, and their directors to establish, investment and lending policies, standards and procedures that a “reasonable and prudent person would apply in respect of a portfolio of investments and loans to avoid undue risk of loss and obtain a reasonable return”. The ICA describes the objective of investment standards as being to avoid undue risk of loss and obtain a reasonable return. (*s492 of the ICA*).

OSFI’s Prudent Person Guideline then provides interpretation of this general requirement. It lists factors that the management and the board of directors of a company are expected to consider in establishing investment and lending policies and in ensuring that they are effectively implemented.

The guideline sets out an expectation that these policies will describe the objectives for investment and lending programs and the overall risk philosophy of a FRI. Investment policies must identify the acceptable ranges for investments and establish limits on exposures to asset type, asset quality, counterparty and counterparty group, industry type and geographical distribution. Insurers must also establish limits to contain the risks arising from potential changes in currency or interest rates.

More specifically, the Prudent Person Guideline requires that FRIs:

- set limits on investments and loans according to their quality;
- perform their own due diligence rather than relying solely on credit rating agencies in establishing their internal investment quality criteria (internal criteria must also be established for assessing the credit quality of borrowers);
- consider in their investment policy the anticipated demand for funds (i.e., liquidity) to pay benefits as they come due and address how the maturity profile of investments should be established in light of this demand;
- establish limits on investments in geographic regions and give consideration to their ability to access those assets as required; and
- within their investment policies, address issues related to diversification on a number of bases including asset type, counterparty exposure and geographical concentration.

FRIs’ investment policies also fall within a larger, board-approved risk appetite framework, which is required under OSFI’s Corporate Governance Guideline. This risk appetite framework establishes the level of aggregate risk an FRI is willing to assume and manage in the pursuit of its business objectives. Risk tolerance limits, such as those for investments, would be captured by this framework. This guideline also requires FRIs to have a risk committee, which has the responsibility to review and discuss policies, such as the FRI’s investment policy.

OSFI’s Derivatives Best Practices Guideline outlines its expectations of management and boards of directors when derivative instruments are part of its investment and financing profile. It also sets out expectations for a sound risk management process.

The Prudent Person Guideline requires that an insurer’s investment policies consider the liability structure of the FRI and address how the investment maturity profile should be established. FRIs need to pay close attention to their choice of investments in relation to

	<p>policy liabilities. The extent of their matching of assets and liabilities is a key driver of the valuation of their policy liabilities. For L&amp;H FRI, for example, the Canadian Asset Liability Method (CALM) valuation methodology is based on asset and liability cash flows (see ICP14).</p> <p>Although the Prudent Person Guideline requires FRI to ensure that their investment policies are implemented by persons with the appropriate level of expertise, OSFI's framework lacks an explicit requirement that the FRI invests only in assets whose risks it can properly assess and manage. (<i>page 2 of the Prudent Person Approach guideline</i>).</p> <p>In relation to more complex or less transparent forms of investment, there are no explicit qualitative requirements applying to FRI other than the general requirements in relation to prudent person governance and risk management.</p> <p>The capital adequacy guidelines (MCCSR and MCT – ICP17) require FRI to hold capital against asset risk (and derivatives exposures). The requirements broadly differentiate between asset types by risk.</p>
Assessment	Largely observed.
Comments	<p>The framework of legislation and guidelines on FRI's investments includes restrictions on certain types of investment, hard limits on particular asset classes (though with exemptions for the largest insurers) and high-level requirements to manage investments in a prudent manner. These standards are complemented by the valuation and capital requirements that incentivise FRI to undertake asset and liability matching and which require capital to be held in relation to particular classes of asset risk. In the nature of the valuation requirements, which allow FRI to take account of the current yields on assets in their assumptions about reinvestment rates, FRI have some incentives to invest in higher yielding assets for asset and liability management purposes and this needs to be accompanied by a more robust framework of requirements on FRI's investment in higher risk and more complex assets.</p> <p>It is recommended that OSFI undertake a review of the Prudent Person Approach Guideline, to strengthen the requirements on investments and in particular to add explicit requirements that FRI invest only in assets whose risks it can properly assess and manage and on investments in complex or less transparent forms of instruments.</p>
<b>ICP 16</b>	<p><b>Enterprise Risk Management for Solvency Purposes</b></p> <p>The supervisor establishes enterprise risk management requirements for solvency purposes that require insurers to address all relevant and material risks.</p>
Description	<p>OSFI's expectations on enterprise risk management are set out in the combination of the following guidelines:</p> <ul style="list-style-type: none"> <li>• Corporate Governance Guideline</li> <li>• Stress Testing Guideline</li> <li>• Internal Target Capital for Insurance Companies Guideline (Internal Target Guideline)</li> <li>• Own Risk and Solvency Assessment (ORSA) Guideline, which is at present a draft requirement scheduled to take effect on 1 January 2014.</li> </ul>

FRIIs are also required to undertake dynamic capital adequacy testing (DCAT) following guidance set out in the Actuarial Standards Board's (ASB) Standards of Practice—Practice Specific Standards for Insurers, Section 2500, Dynamic Capital Adequacy Testing—Life and Property and Casualty. A DCAT report is a forward-looking examination of the insurer's future financial condition under various scenarios. It is prepared by the AA for the Board and must be filed with OSFI on an annual basis. While DCAT requirements are specified by the Actuarial Standards Board, OSFI requires the preparation and submission of DCAT reports using its authority under the ICA to require a valuation by an actuary. In practice, the preparation of a DCAT report is generally accepted and complied with as part of OSFI's expectations. (*paragraph 365(1)(b) of the ICA*).

OSFI's approach is evolving and will continue to evolve after the implementation of the ORSA Guideline. OSFI is moving towards an approach more closely aligned to that which has been adopted for banks—which will require FRIIs to develop their own view of their capital needs based on a comprehensive view of their risks and provide for a review by OSFI of the resulting output.

Of the set of requirements currently in force:

- The Corporate Governance Guideline requires FRIIs to identify the significant risks they face, assess their potential impact and have policies and controls in place to manage them effectively.
- The Stress Testing Guideline requires that institutions use stress testing to address institution-wide risks and consider the concentrations and interactions between risks in stress environments that might otherwise be overlooked.
- The Internal Target Guideline requires FRIIs to establish an Internal Target Capital Ratio (Internal Target) which is the level of capital necessary to cover all their risks with a high level of confidence.

The DCAT framework requires insurers to develop an understanding of the sensitivity of the insurer's financial condition under each major risk category that is relevant to the company. The actuary has also to make an interim investigation if there is a material adverse change in the insurer's circumstances.

Risks covered for L&H companies are: mortality, morbidity, persistency or lapse, cash flow mismatch, deterioration of asset values, new business risk, expense, reinsurance, government and political risk, off-balance sheet risk, and related company risk; and for P&C insurers: loss frequency and severity risk, policy liabilities risk, inflation, premium risk, reinsurance, investment, government and political risk, off-balance sheet risk, and related company risk. Insurers consider the additional risk arising due to membership of a group in their DCAT by assessing related company risk, which is the risk that the insurer may run into financial difficulties as a result of its subsidiaries' or any other related entity's financial difficulties (i.e., contagion risk).

Together these guidelines and the DCAT framework require FRIIs to quantify risks (in parallel with the MCCSR and MCT capital framework) and the capital which they need to hold against them under a range of scenarios, updated on a regular basis.

	<p>The current guidelines require documentation of the FRI's approach. The Stress Testing Guideline requires that FRIs have written policies and procedures governing the stress testing program. The assumptions for each stress testing exercise have to be appropriately documented, including the reasoning and judgements underlying the scenarios chosen and the sensitivity of stress testing results to the range and severity of the scenarios. The Internal Target Guideline requires that analysis supporting the determination and review of an insurer's Internal Target is clearly and formally documented in a report to the Board.</p> <p>OSFI's Corporate Governance Guideline addresses risk governance, specifically the development of a Risk Appetite Framework (RAF) and risk oversight, including the Board Risk Committee and the Chief Risk Officer (CRO)/Risk Management Function (ICPs7 and 8).</p> <p>There is no requirement for a single risk management policy. Requirements on risk policies in different contexts are set out in various documents including the Derivatives Best Practices Guideline and the Sound Reinsurance Practices and Procedures Guideline (Reinsurance Guideline – ICP13). The Prudent Person Guideline requires that every financial institution have a written investment policy that describes the objectives for the investment program and the overall risk philosophy of the institution (ICP15).</p> <p>OSFI expects insurers to have a risk management policy on AML practices and activities.</p> <p>With respect to more complex and less transparent classes of assets and investments in markets or instruments that are subject to less governance or regulation, the Prudent Person Guideline requires insurers to establish policies outlining the circumstances in which derivative instruments can be used (ICP15). In addition, insurers must establish limits on the use of derivative instruments by type of instrument (e.g., swaps, options, futures) and by counterparty. In addition, the Derivatives Best Practices Guideline outlines factors that OSFI expects the management and Board of a FRFI to consider when derivative instruments are part of its investment and financing profile.</p> <p>The Corporate Governance Guideline requires that FRFIs be in a position to identify the significant risks they face, assess their potential impact and have policies and controls in place to manage them effectively. This includes insurance (or underwriting risk). As part of its Supervisory Reviews, OSFI reviews and assesses the underwriting policies and controls implemented by the insurer with a view to mitigating insurance risk.</p> <p>OSFI's Corporate Governance Guideline and supervisory guides detail OSFI's expectations with respect to the Risk Appetite Framework (RAF). In addition, the Corporate Governance Guideline requires the FRFI to set risk limits, which are the allocation of the FRFI's risk appetite statement to: (1) specific risk categories (e.g., credit, market, insurance, liquidity, operational); (2) the business unit or platform level (e.g., retail, capital markets); (3) lines of business or product level (e.g., concentration levels); and (4) more granular levels, as appropriate. Risk limits are often expressed in quantitative terms, and are specific, measurable, frequency-based and reportable.</p>
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	<p>The Draft ORSA Guideline:</p> <ul style="list-style-type: none"> <li>• requires that insurers comprehensively identify and assess all reasonably foreseeable and relevant material risks that may have an impact on the insurer’s ability to continue its operations and maintain investor/market confidence in both normal and stressed situations and to meet its policyholder and creditor obligations;</li> <li>• requires that the ORSA address, among other risks, insurance, market, credit, operational, regulatory compliance and strategic risks;</li> <li>• provides additional examples of other risks and risk considerations, including reputation and liquidity risk;</li> <li>• requires that insurers have a clear and documented process for relating capital to the level of all current and reasonably foreseeable and relevant material risks. The insurer is required to make a clear determination on whether or not, for each risk, an explicit amount (quantity) or type (quality) of capital should be held.</li> </ul> <p>These new requirements in the draft ORSA Guideline are to a significant degree already covered by OSFI’s existing framework of guidelines, as set out above and to that extent the ORSA guideline will function more to consolidate than to extend OSFI’s current approach to risk management requirements for solvency purposes. However, the ORSA Guideline will also add to the approach in some respects, such as requiring a fully documented process to underpin internal risk assessment and capital management. Furthermore, the ORSA requirement will significantly reinforce the need for FRIs to take their own view of overall capital needs, independent of the regulatory framework.</p>
Assessment	Largely observed.
Comments	<p>OSFI has an extensive set of guidelines that require FRIs to identify, measure and manage all material risks, taking into account the results of stress testing. These guidelines also require insurers to make their own evaluation of their capital needs, based on their own assessment of risks. OSFI’s guideline on ORSA requirements, which is currently a draft standard that will be implemented in 2014, will consolidate and extend this framework, emphasising the need for FRIs to take their own view of overall capital needs, independent of the regulatory framework—which is critical to ensuring that OSFI has the necessary input into its own process for evaluating the individual capital adequacy of FRIs. Full implementation of the approach will take some time, even if FRIs are already working on improving their framework based on the draft guideline.</p> <p>It is recommended that OSFI finalise the draft ORSA guideline and set expectations for the early phase of implementation work as soon as possible.</p>
<b>ICP 17</b>	<p><b>Capital Adequacy</b></p> <p>The supervisor establishes capital adequacy requirements for solvency purposes so that insurers can absorb significant unforeseen losses and to provide for degrees of supervisory intervention.</p>
Description	<p>The ICA requires FRIs to maintain adequate capital. OSFI Guidelines provide the framework to assess whether FRIs comply with the ICA: the Minimum Continuing Capital and Surplus Requirements (MCCSR) for Life Insurance Companies (MCCSR Guideline) and the Minimum Capital Test (MCT) for Federally Regulated Property and Casualty</p>

	<p>Insurance Companies (MCT Guideline). (<i>s515(1) of ICA</i>)</p> <p>The MCCR and MCT tests are standardized tests, but internal models may be used for specified risks: segregated fund capital requirements and earthquake risk. The use of models requires OSFI's prior approval.</p> <p>Branches in Canada are also subject to requirements to maintain in Canada an adequate margin of assets over liabilities in respect of insurance business in Canada. The Test of Adequacy of Assets in Canada and Margin Requirements (TAAM) for L&amp;H insurers and the Branch Adequacy of Assets Test (BAAT) are set out in the MCCR and MCT Guidelines. (<i>s608(1) of ICA</i>).</p> <p>Capital requirements for both L&amp;H and P&amp;C FRIs are based on all the material risks defined in the guidelines by applying prescribed factors or shocks to specific on- or off-balance sheet items, backed up by stress tests. The requirements are aimed at enabling FRIs to absorb losses for which technical provisions, including the margins for adverse deviation (see ICP14), prove to be inadequate.</p> <p>Actual capital ratios are expressed as a ratio of actual eligible capital resources to total capital requirements, enabling OSFI to monitor compliance and set clear levels for intervention:</p> <ul style="list-style-type: none"> <li>• Minimum requirements: P&amp;C insurers must maintain capital at 100 percent of the requirement. L&amp;H insurers must hold a minimum 120 percent of the requirement, reflecting an allowance for risk that the standardized test does not or cannot explicitly capture, including operational risk.</li> <li>• Target requirements: all FRIs are also subject to a Supervisory Target ratio, aimed at taking into account additional risks not captured in the general requirements such as volatility in markets and economic conditions, industry innovations, consolidation trends and international developments and (in the case of P&amp;C FRIs, operational risk; this is currently set at 150 percent of the minimum capital requirement).</li> <li>• Internal Target: FRIs have to establish their own internal target capital, subject to OSFI review, to reflect idiosyncratic risk (the Internal Target Capital Ratio for Insurance Companies Guideline). This is the level of capital, based on an FRI's own risk and capital adequacy assessment process, necessary to cover the risks specified in the capital tests as well as all other risks of the insurer. OSFI expects the internal target to exceed the supervisory target by a significant margin. OSFI can and does increase its supervisory attention in the event that an FRI's actual capital fell below its Internal Target.</li> </ul> <p>For L&amp;H FRIs, the MCCR Guideline also sets capital requirements based on net Tier 1 capital—a minimum of 60 percent and a Supervisory Target of 105 percent. In addition, they are required to maintain a minimum amount of available capital of Can\$5 million or such amount as specified by the Minister.</p> <p>Capital available is calculated based on the balance sheet prepared based on IFRSs, taking into account the valuation of all assets and liabilities (ICP 14). Both the MCCR and MCT Guidelines specify how an FRI must assess its capital resources and the qualities which capital must possess for inclusion in capital available.</p>
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OSFI keeps the design and overall calibration of the capital requirements under review. Both the MCCSR and MCT have been subject to different stages of reform and development, in consultation with FRIs and supported by Quantitative Impact Studies. Observation of other countries' approaches and of experience of the regime during the financial crisis (and experience of insolvencies over a longer period, limited as it is for L&H FRIs particularly) are used as inputs into reconsideration of the overall calibration.

An overall level of confidence for the combination of technical provisions and capital is targeted. For both the MCCSR and MCT, the current requirements are, in aggregate, set at a confidence level of approximately conditional tail expectation (CTE) of 99 percent, as suggested by the results of quantitative impact studies. However, because different elements of the overall test are calibrated differently or subject to the exercise of discretion by individual FRIs, in practice, OSFI relies on building in conservatism through the Supervisory Target at 150 percent and the Internal Target above that. Equally, OSFI's legislation acknowledges the need to allow institutions to compete effectively and take reasonable risks. It also recognizes that management and boards of directors are ultimately responsible and that financial institutions can fail.

The minimum and target requirements provide a framework of solvency control levels. Failure to meet these levels or indicators of potential failure in the future can trigger intervention actions as described in the Guide to Intervention for Federally Regulated Life Insurance Companies and Supervisory Guide Applicable to Federally Regulated Insurance Companies. FRIs may be categorised as being in normal or four stages of intervention (ICP10). For example, if a FRI is categorized as Stage 1 (early warning), OSFI has identified "deficiencies in the company's financial condition, policies or procedures or the existence of other practices, conditions and circumstances that could lead to the development of problems described at Stage 2 if not promptly addressed."

There is considerable flexibility in the application of the intervention framework and the level of intervention and accompanying actions are determined on a case-by-case basis. An FRI is automatically categorised as Stage 1 for breaching OSFI's minimum required capital ratios even for one day. However, a FRI whose capital level falls below or even approaches the Supervisory Target may also be categorised as Stage 1 depending on the circumstances.

When it intervenes, OSFI can and often does set a capital buffer requirement, maybe determined through a stress test performed by the company. OSFI has powers, but in only one case in the last ten years has it used them, under section 515(2) of the Act to issue an order requiring compliance with a particular minimum requirement. Failure to comply with an order to increase capital gives grounds for OSFI to take control of the company.

OSFI sets capital requirements principally on a consolidated basis. The scope of the consolidated group is comprehensive in relation to financial companies, i.e. those that carry on a business that a company could carry on directly in accordance with the ICA (insurance, real estate and ancillary business such as agencies, brokerages and mutual funds). However, In relation to:



- Non-operating L&H holding companies, where these are regulated as insurance companies under the ICA (two of the large three L&H groups), the consolidated group at holding company level is subject to a variation of the MCCR, which applies only the Minimum Capital Requirement and an Internal Target but not a Supervisory Target. The OSFI Guideline A2 (Capital Regime for Regulated Insurance Holding Companies and Non-Operating Life Companies) sets how the MCCR is otherwise varied for these groups, which includes exclusion of non-life companies and, with OSFI approval, significant foreign L&H subsidiaries, as well as some allowance for inclusion of senior debt issues in Tier 2 capital. Disclosure of actual ratios is not required. OSFI is considering a revision of this guideline at present.
- Holding companies which are unregulated, which include the holding company for one large L&H FRI and a number of other groups and sub-groups within larger groups (including bank/insurance conglomerates): neither the MCCR nor MCT are formally applied on a consolidated basis (because these are unregulated holding companies). Instead, OSFI relies on supervisory relationships, taking into account the significance of the regulated entities, to collect information and monitor capital adequacy against the MCCR and MCT ratios. In some cases, these expectations are set out in contractual arrangements or letters of undertaking between OSFI and the holding company (see ICP23). The standard solvency levels for intervention are not formally applied, although OSFI monitors capital levels of the groups which it considers significant and would respond to a deterioration in financial condition. Such groups are not required to disclose their overall capital adequacy requirements at the holding company level.

The regulatory capital requirements are set out in published MCCR and MCT Guidelines and the Guideline on regulated holding companies. However, there is no published material setting out the approach to consolidated capital for groups headed by unregulated holding companies. The Guidelines are updated yearly with any proposed changes subject to consultation. Under current plans, OSFI will complete its revision of the MCCR late in 2013 with implementation of the new standard approach expected January 1, 2015. The new MCT standard approach framework is scheduled for implementation on January 1, 2015.

OSFI's approach to the application of capital requirements at the solo legal entity FRI level is less developed. In many cases, where FRIs are not part of groups, the requirements are in practice the same. In other cases, where a solo legal entity is material, OSFI monitors capital adequacy through the reporting and supervisory processes. OSFI is developing a standard for capital adequacy for material FRIs (which will also apply to the large banks) based on a leverage framework, and is implementing aspects with the largest FRIs, although the guidance has not yet been finalised. Medium and smaller companies will not be covered by this requirement. In practice, therefore, the requirements set out in the MCCR and MCT and related parts of the framework, including the MCR and target ratios, apply only at group level.

Material categories of risk are covered in the technical provisions (ICP14), and regulatory capital requirements (MCCR and MCT and the additional requirements derived from the 120 percent minimum standard for L&H companies and 150 percent Supervisory target). MCCR and MCT guidelines set out clearly the risks covered in technical provisions (via Actuarial Standards of Practice on Margins for Adverse Deviations - ICP14) and capital

requirements. Insurance risk and foreign exchange risk are covered in both, in respect of expected losses and unexpected losses. Risk is aggregated in the tests by simply adding the individual risk components together. There is a limited amount of risk diversification in the tests and only in respect of diversification within risk types.

Capital requirements for segregated fund guarantees and earthquake risk maybe calculated using internal models based on specified confidence levels. For example, companies using earthquake models must determine capital for earthquake exposure based on a 1-in-500-year event.

As set out in the Internal Target Guideline, insurers must produce a report that documents their determination of an Internal Target. OSFI reviews the report and assesses whether the process and its results are appropriate and aligned with its own assessment of the insurer's risk appetite and risk profile. OSFI may recommend that an insurer increase its Internal Target. OSFI has sought additional capital where there are minor deficiencies against requirements for use of internal models.

Both the MCCSR and MCT Guidelines specify the capital resources that will qualify as available capital for the purposes of meeting regulatory capital requirements.

- For L&H FRIs, highest quality capital items are included in Tier 1 capital, including common shares and retained earnings.
- For P&C FRIs, capital available is restricted to equity, preferred shares and subordinated indebtedness whose redemption is subject to regulatory approval, and non-controlling interests.

Both guidelines set out various limits, restrictions and deductions, including goodwill and intangible assets (for L&H FRIs, where in excess of five percent of gross Tier 1 capital) and (again for L&H FRIs) adjusted negative reserves calculated policy by policy. P&C FRIs must deduct amounts receivable and recoverable from unregistered reinsurers in excess of the collateral put up by reinsurers (see ICP13).

OSFI allows the use of internal models to determine required capital for segregated funds risk under conditions set out in the March 2002 guide Use of Internal Models for Determining Required Capital for Segregated Funds Risk (MCCSR). These include risk measurement, compliance, data integrity and validation, model testing, systems, reporting and ongoing compliance with requirements.

In light of experience from the financial crisis in relation to both liabilities and capital, OSFI has updated its guidance on required capital for segregated funds. FRIs must obtain written approval from OSFI to use internal models under a process set out in OSFI's publication Capital Model Approval Policy. FRIs need to demonstrate use of the model in risk management as well as a robust technical approach. The policy document requires the model to be integrated into day-to-day risk management.

OSFI's Supervisory Process for Approval and Ongoing Monitoring of Capital Models sets out its approach in relation to ongoing compliance and suitability for using internal models for regulatory capital purposes, including validation against actual market

	<p>performance.</p> <p>The AA must give an opinion on the appropriateness of the controls, models and assumptions, and the accuracy of the resulting required capital levels. All key changes to an approved model must be reported to OSFI in advance of their implementation into the model. Quarterly model performance monitoring meetings are held with FRIs. The Chief Risk Officer must sign an annual attestation of compliance with minimum requirements and internal audit must provide a positive opinion letter in respect of the effectiveness of relevant controls.</p>
Assessment	Largely observed.
Comments	<p>The capital requirements for FRIs are comprehensive, capturing all material risks as well as requiring FRIs to hold capital for risks not covered by standard requirements. The approach is risk-sensitive and encompasses operational risk, although on the basis of additional buffers rather than detailed quantitative requirements. OSFI also requires FRIs to calculate internal capital targets and uses their oversight of this process to assess whether capital of FRIs fully reflects their individual risks. OSFI allows firms to use internal models in limited areas, but applies a full model approval process and ongoing monitoring.</p> <p>A distinguishing feature and a strength of OFSI's regime is its application on a consolidated basis to each operating FRI, even encompassing their foreign insurance operations. However, because of the limitations on its powers over unregulated companies within a group, OSFI's approach to the application of its capital requirements on a consolidated basis varies across groups. Although OSFI is developing a set of requirements for solo legal entity capital requirements to apply to material solo FRIs, the full capital requirements are not applied at the level of the solo legal entity.</p> <p>It is recommended that:</p> <ol style="list-style-type: none"> <li>Unless and until OSFI obtains full powers to apply its regulatory framework to holding companies, it should, in the interests of transparency, set out details of its approach to groups headed by holding companies.</li> <li>OSFI should also consider aligning the requirements for regulated holding companies more closely to those for regulated operating companies.</li> <li>OSFI should finalise its proposed standard for the application of the capital framework on a solo legal entity level and develop a plan for publication of the full approach in due course. OSFI should also establish a policy to address, and review its reporting requirements on intra-group transactions for capital management purposes (for example, capital transferability within the group).</li> </ol>
<b>ICP 18</b>	<p><b>Intermediaries</b></p> <p>The supervisor sets and enforces requirements for the conduct of insurance intermediaries, to ensure that they conduct business in a professional and transparent manner.</p>
Description	Intermediaries (agents and brokers) must be licensed by the provincial supervisor in the

province/territory that they operate. Under the Agreement on Internal Trade that facilitates the movement of labor across Canada, insurance intermediaries licensed in one province can obtain a certificate to act in other provinces without meeting all the requirements. CCIR and CISRO have developed harmonized standards for agent proficiency and classes of licenses. In addition, CCIR and CISRO have adopted a reliance model for reciprocal licensing of insurance agent/broker, effective July 4, 2006. The reliance model incorporates greater harmonization on application forms, continuing education requirements and errors and omissions insurance. A host supervisor relies largely on the regime of the home jurisdiction but may impose further requirements specific to the host jurisdiction. For example, intermediaries in Québec have to pass certain prescribed examination.

Over the past 10 to 12 years, the MGA distribution model has become a dominant distribution channel. A life insurance agent often deals with any number of insurers either directly or through MGAs often moving between MGAs for various reasons. MGAs that engage in the activities of an agent are required by law to be licensed as agents, but MGAs who do not engage in the activities of an agent are not required to be licensed. Industry participants confirmed that virtually all MGAs are also operated by licensed intermediaries. The CCIR's consultation paper on MGAs in May 2012 noted that insurers adopt diverse practices in their outsourcing to (e.g., agent supervision) and monitoring of MGAs. CCIR concluded that while "there are no specific consumer protection goals that would be advanced through an MGA specific licensing regime", supervisors need to understand better the various business models of MGAs and life insurers should have effective systems and controls wherever they use a MGA to manage their relationships with agents or salespersons.

Banks involved in distributing insurance policies are subject to specific rules. In particular, they are prohibited from promoting insurance policies unless the insurance products are authorized products, i.e. those that are closely related to their lending businesses<sup>65</sup>.  
(*section 416 of Bank Act, Section 2 and section 6 of Insurance Business (Banks and Bank Holding Companies) Regulations*)

The general regulations governing the distribution of insurance products also apply to products sold through the Internet (with appropriate adjustments). In 2012, the CCIR conducted a survey regarding electronic commerce in insurance products. AMF also simultaneously published a consultation on internet insurance offerings in Québec, which is likely to lead to amendments to the Québec legislation.

#### **AMF**

The regulatory regime for intermediaries in Québec provide for two categories of

<sup>65</sup> Authorized products include credit or charge card related insurance, creditors' disability insurance, creditors' life insurance, creditors' loss of employment insurance, creditors' vehicle inventory insurance, export credit insurance, mortgage insurance and travel insurance.

	<p>authorization:</p> <p>a) Representative's certificate – issued to individuals and valid for one year, and is renewable, provided they continue to meet the authorization requirements<sup>66</sup>. (<i>Regulation respecting the Issuance and Renewal of Representatives' Certificates</i>).</p> <p>b) Registration of a firm, an independent partnership or an independent representative. Certified individuals may act: on behalf of one or several firms as an employee or affiliated representative; on behalf of an independent partnership as an associate or an employee; or as an independent representative. The application for registration must be supported by the required information. Registration does not have an expiry date, unless cancelled or suspended by AMF. However, an intermediary must submit an annual maintenance of registration form to update information submitted for AMF to check whether it continues to meet the conditions for registration. (<i>Regulation respecting the Registration of Firms, Representatives and Independent Partnership</i>).</p> <p>Any person who acts as an intermediary without AMF's authorization is liable to sanctions under the DA<sup>67</sup>. AMF maintains a register of intermediaries authorized on its website. A representative or registrant may be authorized for more than one discipline or discipline class. As at November 2012, there were 30,839 certified representatives; employed or associated with 14 independent partnerships, 3,135 independent representatives and 3,632 firms. (<i>s234, s408 &amp; s482 of DA and s19(a) of IA</i>)</p> <p>Insurers usually use intermediaries to distribute insurance products but can also sell their products directly ("distribution without a representative" or DWR) or they may, by giving out brochures or flyers or using direct mail or any other form of publicity, invite the public to purchase insurance products in Québec. An insurer must register as an intermediary, if it distributes its products through certified intermediaries. An insurer must register as a firm only if it wishes to sell insurance products through representative employed by it. Insurers are accountable to AMF for the proper distribution of their products under both approaches. If an insurer adopts the DWR model, it must submit its distribution guide and compliance report to AMF before offering products through distributors. AMF assesses the guide and may require an insurer to make amendments to comply with the DA. Insurers may also work with banks using the DWR business model. (<i>s12, s408 to s444 of DA</i>)</p> <p>Before issuing a representative's certificate, AMF must ensure that an applicant meets training requirements and the minimum level of education or equivalent experience. It must also verify that the candidate meets the standards of professionalism, competence and integrity<sup>68</sup>. Prospective intermediaries must pass AMF examinations to determine whether they are sufficiently qualified to advise clients. They must also complete a</p>
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<sup>66</sup> Under the DA, an insurance representative (natural person) is either a representative in insurance of persons, a group insurance representative, a damage insurance agent or a damage insurance broker.

<sup>67</sup> The fines range from Can\$ 2,000 and Can\$ 200,000 depending of the facts of the case (*s. 461, 462 and 485 of DA*)

<sup>68</sup> Through checks done on the questionnaire information: background, any disciplinary or criminal record, financial situation (winding-up or bankruptcy etc.), supervisory measures imposed (suspension of certificate), unpaid fines or civil suits in relation to activities in the financial services sector.

<p>probationary period (supervised by a certified intermediary). The requirements differ depending on the discipline or discipline class<sup>69</sup> applied for, i.e., stricter for disciplines involving more complex products.</p> <p>Representatives are required to maintain their competencies through mandatory continuing education courses. They must earn training points, depending on the discipline or discipline class(es) certified. (<i>Regulation of the Chambre de la sécurité financière respecting Compulsory Professional Development, Regulation respecting the Compulsory Professional Development of the Chambre de l'assurance de dommages and Regulation respecting the Compulsory Professional Development of Financial Planners</i>).</p> <p>Intermediaries operating as corporations are subject to general corporate governance legislation.<sup>70</sup> Certain corporate governance information is filed at the time of application e.g., shareholders, including insurers holding direct or indirect interest. The DA and related regulations also establish some corporate governance requirements, e.g., disclosure of business relationships, supervision of executive officers and employees, record keeping, confidentiality of information, sharing of commissions, etc. There is scope for AMF to establish proportionate corporate governance principles that are tailored to intermediaries, particularly in the fair treatment of policyholders. (<i>s26, s85 of DA, Regulation respecting Information to be provided to Consumers (Disclosure-Reg), Regulation respecting Firms, Independent Representatives and Independent Partnership</i>).</p> <p>Intermediaries are subject to specific disclosure requirements including: the discipline or discipline class they are authorized to practice; certain business relationship with a FI or another intermediary. Financial planners<sup>71</sup> must enter into a detailed written agreement with the client before providing services. Similar obligation has been proposed for representatives involved in group insurance. (<i>Regulation respecting the Pursuit of Activities as a Representative (Representatives-Reg) and s26 &amp; s147 of DA and Disclosure-Reg</i>)</p> <p>A representative who receives compensation directly from his client must disclose the amounts and whether he is receiving other sources of compensation. While there is no requirement to disclose specific amount and method of compensation, provisions related to conflicts of interest and sales contests state that incentives must be used with the utmost respect for the client, while minimizing potential conflict of interest. In the case of DWR, compensation to distributor exceeding 30 percent of premiums must be disclosed (<i>s17 &amp; s431 of DA, s4.1 of Disclosure-Reg, s5 of Representatives-Reg and Code of Ethics</i>).</p> <p>An intermediary who handles clients' money must deposit the money in a separate account from the intermediary's other accounts and confirm compliance with AMF by</p>
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<sup>69</sup> The discipline classes are: insurance of persons, group insurance of persons, financial planning, P&C insurance.

<sup>70</sup> Specifically: Civil Code of Québec, Business Corporations Act, Canadian Business Corporations Act.

<sup>71</sup> AMF controls the use of the title "Financial Planners" whose role are to provide advice but not permitted to sell financial products. There were 4,635 Financial Planners at the time of assessment.

<p>declaration. Moreover, insurance monies paid through an intermediary are deemed to have been paid directly to the insurer. Intermediaries must also contribute to the Financial Services Compensation Fund, which compensates victims of fraud, fraudulent tactics and embezzlement. (s2(17), 4(7) and 6(11) of Regulation respecting the Registration of Firms, Representatives and Independent Partnerships, s4 of the Representative-Reg, s102 s146, s258 &amp; s437 of DA, Regulation respecting the Eligibility of a claim submitted to the Fonds d'indemnisation des services financiers).</p> <p>AMF's off-site monitoring is largely based on information submitted for the annual maintenance of registration form or renewal applications for representative certificates. In addition, AMF also receives third party information on intermediaries, such as disciplinary measures taken by the SROs or consumer tips and complaints. The information is used as inputs for its risk assessment process, which also considers the period in business, the scale of operations e.g., number of representatives and disciplines authorized and the number of complaints etc.</p> <p>AMF carries out periodic routine inspections as well as risk-based inspections and it may also conduct for-cause inspections to address specific supervisory concerns (typically not included in the inspection plan). Intermediaries that are considered as a higher risk will generally be targeted for inspections. The routine inspections allow AMF to cover a broader set of intermediaries and help to validate its risk assessment process. The scope of its inspection includes reviews of policies and procedures, books and records and the use and protection of confidential customer information. Inspection procedures include testing the complaint management policies and procedures and reviews of books and records (including customers' files) for proper recording of commissions and transactions. AMF also inspected MGAs, which are registered in Québec, and found cases of inadequate internal controls e.g., lack of manuals and procedures etc.</p> <p>AMF issues a deficiency report upon completion of an inspection outlining the areas in which the intermediary fails to meet regulatory requirements. It requires an action plan and a commitment from the intermediary to address the deficiencies noted, with particular attention for significant deficiencies. AMF reviews and follows up on the responses to its deficiency reports and may check implementation at a subsequent inspection<sup>72</sup>. Enforcement actions may be taken if intermediaries fail to address its concerns adequately (ICP 11).</p> <p>AMF has created a cyber-surveillance team to enhance the detection and the prevention of illegal sale of insurance products via internet and social networking services. It also reviews infomercials on radio stations to identify inappropriate advice and solicitation of insurance products (e.g., segregated funds).</p> <p>Complaints and tips are generally received by AMF's Contact Centre, which will perform an initial assessment. The matter will be referred to compliance, inspection or</p>
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<sup>72</sup> Examples of the most frequent irregularities noted during inspections of intermediaries include: the absence or incomplete analysis of financial needs of clients; failure to ensure proper documentation (e.g., blank signed forms); working capital deficiencies and failure to ensure compliance with the policy replacement procedure.

	<p>investigation teams or other organizations, as appropriate. Each complaint is acknowledged (generally within two to five days) with the contact information of the AMF staff assigned.</p> <p><b>FSCO</b></p> <p>Any person wishing to carry on the business as an insurance intermediary in Ontario must receive a license from FSCO or RIBO. RIBO licenses independent general insurance brokers and FSCO licenses all other insurance agents. As of June 8, 2012, FSCO regulated 46,222 insurance agents; 4,632 corporate insurance agencies; and 1,657 insurance adjusters. As of July 31, 2012, RIBO regulated 17,526 individuals and 1,204 active businesses. (<i>s2 of Regulation 347/04</i>)</p> <p>Employees of insurers are required to be licensed if they engage in the activities of an agent. The OIA does not require people who enroll others under a group insurance policy, e.g., credit life insurance sold by banks, to be licensed as agents. (In some provinces, e.g., Alberta and Saskatchewan, banks are required to hold restricted license if they engage in intermediary activities). Staff of insurance brokerages that are owned by an insurer or are publicly-traded must be licensed under the RIB Act.</p> <p>An applicant for a license from FSCO or RIBO<sup>73</sup> must first pass the relevant qualifying examinations and meet the criteria set out in Regulation 347/04 and RIB Act and intermediary regulations. FSCO and RIBO conduct police background checks on prospective intermediaries. They may also issue conditional licenses. An application for an agent's license must be accompanied by the certificate of a sponsoring insurer, including a statement that it has screened the applicant and is satisfied with the suitability of the applicant. FSCO's resources are augmented by Licensing Link, an online system that improves the efficiency of the licensing process. The license of an agent is subject to annual or bi-annual renewals depending on the class of insurance. (<i>s2 to s4 and s6 of Regulation 347/04</i>)</p> <p>FSCO publishes a list of all intermediaries it licenses and disciplinary actions taken against intermediaries on its website. RIBO publishes notifications of disciplinary action in its "Bulletin". On a weekly basis, FSCO emails a list of the agents whose licenses have been revoked, suspended or surrendered, to insurers and other supervisors. The OIA empowers FSCO and RIBO to take action against those individuals or entities that are carrying on insurance intermediation without the necessary license. FSCO has taken action against unlicensed intermediary. Both RIBO and FSCO publish warning notices relating to unlicensed activities on their websites.</p> <p>Insurers are required to have comprehensive monitoring system to ensure agents comply with legal and regulatory requirements and report unsuitable agents to FSCO. It is a condition of licensing that agents and corporate agencies facilitate FSCO's examinations and inquiries. FSCO conducts periodic audits of renewal applications by life</p>
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<sup>73</sup> RIBO has a three tiered licensing regime: The Entry Level (1) (Acting under Supervision), the Unrestricted Technical Only license (Level 2), which enables the licensee to act without supervision, and the Principal Broker (unrestricted) licensee (Level 3).



	<p>agents, e.g., to check their declaration on compliance with the requirement to complete 30 hours of continuing education every two years. RIBO conduct on-site inspections every three to five years to ensure that intermediaries have proper policies and procedures in place. Spot checks are also done to ensure continuing qualification and suitability. A Principal Broker must report serious breaches of the Code of Conduct and regulatory requirements promptly. (s12 of Regulation 347/04 and CLHIA Guideline G8 - Screening Agents for Suitability and Reporting Unsuitable Agents and RIBO's Principal Broker Handbook)</p> <p>Agents and brokers are subject to laws that require them to do certain things and to refrain from doing other things. Since the vast majority of life agents supervised by FSCO are individuals there are no corporate governance requirements. However, Ontario law imposes a requirement on any insurer appointing an agent to act on its behalf to screen the suitability of the agent, monitor the compliance of the agent and to report non-compliance to FSCO. Insurers report unsuitability to FSCO. FSCO also does not have the resources to undertake across the board proactive CoB supervision including governance of agencies (ICP 2). RIBO has the resources to respond to operational or governance concerns brought to its attention.</p> <p>Life insurance agents must disclose to customers, the names of all the insurers and the names of all the product providers that they represent. General insurance agents can only represent one insurer (exception is an affiliated group of insurers can use the same agent). Brokers and agents must disclose the insurers that they are contracted with or represent, respectively, to applicants for automobile insurance and they must disclose any (potential) conflict of interest associated with a transaction or recommendation.</p> <p>An agent or broker who receives premiums (except life insurance<sup>74</sup>) from clients is deemed to hold the monies in trust for the insurer. Similarly, monies received from an insurer e.g., claim payment is deemed to be held in trust for the beneficiary. Agents or brokers are required to pay the monies to the insurer or the beneficiary within 15 days of written demand. Funds received by a broker on behalf of insurers or from insurers are deemed to be trust funds. Life insurance agents must have errors and omissions insurance, which includes coverage for fraudulent acts. RIBO maintains a Professional Indemnification Fund covering insolvency of brokers.</p>
Assessment	Largely observed.
Comments	The provincial supervisors have been collaborating to promote harmonization of the different regulatory regimes for intermediaries, with CISRO taking a proactive role. Both AMF and FSCO supervise a large population of intermediaries in their respective jurisdictions. While the regulatory regimes for intermediaries in Ontario and Québec are broadly similar, there are differences in key areas e.g., the use of SROs. Licensing criteria and on-going compliance requirements are clearly established under both regimes, supported by supervisory guidance. Regulatory information is largely based on

<sup>74</sup> The non-application of the trust concept to life insurance recognizes that payments to the insurer or the client would normally be in the form of a cheque payable to the insurer or the client, or the insurer collects payment directly from the client.

	<p>information submitted for renewals of licenses/certificates, supplemented by third party notifications e.g., from SROs or complainants. Most intermediaries are individuals and there are no explicit corporate governance requirements for intermediaries although incorporated entities are subject to general obligations under the relevant general corporate laws. However, insurance laws impose duties and prohibitions on the actions of intermediaries.</p> <p>AMF conducts routine inspections of intermediaries, generally targeting intermediaries with higher risks. FSCO's supervisory approach is more reactive, mainly in response to self-declarations of non-compliance or complaints/information received. While Ontario laws requires that insurers screen and monitor their agents and report non-compliance, this is complicated by the fact that a significant number of agents represent more than one insurer or place business through MGAs. While the CLHIA has established industry guidelines on MGAs, the trade-offs arising from a self-regulatory approach have to be weighed carefully and on an on-going basis.</p> <p>The authorities are advised to:</p> <ol style="list-style-type: none"> <li>a) Maintain the positive momentum in promoting appropriate harmonisation of the regulatory regimes and supervisory practices with respect to intermediaries across provinces, e.g., regulatory treatment of client monies;</li> <li>b) Consider establishing proportionate governance expectations tailored for intermediaries, focussing on achieving fair treatment outcome for policyholders;</li> <li>c) Implement the recommendations of the CCIR related to the regulatory treatment of MGAs across provinces; and</li> <li>d) Ensure that FSCO has adequate resources for effective supervision of intermediaries.</li> </ol>
<b>ICP 19</b>	<p><b>Conduct of Business</b></p> <p>The supervisor sets requirements for the conduct of the business of insurance to ensure customers are treated fairly, both before a contract is entered into and through to the point at which all obligations under a contract have been satisfied.</p>
Description	<p>CCIR coordinates and promotes the harmonization of the CoB regimes of provincial supervisors and has developed a risk-based supervision approach (ICP 9). In 2008, CCIR and CISRO jointly issued three principles on intermediaries' obligations to act with due skill, care and diligence: priority of the client's interest; disclosure of (potential) conflict of interest; and product suitability. The JFFMR has reviewed insurers' and mutual funds' processes when designing and developing new products and their marketing materials, with the goal of ensuring that the interests of consumers are taken into consideration.</p> <p>Insurance industry associations have also taken initiatives to ensure that their members act with due skill, care and diligence. They have issued voluntary codes including the Advocis Code of Conduct, the Independent Financial Brokers of Canada Code of Ethics for Intermediaries, and IBC's Standards of Sound Marketplace Practice, CLHIA's Guideline</p>

<p>on Individual Variable Insurance Contracts Relating to Segregated Funds (IVIC Guideline).<sup>75</sup></p> <p>Segregated funds and mutual funds are similar investment products but are subject to different regulatory regimes, with segregated funds regulated by insurance regulators and mutual funds by securities regulators. In October 2008, the JFFMR released a framework for point of sale disclosure for segregated funds and mutual funds, concluding a five-year project to create a more effective, harmonized consumer disclosure system.</p> <p>In July 2009, the web-based Complaint Reporting System established by FSCO and AMF was extended to all provinces except British Columbia. The system provides a convenient single window for insurers to submit biannual regulatory reports in all jurisdictions where they do business. Supervisors can review individual cases, which do not identify the complainants, as well as company-specific data and industry-level data.</p> <p><b>AMF</b></p> <p>The IA establishes insurers' obligations to adopt sound commercial practices. Every insurer must act with honesty and loyalty in the best interests of its insured, shareholders or members. A director or officer of an insurer shall exercise the care, prudence, diligence and skill that a reasonable person would exercise in similar circumstances. He shall also act with honesty and fairness in the best interest of the insurer. In doing so, he shall take into account the interests of the insured, the shareholders/members, and avoid conflict of interests. (<i>s222.2, s244, s285.2 and 285.28 of IA</i>).</p> <p>The DA requires intermediaries to act with due skill, care and diligence when dealing with customers, e.g., honesty and loyalty, compliance, supervision. (<i>s16, 84 to 86 and 137 of DA</i>) This is complemented by the three Codes of Ethics mentioned in ICP 2. AMF has also issued guidelines on its supervisory expectations, e.g., the Residential Hypothecary Lending Guideline for insurers offering residential loans. (<i>s325.0.1 and seq. of IA</i>)</p> <p>In promoting insurance products, insurers and intermediaries may not exaggerate the extent of the protection offered or the benefits, nor minimize the cost involved. An insurer must also specify the exclusions likely to affect the nature or scope of insurance protection and indicate the limits to protection. AMF has issued guideline covering advertising, including unfair and deceptive acts, advantages and limitations, source of statistics, testimonials, performance data and performance comparisons. The advertisement of a financial product by a firm, an independent representative or an independent partnership requires authorization from an insurer. A representative must not make any false representations as to his level of competence or the quality of his services, or make statements that are incomplete, false, deceptive or liable to mislead. (<i>IA-Reg, IVIC Guideline, Regulation respecting Firms, Independent Representatives and</i></p>
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<sup>75</sup> The IVIC Guideline specifies that an insurer shall provide an annual statement to policyholders, take the necessary measures to ensure continuous availability of the Funds Facts document, send written notice to each policyholder when there is a partitioning of assets held in segregated funds or when there is a merger with another segregated fund and other fundamental changes.

*Independent Partnerships and Code of Ethics).*

Insurers must properly inform customers of the product or service offered. The disclosure regime for intermediaries is governed by the DA, the Disclosure-Reg, Representatives-Reg and Codes of Ethics. Segregated funds policies are subject to specific disclosure requirements. For DWR, the DA prescribes some content of the distribution guide to be elaborated by insurers and the obligations of the distributors. (*s410 to s416 and s429 to s439 of DA*).

Representatives must obtain the necessary information to assess a client's needs and propose product that best meets those needs. They must also describe the proposed product in relation with the needs identified and specify the nature of the coverage. A distributor must describe the product in accordance with the distribution guide; explain the nature of the guarantee; and highlight the exclusions under the guarantee. (*s27, s28 s411 & s431 of DA, s6 of Representatives-Reg*).

The DA requires intermediaries to disclose business relationships with an insurer. Representatives may not take part directly or indirectly in a contest or a promotion providing non-pecuniary benefits, as an incentive to promote or sell a product that does not meet the specific needs of clients. The Code of Ethics also expects representatives to be independent and avoid conflict of interest. AMF has submitted to the MFEQ its proposals to amend the Regulation respecting Firms, Independent Representatives and Independent Partnerships to disallow any incentives that could influence a representative to the detriment of clients. (*s. 26 of DA and Reg-Representatives*).

Insurers and intermediaries must establish proper policies and procedures to handle claims equitably. They should also have a mechanism for examining complaints and resolving disputes in a timely and fair manner. All complaints received must be reported to AMF, including the number and nature of the complaints. AMF has published an example of a Complaint Examination and Dispute Resolution Policy to guide intermediaries in adopting best practices. It also handles claims and complaints filed with it and can assist consumers with filing a complaint, act as a mediator and provide access to mediation and conciliation services. (*s285.29 of IA and s103, s103.2, s186, s187 & 146 of DA*).

AMF has issued a notice, in May 2013, on the obligations of insurers and intermediaries to service policies until expiry, with a particular focus on orphan policies.

An Act Respecting the Protection of Personal Information in the Private Sector establishes specific rules to protect the privacy of information obtained from customers, which applies to insurers and intermediaries in Québec. No person may communicate to a third person the personal information of another person except with the consent from the latter. The obligation is complemented by the DA through additional requirements to safeguard confidentiality. (*s23, s25, s30, s33 to s37 and s91 to s92 of DA*).

AMF issued the Commercial Practices Guideline on 13 June 2013 to set out its supervisory expectations regarding fair treatment of consumers:

- Fair treatment of consumers is a core component of governance and corporate

	<p>culture;</p> <ul style="list-style-type: none"> <li>• Design and marketing of new products take into account the needs of the various target consumer groups;</li> <li>• Consumers are properly informed to make enlightened decisions regarding products, before, during and after the purchase thereof;</li> <li>• Incentives do not affect the fair treatment of consumers;</li> <li>• Product advertising is accurate, clear and not misleading;</li> <li>• Claims and complaints are examined diligently and settled/resolved fairly, using procedures that are simple and accessible to claimants/consumers; and</li> <li>• Adequate protection of the confidential personal information.</li> </ul> <p>AMF intends to assess the extent to which FIs are achieving the expected results set forth in the guideline through its supervision program (ICP9).</p> <p>AMF plays a major role in financial literacy in Québec and conducts surveys of industry players and consumers to better meet their needs. As part of its strategic plan, AMF has developed an Index of Financial Awareness in Québec that measures the relevance and usefulness of knowledgeable behavior as well as the adoption of such behavior. AMF also manages the Education and Good Governance Fund, which supports consumer education and protection, promotes good governance, and improving knowledge level of intermediaries (e.g., scholarships and excellence awards).</p> <p><b>FSCO</b></p> <p>The OIA, RIB Act and the related regulations establish CoB requirements for insurers and intermediaries. For intermediaries, this includes requirements regarding education, error and omissions insurance, suitability screening, licensing, professional competence, ethical conduct and obligations to policyholders (ICP 18).</p> <p>Insurers are prohibited from unfair or deceptive acts or practices, which include: acts prohibited under the OIA or regulations; unfair discrimination between individuals or risks; misrepresentations or material omissions; false or misleading statements; incomplete comparison of insurance policies to induce lapses, forfeitures or surrenders; inducement to buy insurance; undisclosed charges; unreasonable delay in adjustment and settlement of claims; or issuance/variation of automobile insurance conditional on the purchase of another policy. Brokers are required to discharge their duties with integrity, to be competent, serve the client in a conscientious, diligent and efficient manner and provide quality service. FSCO and RIBA have taken enforcement actions for unfair or deceptive acts or breaches of intermediaries' obligations. Going forward, the FSCO is open to adopting a more positive approach in requiring insurers and intermediaries to ensure fair treatment outcome for clients. In this regard, FSCO created the Market Intelligence and Analysis Unit in 2012 as part of a proactive approach in identifying and monitoring trends and risks in the marketplace and providing analysis for evidence-based executive decision making. (<i>s439 of OIA and Insurance Regulation 7/00 and R.R.O. 1990, Regulation 991</i>)</p> <p>Currently, there is no explicit requirement on insurers to take into account the interests of different types of customers when developing and marketing insurance products. FSCO and RIBO often collaborate on concerns about insurers' marketing of products when notified by intermediaries. Most of these matters are subject to interpretation or</p>
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	<p>relate to contentious products, which are generally voluntarily removed from the market.</p> <p>FSCO's authority regarding the timing, delivery and content of point of sale material varies on a product specific basis. For example, if an insurer does not intend to renew a motor insurance, it is required to give the consumer or broker not less than 30-day or 45-day notice, respectively. For segregated funds policies, Key Facts (a brief summary of the most important policy information) and Fund Facts (a two page summary prepared for each segregated fund outlining its key attributes) must be provided. When recommending the replacement of life policies, an agent is required to provide a declaration<sup>76</sup> to alert policyholders not to forfeit benefits that may be unavailable in the new policy.</p> <p>Given the size of the market and number of products, as well as the scale of marketing activity, FSCO and RIBO have limited ability to consistently monitor the timing, delivery, and content of point of sale material. FSCO is currently establishing a project on life insurance suitability to understand agents' products suitability practices at the point of sale.</p> <p>Insurers and intermediaries are expected to provide appropriate advice and ensure product suitability based on clients' needs, which is supported by minimum knowledge and qualifications requirements. FSCO encourages stakeholder associations to develop codes of conduct that reinforce the duty of care to understand clients' insurance needs, including the client's objectives and financial circumstances. RIBO encourages brokers to document in their files the advice given to clients, particularly if the client does not want to hear or follow that advice.</p> <p>L&amp;H agents and brokers must disclose to a client or prospective client any (potential) conflict of interest associated with a transaction or recommendation. Agents are prohibited from offering an inducement or using coercion or undue influence<sup>77</sup>. P&amp;C insurers and brokers typically include commission disclosures on their websites. (<i>s16 and s17 of Insurance Regulation 347/04 and s7.1 of and R.R.O. 1990, Regulation 991</i>)</p> <p>The IA requires insurers to provide information relating to policy terms and conditions to consumers on an ongoing basis including annual policy statements to segregated fund policyholders. There is no explicit requirement on insurers to service policies appropriately through to the point at which all obligations under the policy have been satisfied, beyond disclosure requirements e.g., dealing with orphan policies.</p> <p>FSCO expects insurers to adopt governance frameworks that will lead to positive market conduct outcomes. As the vast majority of insurers operating in Ontario are FRIIs, FSCO</p>
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<sup>76</sup> CISRO has developed a harmonized declaration that requires an agent to fully explain the benefits of the proposed new policy compared to the existing policy.

<sup>77</sup> In August 2012, an agent's license was revoked after the Advisory Board found that he made false or misleading misrepresentations to clients regarding the advantages of placing new or replacement insurance in order to secure business. FSCO also conducted on surveys of insurers' and intermediaries' and found a high level of observance with the CCIR/CISRO principles with respect to conflict of interests.

	<p>relies heavily on OSFI's due diligence with respect to corporate governance and background checks on directors and senior management of FRIIs.</p> <p>Unreasonable delay in, or resistance to, the fair adjustment and claims, is a prescribed unfair and deceptive act or practice. The Statutory Accident Benefits Schedule sets out detailed claims handling procedures and timelines for motor claims. FSCO has express power to suspend/cancel an insurer's license for failure to pay an undisputed claim. In 2009/2010, FSCO's Dispute Resolution Services arbitrator levied seven special awards against insurers found to have unreasonably withheld or delayed payments in statutory benefits claims.</p> <p>Insurers are required to designate a complaints officer to receive consumer complaints and refer unresolved complaints<sup>78</sup> to an independent third party for review. Depending on the nature of the complaint, insurers will either advise the consumer to contact FSCO or provide the name and details of the relevant industry OmbudService. The Superintendent of Financial Services may appoint an employee to serve as Insurance Ombudsman and inquire into complaints about insurers' business practices.<sup>79</sup> RIBO's complaint handling process comprises a Complaints Committee and Discipline Committee, both comprising brokers and public members appointed by the government to protect public interest. The Complaints Committee reviews complaints and refer possible misconduct to the Discipline Committee. The Discipline Committee has the authority to reprimand, impose additional educational or financial reporting requirements, or restrict, suspend, fine or revoke a registration of a broker. (s5.1 of OIA)</p> <p>Due to an unprecedented increase in applications for mediation, a significant backlog of mediation files has developed at FSCO, resulting in longer wait times. FSCO has undertaken several initiatives to address the backlog,<sup>80</sup> with a resulting 50 percent increase in productivity.</p> <p>The collection, use and disclosure of personal information by commercial organizations, including insurers and intermediaries, is governed by and enforced under the Personal Information Protection and Electronic Documents Act. Under the Act, personal information may be collected, used and disclosed only for purposes that a reasonable person would consider are appropriate in the circumstances and the security and integrity of personal information must be safeguarded. The Office of the Privacy Commissioner of Canada administers and enforces the Act and monitors protection of</p>
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<sup>78</sup> Mediation of disputes about statutory accident benefits is mandatory in Ontario and must be conducted through FSCO by Dispute Resolution Service before the dispute can proceed to arbitration or court.

<sup>79</sup> In September 2012, as a result of a number of complaints received about an insurer, FSCO conducted a review of the insurer's complaint process and data. As a result, FSCO required the insurer to submit a written plan to address certain issues.

<sup>80</sup> A private sector dispute resolution service has been engaged to handle up to 2,000 mediation files per month. Secondly, parties awaiting mediation may jointly consent to extend the time for the completion of the mediation process. The third initiative involves the completion of a Consent to Fail Mediation Form in situations where parties have made genuine efforts to resolve a dispute without any success, upon which FSCO will assign the request to a mediator.

	<p>privacy matters. A Model Code has been established under the Act, which requires organizations to develop guidelines and implement procedures on various aspects including the retention and destruction of personal information.</p> <p>FSCO and RIBO disclose information that they consider in the public interest, within their statutory limitations. FSCO provides several types of information that support the fair treatment of customers. For example, FSCO publishes: lists of licensed entities, warning notices regarding unauthorized/unlicensed entities and disciplinary actions against insurers and intermediaries. FSCO's website also provides a financial literacy portal, providing consumers with access to relevant financial information to make informed decisions. FSCO engages consumers via social media (e.g., Twitter) providing information on consumer awareness tips and warning notices.</p>
Assessment	Partly observed.
Comments	<p>At the national level, CCIR coordinates and promotes the harmonization of the CoB regimes of provincial supervisors and has developed a risk-based supervision approach, which is adopted by FSCO and which played a large role in the development of the AMF's Supervisory Framework. The JFFMR has reviewed insurers' and mutual fund company processes when designing and developing new products, with the goal of ensuring that the interests of different types of consumers are taken into consideration. Insurance industry associations have also taken initiatives to ensure their members act with due skill, care and diligence including voluntary codes of conduct. There is a nationwide Complaint Reporting System accessible by all provincial supervisors (except British Columbia).</p> <p>The IA, DA and related regulations as well as AMF guidelines provide for fair treatment of policyholders and disclosure requirements for insurers and intermediaries in Québec. These include promoting a culture of fair treatment of customers, product development and promotion, timely and equitable handling of claims and complaints and policy servicing obligations. The privacy of customers has statutory protection.</p> <p>FSCO and RIBO have established CoB requirements through to the point all obligations under a contract have been satisfied. Due to resource constraints, FSCO and RIBO have limited ability to consistently monitor the timing, delivery, and content of point of sale material. They have issued limited supervisory guidance (except for motor insurance) and leverage on stakeholder associations to develop their own codes of conduct. As the vast majority of insurers operating in Ontario are FRIs, FSCO relies heavily on OSFI's due diligence with respect to corporate governance and background checks on directors and senior management of FRIs.</p> <p>The authorities are advised to strengthen the current CoB regimes:</p> <ul style="list-style-type: none"> <li>(a) Continue the proactive initiatives by CCIR and JFFMR to enhance consistency of CoB regulatory regimes across provinces;</li> <li>(b) Empowering FSCO to issue enforceable rules on product development and promotion as well as require insurers and intermediaries to conduct needs analysis before providing advice and meet policy servicing obligations; and</li> <li>(c) Review the adequacy of supervisory resources of FSCO for regulatory policy</li> </ul>



	formulation and conduct more proactive CoB supervision.
<b>ICP 20</b>	<p><b>Public Disclosure</b></p> <p>The supervisor requires insurers to disclose relevant, comprehensive and adequate information on a timely basis in order to give policyholders and market participants a clear view of their business activities, performance and financial position. This is expected to enhance market discipline and understanding of the risks to which an insurer is exposed and the manner in which those risks are managed.</p>
Description	<p>FRIIs are subject to extensive disclosure requirements under both the Canadian framework of financial reporting standards, which since the start of 2011 has been closely based on IFRS, and requirements set by OSFI:</p> <ul style="list-style-type: none"> <li>• For financial statements, OSFI has required (in a letter dated April 2008) that all FRIIs apply IFRS and not only those FRIIs which are “publicly accountable enterprises” (the general basis for the application of IFRS in Canada). This means that the same standards apply whether or not the FRII is listed, otherwise issues publicly available instruments or is publically accountable enterprise as defined. IFRS have been adopted with limited variations by the Canadian Accounting Standards Board. Where the IFRS accommodate the use of national standards on an interim basis (as does IFRS4 in relation to the accounting and disclosure requirements for insurance liabilities pending further work – Phase II), FRIIs are required to use accepted actuarial practice in the Standards of Practice issued by the Actuarial Standards Board, which include disclosure as well as valuation requirements. (<i>s365(2) of the ICA</i>)</li> <li>• OSFI has also issued disclosure guidelines aimed at supplementing the disclosures required under IFRS: Guideline D-1A Annual Disclosures (Life Insurance Enterprises) and Guideline D-1B Annual Disclosures (P&amp;C Insurance Enterprises) set out mainly qualitative disclosure requirements, in relation to FRIIs’ risk management; Guideline D-9 Source of Earnings Disclosure (Life Insurance Companies) sets out how FRIIs should present earnings statements; and Guideline E-16 Participating Account Management sets out extensive requirements on disclosures in relation to participating policies.</li> </ul> <p>In addition, all FRIIs are subject to an ICA requirement that the directors of a FRII place before shareholders and policyholders at every annual meeting audited financial statements as well as the reports of the external auditor and AA. (<i>s331 and s349 of the ICA</i>)</p> <p>OSFI does not otherwise explicitly require that financial statements are made available to policyholders. There are provisions in the ICA for the Governor in Council to issue regulations requiring all FRIIs to make their financial reports and associated disclosures available to the public on request, but these powers have not so far been used. OSFI’s guidelines encourage FRIIs to adopt the practice voluntarily. (<i>s673.1 (1)(b) of ICA</i>)</p> <p>These requirements in the legislation and OSFI guidelines are further supplemented by disclosure guidance issued by the Canadian Institute of Actuaries, which in particular elaborate on the application of IFRS standards and on the preparation of the section of annual financial statements on Management’s Discussion and Analysis.</p> <p>The effect of these requirements and guidance is that extensive information, both quantitative and qualitative and on earnings as well as balance sheet data, is available on FRIIs on a consistent and timely basis (at least annually):</p>

	<ul style="list-style-type: none"> <li>• Because it has adopted IFRS relatively closely, the accounting and disclosure framework has imported an underlying approach (set out in the IASB Conceptual Framework) that is aimed at making available information that is relevant, timely and useful to market participants.</li> <li>• Specific international standards address disclosure requirements in relation, for example, to financial performance as well as capital management, including regulatory capital requirements (IAS1). IFRS 4 sets out requirements for disclosure of the basis of the valuation of insurance liabilities as well as information on the nature and extent of risks in insurance business, including information on actual claims against previous estimates. IFRS 13 will, once it takes effect for 2013 financial statements, set out disclosure requirements in relation to the fair valuation of assets.</li> <li>• OSFI's guidelines then tailor this to the particular circumstances of FRIs, requiring, for example, disclosures on FRIs' investments and risk management practices, and to an extent to the needs of policyholders (in particular the guideline on participating policies).</li> <li>• The Actuarial Standards Board's Standards of Practice set out both valuation and disclosure requirements in relation to technical provisions.</li> </ul> <p>Information is also available from the OSFI website where quarterly consolidated financial data on all FRIs are posted and available free of charge.</p> <p>While the overall disclosure requirements are extensive, they apply in full only at the consolidated level. OSFI's disclosure guidelines apply to FRIs on a consolidated basis only. Individual FRIs within a group are required to prepare financial statements in accordance with IFRSs and to present these to the annual meeting (and to submit them to OSFI) but they do not have to be made available to policyholders other than to those who attend the meeting. Nor are these statements required to be available for use by market participants, except on demand to the FRI itself. As a result, policyholders may not have access to financial information on the legal entities by whom their insurance policy has been issued.</p>
Assessment	Partly observed.
Comments	<p>At the group consolidated level, disclosure requirements are extensive, but these are not fully matched by comprehensive requirements applying to regulated legal entities at the solo level, especially with respect to disclosure of information on the capital of FRIs. The application of the IFRS framework to all FRIs and not only to public companies has ensured that consistent standards are applied across firms. However, reliance on IFRS also risks there being some gaps between the disclosure requirements of the standard-setters and the requirements applicable to FRIs to meet regulatory objectives, including making information available to policyholders. OSFI and the Actuarial Standards Board have filled these gaps to a large extent through their guidelines and the Standards of Practice but the reliance on IFRS creates risk of divergence which requires careful monitoring.</p> <p>It is recommended that:</p> <p>(a) the authorities ensure that FRIs publish (in a format readily available to policyholders as well as market participants generally) both the information on the financial position of the individual legal entities at the solo level in addition to group</p>

	<p>consolidated requirements, and information about the FRI's capital; and that the application of OSFI's guidelines clearly extends to cover FRIs on an individual as well as a consolidated basis; and</p> <p>(b) The authorities maintain their existing process for monitoring IFRS developments to ensure a timely and appropriate response to these developments and determine whether new standards or changes to existing standards have the required impact on disclosure as well as financial soundness requirements.</p>
<b>ICP 21</b>	<p><b>Countering Fraud in Insurance</b></p> <p>The supervisor requires that insurers and intermediaries take effective measures to deter, prevent, detect, report and remedy fraud in insurance.</p>
Description	<p>Both fraud and obstruction of justice (which addresses prejudicing an investigation into fraud) are criminal offences. The power to enact criminal law is exclusively under federal jurisdiction and the federal Criminal Code (section 380 sets out the main provisions), outlines offences and sanctions. Each province's Attorney General is responsible for the administration of the Criminal Code in the province.</p> <p>Because provincial jurisdiction covers matters of "property and civil rights", provincial insurance legislation also contains regulatory provisions and sanctions dealing with fraud-like misconduct or dishonest or deceptive practices in the conduct of insurance business. Regulatory sanctions and enforcement powers (ICP11) are therefore available to address non-compliance with fraud provisions by insurers and intermediaries. Non-compliance with certain sections of provincial insurance codes may also represent a criminal offence subject to certain specific sanctions.</p> <p>Issues relating to fraud in insurance are addressed in OSFI's supervisory framework under the heading of operational risk (ICP9) for L&amp;H and P&amp;C FRIs. Fraud vulnerabilities and controls are therefore assessed in supervisory work on FRIs, while market wide issues may be taken through OSFI's process for emerging issues (including Emerging Issues Committee – ICP24).</p> <p>In Canada, there are particular challenges from the high incidence in recent years of fraud in relation to car insurance in Ontario (estimated at between 8 and 18 percent of annual claims costs and partly reflecting the significant no-fault accident benefits in insurance contracts). OSFI and FSCO meet quarterly and exchange information (and with criminal law enforcement authorities) in this area and to engage with industry initiatives. The Operational Risk Division within OSFI's specialist risk area (Supervision Support Group) has a particular responsibility to monitor trends as well as supporting supervisors, as do the supervisory teams for P&amp;C FRIs.</p> <p>OSFI also issues warning notices on its website if there are violations or fraud related to the ICA. There are approximately 20 insurance-related notices, although the most recent is from 2003.</p> <p>Supervisory assessments in this area are usually conducted through a significant activity review (ICP9) of claims (in the case of P&amp;C insurance) or the line of business (L&amp;H insurance). Subject to a judgment that the risk is material, in line with its general</p>

supervisory approach, OSFI would review the controls and processes to monitor and control fraud. In reviewing the quality of a FRI's Internal Audit, supervisors are directed to consider whether the function has completed fraud-sensitive audits.

Fraud risk is included in the discussions that supervisors and operational risk specialists have with the larger FRIs on a quarterly basis, which may include reviews of relevant management reports, internal audit reports, board minutes as well as discussions with the Chief Risk Officer. OSFI has sufficient regulatory and supervisory staff assigned to each FRI or insurance group. In one recent case, OSFI and FSCO cooperated in responding to significant claims inflation reported by one P&C FRI in relation to business in Ontario. The work resulted in management letters to the FRI outlining major weaknesses in key risk management functions such as actuarial oversight, risk management, financial oversight and senior management.

OSFI's guidelines, advisories and letters also include provisions on fraud, both general requirements on good governance and controls such as the Corporate Governance guideline and specific provisions including the guideline Background Checks on Directors and Senior Management of FREs, which highlights that fraud will be taken into account at the licensing stage.

There is no specific provision to evaluate periodically the effectiveness of the regulatory effort on fraud, including OSFI's regime itself, but OSFI reviews its overall approach regularly and would react to new and emerging issues through the ERC process.

#### **AMF**

AMF takes a similar approach to fraud awareness and supervisory work, particularly in relation to insurance companies. AMF's mandate, under section 4 of the AMF Act, includes the protection of consumers against unethical, abusive or fraudulent practices. (*s8 of AMF Act*).

AMF has issued a Financial Crime Risk Management Guideline, addressed to both L&H and P&C insurers with activities in Québec. This covers risk management practices required in order to prevent and detect activities associated with financial crime, including good governance, and to prevent and mitigate the fraud effectively.

While AMF has not issued guidelines on combating fraud to intermediaries, the DA binds directors and officers to act with honesty in dealing with customers. AMF's supervisory work on intermediaries includes the review of controls in relation to financial crime. (*s4 & s8 of AMF Act*).

AMF draws on intelligence relating to fraud risk gathered from specialized intelligence units operating at national and provincial levels, although these focus mostly on securities related fraud. It has also established an Intelligence and Analysis Centre, which gathers and analyzes intelligence to support investigations teams and to facilitate the identification of new trends, including in the area of insurance-related fraud.

A separate Investigative Support Specialized Unit supports the Enforcement Division with

<p>a mandate to transfer knowledge, including fraud vulnerabilities, to AMF investigators. AMF's extensive powers of investigation and enforcement can be used in relation to fraud and it has taken action in this regard, including seeking criminal enforcement action, imposing administration penalties and the removal of an insurance company's license.</p> <p>In common with OSFI, there is no specific policy to evaluate periodically the effectiveness of the regulatory effort on fraud, although it does regularly review its overall supervisory approach.</p> <p>AMF cooperates with law enforcement and other regulatory agencies on issues relating to fraud, including provincial police and relevant self-regulatory bodies. A particular focus of activity (and a key fraud-related risk identified by AMF) is the offering in Québec of insurance by unlicensed entities.</p> <p><b>FSCO</b></p> <p>FSCO has put a high priority on insurance fraud issues, reflecting the significance of car related fraud in Ontario. It works with OSFI, as noted, and with law enforcement agencies. Insurance misconduct, often referred to as fraud, is an offence under the Ontario insurance legislation. For 2012, of the eight on-site compliance examinations of insurers which FSCO conducted, six were related to combating fraud measures in insurance across 14 companies, representing 46 percent of the automobile insurance market.</p> <p>A particular focus has been on ensuring compliance with the Statutory Accident Benefits Schedule (SABS), a regulation under the OIA, which sets out the detailed procedures for claiming and for payment of benefits. In 2013, the regulations were changed to reflect various recommendations of the Anti-Fraud Task Force.</p> <p>FSCO has taken actions to penalize intermediaries for fraudulent practices, including a 2009 case where a cease and desist order was issued against an intermediary for fraudulently misrepresenting that they were offering insurance cover (the license was also withdrawn). FSCO has made insurance fraud a priority in its 2013 strategic plan. Fraud issues are therefore being given a high priority in FSCO supervisory work – fraud control, especially in relation to motor insurance, will be examined in a combination of questionnaires, off-site and on-site reviews to assess and monitor the effectiveness of the internal control systems used by insurers and intermediaries to manage fraud risks.</p> <p>The high incidence of motor insurance fraud in Ontario led to the establishment of an official inter-agency Task Force to develop a strategy for addressing the issues. The Steering Committee of the Task Force, in November 2012, recommended a range of measures to strengthen the regulatory framework. These include strengthening the powers of FSCO, including extensions of the scope of FSCO regulation to include unfair and deceptive practices and formerly licensed insurance companies. A number of these recommendations have been implemented in changes to legislation that took effect on 1 June 2013, including giving insurers authority to require claimant confirm receipt of goods and services that have been billed.</p>
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	<p>While the subject of other Task Force recommendations (including those relating to fraud awareness amongst consumers) fall outside the scope of ICP requirements, the report also drew attention to the need for FSCO to have adequate resources to meet its regulatory objectives, free from unnecessary hiring constraints.</p>
Assessment	Observed.
Comments	<p>There is a well-developed framework of legislation at federal and provincial levels enabling criminal and regulatory authorities to detect, investigate and apply sanctions in cases of insurance fraud. Cooperation has been evident, especially in the area of motor fraud in Ontario, which has also been the subject of an initiative by the provincial government (an Anti-Fraud Task Force) to address the issues. Regulatory requirements on insurers are set out clearly in relevant laws and guidelines. Fraud controls are included in supervisory work by OSFI, AMF and FSCO, where considered material under the risk-based approach taken by the three supervisors. FSCO is appropriately making motor fraud controls a high priority. Enforcement action has been taken in practice.</p> <p>It is recommended that while their enforcement work has included action against intermediaries in relation to misrepresentation of insurance cover to a customer, AMF and FSCO should consider the merits of setting out their expectations of intermediaries in the area of fraud controls more clearly.</p>
<b>ICP 22</b>	<p><b>Anti-Money Laundering and Combating the Financing of Terrorism</b></p> <p>The supervisor requires insurers and intermediaries to take effective measures to combat money laundering and the financing of terrorism. In addition, and the supervisor takes effective measures to combat money laundering financing of terrorism.</p>
Description	<p>Arrangements for the regulation and supervision of anti-money laundering and countering the finance of terrorism (AML/CFT) requirements in Canada are set out in federal law, the Proceeds of Crime (Money Laundering) and Terrorist Financing Act (PCMLTFA) and its regulations. These apply only to L&amp;H insurers, whether incorporated under the ICA or equivalent provincial legislation, and not to P&amp;C insurers. Branches of foreign L&amp;H insurers are captured. Intermediaries are covered by the legislation, directly if they are licensed as intermediaries and indirectly if they act as agents of a L&amp;H insurers (via obligations placed on the L&amp;H insurer which employs them).</p> <p>The Financial Transactions and Reports Analysis Centre of Canada (FINTRAC) is responsible for the administration and enforcement of the PCMLTFA in respect of all insurers in Canada subject to the legislation. The requirement that insurers take effective AML/CFT measures (including record-keeping, verification of identities and reporting of suspicious transactions) is established through Part I of the PCMLTFA. The PCMLTFA regulations also require that L&amp;H insurers develop and apply written policies and procedures that are kept up to date and approved by a senior officer.</p> <p>OSFI, AMF and FSCO are not designated competent authorities in this area but interpret their mandates, supervisory powers as being sufficiently broad to encompass oversight of the risk management processes of regulated entities with their AML/CFT obligations. They have, to differing degrees, issued guidelines to relevant entities setting out supervisory expectations in this area, and build the assessment of compliance into their</p>

<p>supervision work, within the framework of their risk-based approach and taking into account the lead role of the FINTRAC.</p> <p><b>OSFI</b></p> <p>OSFI has issued specific guidance in this area to all FRFIs subject to the PCMLTFA, including L&amp;H FRIs. Guideline B-8 on Detering and Detecting Money Laundering and Terrorist Financing sets out in some detail what OSFI expects of L&amp;H FRIs in respect of the obligations set out in the PCMLTFR, focusing on the scope and content of required AML/CFT program for establishing and maintaining effective AML/CFT risk management and controls. The program should include board and senior management oversight, appointment of an appropriate individual responsible for implementation of the program, the assessment of inherent money-laundering and terrorist financing risks, written AML/CFT policies and procedures that are kept up to date and control policies and procedures designed to comply with the legislation. These must be incorporated into, or referenced by, the entity's LCM framework (ICP8). Training, assessment of controls and effectiveness testing are also required.</p> <p>OSFI has established an Anti-Money Laundering and Compliance Division to lead on its AML/CFT assessment program. Supervisory assessments evaluate the adequacy of policies and procedures at FRFIs in relation to AML/CFT. The approach is risk-based, in relation to the frequency and depth of AML/CFT assessments at L&amp;H FRIs, and applies to the group, including branches and subsidiaries located outside Canada. L&amp;H FRIs are categorized into three broad groups based on the overall risk of ML and TF. FRIs showing the highest overall risk profile are subject to an AML/CFT assessment approximately every three to four years; others are either reviewed every four to five years. FRIs that show the low or minimal risk profile are subject to a desk-based examination by FINTRAC.</p> <p>The Anti-Money Laundering and Compliance Division takes the lead on maintaining OSFI's general awareness of AML/CFT issues and risks, through exchange of information with FINTRAC and relevant international authorities (under the PCMLTFA, FINTRAC is designated to disseminate financial information concerning suspected AML/CFT within insurers' and intermediaries' activities to law enforcement or to foreign financial intelligence units. Although P&amp;C insurers are not subject to the PCMLTFA framework, OSFI monitors potential new risks in this area.</p> <p>Since 2004, federal legislation has enabled FINTRAC and financial regulators in Canada, including OSFI, to exchange information on compliance with Part 1 of the PCMLTFA. OSFI and FINTRAC have signed a MOU under which they exchange information relating to L&amp;H FRIs' compliance with the legislation. OSFI passes to FINTRAC relevant information on its AML/CFT assessments of L&amp;H FRIs and processes information received from FINTRAC, which could include requests from foreign jurisdictions for assistance with investigation of AML/CFT cases. OSFI is able to exchange information with provincial regulators but has not done so in practice or received requests from information from provincial regulators.</p> <p>OSFI does not have specific AML/CFT arrangements for exchange on information with foreign prudential supervisors but would exchange, if necessary, under its MoUs or</p>
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	<p>general arrangements for information exchange (ICP 3). In practice, most direct exchanges are via FINTRAC.</p> <p><b>AMF</b></p> <p>AMF takes a similar approach, except that in practice its arrangements with FINTRAC (under an MoU signed in June 2006) provide for FINTRAC to undertake much of the supervisory work in this area. This is to prevent duplication of effort. AMF has issued guidance on Financial Crime Risk Management in June 2012, which applies to L&amp;H insurers under AMF's principles-based approach. It sets out risk management practices for insurers in order to prevent and detect activities associated with financial crime, including AML/CFT; and communication of information regarding activities associated with financial crime with each relevant authority, subject to applicable laws.</p> <p>AMF can and does share supervisory information with FINTRAC. AMF's supervisory program also includes compliance with PCMLTFA requirements by L&amp;H insurers and intermediaries, taking a risk-based approach and taking account of the role of FINTRAC. The MoU with FINTRAC also enables AMF to share information on AML/CFT issues.</p> <p><b>FSCO</b></p> <p>FSCO takes a similar approach, including the application of a risk-based approach to the supervision of compliance with the PCMLTFA, taking into account that there are no longer any L&amp;H insurers that are incorporated in Ontario. It has not issued specific rules or guidelines in relation to AML/CFT issues. In relation to intermediaries, it reminds companies of their obligations under the PCMLTFA). FSCO can and does communicate issues in relation to AML/CFT with FINTRAC.</p>
Assessment	Observed.
Comments	<p>OSFI, AMF and FSCO are not designated competent authorities for AML/CFT. However, all three supervisors have arrangements in place to communicate with FINTRAC, the Financial Intelligence Unit for Canada and competent authority in relation to AML/CFT arrangements that encompass all L&amp;H insurers, whether incorporated by OSFI or a provincial authority; and intermediaries. Information exchange takes place in practice and there is an awareness of ML/FT risks and vulnerabilities and of the importance of securing a high degree of compliance by regulated entities.</p> <p>Information exchange with foreign authorities is dealt with mainly by and through FINTRAC, but OSFI may also exchange information directly in connection with its work on the overseas operations of Canadian L&amp;H FRIs. OSFI and AMF go beyond the requirements of ICP22 by establishing specific guidelines setting out their expectations of insurers (there is no similar guidance for intermediaries); and by building AML/CFT compliance into their supervisory work. OSFI has a particularly extensive program of supervision work and a specialist unit to support it. AMF and FSCO take a risk-based and proportionate approach to the supervision of L&amp;H insurers, reflecting both international standards and the work of OFSI on FRIs and overall responsibilities of FINTRAC.</p> <p>In relation to intermediaries, AMF and FSCO should consider how best to set out their expectations in more detail, drawing on their supervisory work and experience.</p>



<b>ICP 23</b>	<p><b>Group-wide Supervision</b> The supervisor supervises insurers on a legal entity and group-wide basis.</p>
Description	<p><b>Scope of the group subject to group-wide supervision</b> The ICA establishes requirements at the legal entity level and does not provide a definition on “insurance group.”<sup>81</sup> Although Part XVII of the ICA governs “holding bodies corporate of life companies”, no insurance holding company has been established under Part XVII at the time of assessment. Part XVII does not cover the P&amp;C industry such that a consistent framework for L&amp;H and P&amp;C groups would be applied only where a P&amp;C group contained at least one L&amp;H FRI. The Minister is vested with the authority to issue letters patent incorporating a holding company based on the same criteria as those for the incorporation of a FRI. (<i>s699, s709 and s712 of ICA</i>).</p> <p>OSFI identified 41 insurance groups at the request of the assessors. This identification was based on OSFI’s definition of a group as “where there is more than one FRFI with the same ultimate parent”, which could be a group of FRFIs within the same or across financial sectors.</p> <p>However, beyond the definition used for purposes of the FSAP, in practice OSFI monitors both the regulated and non-regulated entities within the group (if they are material). If the non-regulated entities are downstream, supervisors monitor them (on an indirect basis). For example, supervisors consider holding companies and brokerages that an insurer owns if they have significant investments.</p> <p>Supervisors also monitor the overall consolidated group of the ultimate parent (which would include all the non-regulated entities) in the quarterly monitoring process.</p> <p>Two of the large insurance groups are headed by non-operating insurance companies that do not have policyholders but are federally regulated by OSFI. Non-operating insurance companies, operating FRIs and potential holding companies (to be established under Part XVII of the ICA) are supervised as federally regulated head of groups (FRHOG). Another 17 insurance groups are headed by unregulated holding companies, while another six are sub-groups, either as part of larger conglomerate groups supervised by OSFI or by other supervisors.</p> <p>OSFI identifies the scope of groups through its supervisory activities in ascertaining the significant activities of FRFIs and the FRHOG (ICP 9). For non-regulated holding companies operating in Canada, Canadian subsidiaries of a foreign parent as well as Canadian branches, OSFI supplements information submitted by FRIs with publicly available information and supervisory coordination (e.g., supervisory colleges) to identify the scope of the group. OSFI continuously reviews and where appropriate, updates the scope of a group, e.g., for restructurings, acquisitions or changes in the significant activities, which would be reflected in its supervisory scope.</p>

<sup>81</sup> The definition of members of a group is made in relation to an FRI’s investments only but not for the purpose of group-wide supervision. (*s490(2) of ICA*)

OSFI utilizes the internal reporting and organizational charts of FRIs to understand the group structures and where necessary, interviews the board and senior management. If a FRI establishes foreign branches or subsidiaries, OSFI may obtain an undertaking from the foreign insurance company to provide access to information on their foreign operations. OSFI has not found the need to require any insurance group to restructure or take other measures to address group structures that might hinder effective supervision.

### **Group-wide supervision**

OSFI adopts different approaches to group-wide supervision, in accordance with its legal authority and powers:

- a) *Where an insurance group is headed by a FRHOG*, OSFI supervises the group as a whole on a consolidated basis and supervises directly the FRFIs within the group. Two of the large insurance groups are amongst the groups regulated using this approach although because in their case the FRHOG is a non-operating insurance company, a distinct approach to capital regulation is applied (under the OSFI Guideline A2: Capital Regime for Regulated Insurance Holding Companies and Non-Operating Life Companies - see ICP17).
- b) *Where an insurance group is headed by a non-regulated entity*, OSFI's supervision is applied indirectly through letters of undertaking with the regulated FRI parent, which "may" contain requirements such as:
  - Filing of financial and corporate information that are publicly available or filed with another supervisor;
  - Notification of any change in the directors or external auditors;
  - Examination and inquiry into its business and affairs;
  - Extend the audit of any financial statements at the FRI's expense; and
  - Submission of the valuation of actuarial and other policy liabilities by an OSFI approved actuary on a periodic basis.

Five insurance groups including one large L&H group are supervised on this basis.

*For foreign branches operating in Canada*, OSFI's Supervisory Framework is applied solely to their Canadian operations, but includes an assessment of the strength of parental support for the Canadian operations. OSFI monitors the performance of their head offices and affiliated entities using information provided by the branches, publicly available information and supervisory cooperation and communication with the home (and other) supervisors.

At the time of assessment, OSFI has executed supervisory contract/undertaking with five out of 17 of the groups headed by unregulated holding companies. The terms of the undertaking are negotiated with the respective groups and the undertakings, which are not standard across groups, are deemed as confidential information. OSFI decides, on a case-by-case basis, whether to execute similar undertaking with the other groups, taking into account their group structures and other supervisory considerations e.g., whether OSFI is being provided with all information it needs for supervision.

The other groups are subject to OSFI's consolidated supervision, which in the case of a

	<p>financial conglomerate, focuses on the ultimate parent (for example, one insurance subgroup is regulated as part of consolidated supervision at the parent bank level). The consolidated supervision of such groups does not include a requirement to report to OSFI on risk concentrations and significant intra-group transactions and exposures at the group level.</p> <p>The ICA empowers OSFI to obtain information from non-regulated affiliated entities to determine compliance with the ICA and that the entity is in a sound financial condition (<i>s671 of ICA</i>).</p> <p>While OSFI has no direct legal authority over the non-regulated entity (other than <i>s671 of ICA</i>), it uses indirect means such as requiring an increase in capital in a FRFI. OSFI also regularly works with home country regulators, as outlined in ICP25.</p> <p>Where applicable, OSFI's scope of supervision includes all related entities that are relevant to the insurer from a risk perspective, whether upstream, downstream, or peers. OSFI expects the compliance functions of the head of OSFI-regulated insurance groups to oversee adherence to regulatory requirements in all jurisdictions in which the group operates. (<i>Legislative Compliance Management Guideline</i>)</p> <p>For conglomerates supervised by OSFI, the lead supervisor will be from the industry group responsible for consolidated supervision at the parent entity level. Where there is no lead supervisor for the group, cross-sector subsidiaries or branches, there are supervisory protocols between the supervision groups to promote consistency of material messages, ratings and interventions delivered by the insurance supervisors to FRFIs that have affiliated FRFIs operating in another financial sector.</p> <p>The number, knowledge and experience of supervisors assigned to each insurance group are based on the size, nature, complexity and risk profile of each insurance group. Supervisory staff is supported by risk, actuarial, governance and other specialists, facilitated by an integrated IT system. OSFI does not have concerns about the adequacy of supervisory resources.</p> <p>There is no standardized reporting requirement on risk concentration and intra-group transactions and exposures. Although the ICA prohibits related party transactions, these are defined narrowly for these purposes, with many exemptions<sup>82</sup>. (<i>s521 to s528, s533 and s534 of ICA</i>)</p> <p>Transactions with a related party, a wholly owned subsidiary and any party outside the group that exceeds 10 percent of a FRI's assets during a rolling 12 month period must be</p>
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<sup>82</sup> The permitted transactions include: a) immaterial transactions; b) reinsurance transactions; c) fully secured loans or guarantees; d) borrowing from or issuing segregated fund policies to related parties; e) purchase of Canadian/provincial government securities or securities guaranteed by the Canadian/provincial government; f) sale of assets that have an active market; g) assets transactions with related FRFIs; h) asset transactions in re-structuring approved by OSFI and leasing assets to/from a related party; i) approved asset transactions related to portfolio transfers; j) provision of services used in the ordinary course of business; and k) prescribed transactions.

	<p>approved by OSFI. Board approval is required for aggregate exposures to related parties that exceed two percent of a FRI's regulatory capital. (s528.1 to s528.3 and s530 of ICA)</p> <p><b>Group-wide market conduct</b></p> <p>AMF supervises the groups for which it is the home supervisor and the CoB of insurers doing business in Québec that are part of a group supervised by another supervisor e.g., OSFI or other foreign home supervisors. The Sound Commercial Practices Guideline issued in June 2013 articulates AMF's expectations on group-wide market conduct (ICP 19).</p> <p>FSCO supervises insurers' CoB on a legal entity basis and is generally able to monitor the conduct of group structures by leveraging on supervision of regulated entities, e.g., applications for licensing, statutory filings and licensing conditions. However, there is no explicit group-wide market conduct requirement<sup>83</sup>. FSCO only has the resources to conduct risk-based and reactive monitoring and enforcement of group structures through its supervision of licensed entities.</p>
Assessment	Partly observed.
Comments	<p>The ICA, IA and OIA do not have an explicit definition for insurance group nor the scope of an insurance group for the purpose of group-wide supervision. Nonetheless, the three supervisors address certain elements of group-wide supervision within the parameters of their legal authority.</p> <p>OSFI adopts different approaches to group-wide supervision within the parameters of its legal authority. A consolidated supervision approach is applied to L&amp;H FRIs headed by a regulated entity in accordance with the statutory basis of the ICA. A L&amp;H holding company can be established under the ICA although no such holding company has been established. For groups headed by non-regulated entities, OSFI's supervision may be applied indirectly through unpublished contracts or letters of undertaking on a case-by-case basis. Currently, only five of the 17 groups headed by unregulated holding companies have executed such undertaking and the terms vary, based on negotiation with the unregulated entity. OSFI has no legal authority over the non-regulated holding company and can only use indirect means such as an increase in capital in a FRI. Further, the OSFI capital adequacy framework for holding companies (the A2 Guideline: Capital Regime for Regulated Insurance Holding Companies and Non-Operating Life Companies) does not apply to holding companies regulated indirectly via a contract or undertaking (ICP 17).</p>

<sup>83</sup> Certain provisions of the OIA address affiliated groups and entities, but for specific, limited purposes and with varying definitions and the OIA does not address insurance groups. Neither the OIA nor the FSCO Act grants FSCO the express legal authority or supervisory power to supervise certain entities within the identified scope of the group e.g., non-regulated entities, entities regulated by other provincial supervisors or other sectoral supervisors.

	<p>OSFI therefore applies both an indirect approach to consolidated supervision<sup>84</sup>, having no general powers in respect of holding companies, and also a direct approach, in the case of two of the three major groups, where the holding company is also a (non-operating) insurance company. OSFI's indirect approach differs in outcome from both the direct approach in the case of the two large groups headed by non-operating insurance companies. For example, the holding company of one large L&amp;H group is not directly subject to the same capital adequacy requirements as the other two large L&amp;H groups. The indirect approach for the other groups varies depending on the terms of the undertaking negotiated with the unregulated holding companies. In addition, as it takes time to negotiate an undertaking, this approach would not be effective, especially with an entity that is reluctant to provide information to OSFI.</p> <p>AMF has recently extended its Sound Commercial Practices Guidelines to cover financial groups and exercises consolidated supervision of insurance groups. FSCO has not established group-wide market conduct requirements and supervises insurers' CoB on a legal entity basis.</p> <p>It is recommended that the authorities formulate and implement a clear and consistent regulatory regime for group-wide supervision under the relevant insurance laws. Key elements of the regime should cover the scope of group-wide supervision, including material non-regulated entities; prudential and market conduct requirements at the group level. Going forward, it is advised that the authorities empower the supervisors to take necessary remedial and enforcement measures at the level of the holding company, in line with emerging international best practices.</p>
<b>ICP 24</b>	<p><b>Macroprudential Surveillance and Insurance Supervision</b></p> <p>The supervisor identifies, monitors and analyses market and financial developments and other environmental factors that may impact insurers and insurance markets and uses this information in the supervision of individual insurers. Such tasks should, where appropriate, utilize information from, and insights gained by, other national authorities.</p>
Description	<p>OSFI's approach to macroprudential issues in insurance regulation is based on:</p> <ul style="list-style-type: none"> <li>• Maintaining a capacity, including a dedicated team, for market wide information gathering and analysis.</li> <li>• An internal process to identify, prioritise and ensure that action is taken on emerging risks: this is the focus of the Emerging Risks Committee (ERC).</li> <li>• Linking the market wide analysis of risk to supervisory work on individual FRIs, as well as feeding back insights and intelligence from supervisory work into the market wide process.</li> </ul>

<sup>84</sup> While the IAIS accepts that some jurisdictions may use an "indirect approach," this is subject to the condition that "in effect, the outcome is similar to having the supervisory requirements applied directly on those entities within the insurance group from which the risks are emanating." (Paragraph 15 of the Introduction to the ICP Material).

- Interaction between supervisors with responsibility for individual FRIs and risk specialists, which is managed within the supervision unit.
- Specific market wide actions including a regular market wide stress test.
- Developing a framework for the identification of systemically important individual FRIs, taking into account the approach already applied to banks.

While aspects of this framework are more advanced for banks than for FRIs (including the identification of systemically important institutions), it applies in full to both L&H and P&C insurance markets. ERC agendas include standing items on insurance as well as specific issues. There is a particular focus on key vulnerabilities in the Canadian market such as earthquake exposure and the exposure of some L&H FRIs to the low interest rate environment.

OSFI's Risks, Surveillance and Analytics Division is responsible for market wide analysis and for managing the ERC process. The Division participates in quarterly meetings between OSFI and the large insurance groups aimed at identifying market wide issues; and coordinates input from Assuris, the national L&H insurance compensation scheme and provincial regulators through the CCIR. The Division also coordinates OSFI's regular market wide stress tests (usually annual but OSFI is looking to the results of the quantitative impact studies being undertaken in connection with the planned revision to the capital adequacy requirements).

The ERC itself meets at least monthly (and more often if necessary to coordinate a response to new developments), and comprises senior staff across the organisation and is chaired by the head of the Specialist Support Group. The agenda covers emerging risks from outside Canada as well as domestic risks.

Recent actions taken in response to ERC decisions included reviews of FRI reports on management actions on how they would respond to a particular market development. ERC decisions also inform OSFI input into the design of the Dynamic Capital Adequacy Testing required to be undertaken by FRIs on an annual basis. OSFI's requirements on managing earthquake risk are currently being updated, partly in response to market wide monitoring of potential losses. Catastrophe risk generally is under review following escalating weather-related claims. Under OSFI's Supervisory Framework, market wide analysis also informs cross-firm supervisory work, for example a review of reinsurance programs.

OSFI also conducts a quarterly review of the L&H and P&C sectors, based on supervisory analysis and reports from the risk experts within the Specialist Support Group. The objective is to integrate the frontline supervisory perspective with that of the cross-sector specialists. Recent issues covered include the impact of the decisions of the Ontario regulators on auto insurance rates, i.e., the prudential implications of a significant insurance product, pricing and market conduct regulatory decision.

The link between the wider analysis and review of market trends and emerging risks managed through the ERC and OSFI's supervisory process is provided by that component of the Supervisory Framework that addresses the Operating Environment (ICP 9). The Risk Assessment Document (RAD) sets out environmental factors with

	<p>potential impact on a FRI. Examples of current RADs (for L&amp;H FRIs) cover issues such as the low interest rate environment, volatility in global financial markets and credit risk in commercial real estate. Supervisors are then expected to reflect relevant and material issues in supervisory plans. OSFI's IT and data management capacity to support both supervisory and macro surveillance work is adequate.</p> <p>In addition, insurance sector issues and individual FRIs are also captured by the process for coordination between federal financial sector supervisory agencies. The focus of the FISC is on individual institutions. The SAC focuses more on system wide issues, including system-wide vulnerabilities. SAC meets quarterly or more frequently as required.</p> <p>OSFI makes aggregated market data publicly available. The ICA sets out a process for agreeing with the industry on which data may be published from OSFI returns, taking into account the confidentiality of much of the reported material. The process includes consultation with the industry and approval for disclosure by the Assistant Superintendent, Regulation and the Minister. <i>(s673(1) of the ICA, s 22(3) of the OSFI Act)</i></p> <p>Some of the approved data is available on OSFI's website and a larger set is made available by OSFI through a third-party disclosure service. The data is published on a quarterly and annual basis.</p> <p>OSFI feeds back its analysis and conclusion on risk in insurance markets through industry seminars and communications. A recent example is a speech by the Superintendent that addressed, amongst other issues, the challenges to P&amp;C FRIs active in the Ontario motor insurance market from recent developments in rate regulation in the province.</p> <p>OSFI is developing its approach to the identification and regulation of systemically important insurance companies, drawing on the methodology applied to banks. Its approach to supervision and the allocation of supervisory resources already takes account of the scale and nature of individual FRIs, recognizing the scale of the large L&amp;H FRIs in particular. While OSFI does not formally categorize FRIs by scale, systemic importance or other indicators, it allocates more resources and undertakes more intensive supervision of the large groups. The identification of non-core (or non-traditional) activities would be addressed at the level of individual FRIs through identifying significant activities; and at the sector wide level through the ERC process and supporting work.</p>
Assessment	Observed.
Comments	<p>OSFI has a well-developed framework of macroprudential surveillance that seeks to integrate the supervisory framework for individual FRIs with a market wide view of key risks and a capacity to respond to emerging issues, through supervisory action and by escalation for discussion with other federal agencies.</p> <p>Priorities which OSFI may want to consider for the future, in addition to finalizing its approach to potentially systemically important FRIs, include:</p> <p>(a) Ensuring that it has access to data sources and continuing to develop the international dimension of its macroprudential work through liaison with other</p>

	<p>regulators.</p> <p>(b) Considering whether it's mainly sector-based approach is adequately complemented by consideration of linkages between banks and insurers; and</p> <p>(c) Extending its consideration of risks arising from system-wide market conduct issues, including reputational risks from non-compliance by FRIs and potential conflict between prudential and market conduct regulation.</p>
<b>ICP 25</b>	<p><b>Supervisory Cooperation and Coordination</b></p> <p>The supervisor cooperates and coordinates with other relevant supervisors and authorities subject to confidentiality requirements.</p>
Description	<p><b>Domestic Arrangements</b></p> <p>The domestic supervisory cooperation arrangements are documented in Section C. Information exchange amongst federal and provincial supervisors is described in ICP 3.</p> <p><b>International Cooperation</b></p> <p>OSFI is a signatory to the IAIS Multilateral MoU and has formal bilateral MoUs with over 30 foreign regulators (ICP 3).</p> <p>OSFI has hosted and taken part in numerous supervisory colleges to foster cooperation and information exchange in the context of group-wide supervision. These meetings, including crisis management panels, discussed cross-border coordination issues for both legal entity and group-wide matters. The college meetings that are hosted by OSFI are tailored to the nature, scale and complexity of the group concerned.</p> <p>The terms of OSFI's MoUs address: a) information flows between involved supervisors; b) the communication expectation for both the home and host supervisors although it does not explicitly provide for communication with the head of group; c) periodic visits or meetings, as appropriate; and d) arrangement for the sharing of information to facilitate supervision and to promote the safe and sound functioning of FIs with cross-border establishments in their respective countries (which implicitly requires comprehensive assessment of a group).</p> <p><b>Group-wide Supervision Arrangements</b></p> <p>Generally, OSFI's approach is that the home supervisor is the group-wide supervisor (GWS), consistent with the views of its foreign supervisory counterparts. OSFI is the GWS for all the large Canadian, internationally-active life insurers and has initiated a variety of supervisory colleges.</p> <p>As the GWS, OSFI invites all relevant host supervisors to participate in its colleges to facilitate information sharing and coordination to ensure the effective functioning of both the parent entities and their cross-border foreign operations (e.g., branches/subsidiaries). If OSFI wishes to conduct an onsite inspection in a host jurisdiction, it will first contact the host supervisor and offer the OSFI inspection to be scheduled as part of the host supervisor's onsite examination. Sharing of findings/views and required actions (if any) after the onsite is routine. With respect to P&amp;C FRIs, OSFI is rarely the GWS. Nonetheless, OSFI discusses with involved supervisors the need to</p>



	<p>establish a supervisory college and who should lead. OSFI has not hosted any P&amp;C supervisory colleges to date.</p> <p>Where OSFI is the GWS, it will take responsibility for initiating discussions on suitable coordination arrangements, and will assume the lead role in the establishment and functioning of supervisory college meetings. OSFI has hosted universal, core, regional and focused colleges (e.g., crisis management panels). OSFI will typically consult host supervisors on the design and scope of the college in order to ensure that the college addresses the specific needs of supervisors.</p> <p>During an OSFI-led college, typically the Chairman of the Board, senior executives, and external auditor present financial and strategic information on behalf of the company with time for questions from participating supervisors. All information exchanged is highly confidential and subject to stringent safeguards. The Assessors reviewed the meeting agenda for the supervisory colleges of two insurance groups, noting the strategic and holistic focus as well as engagements of all relevant stakeholders including internal and external auditors of the groups.</p> <p>After each OSFI-led college and subsequent to quarterly monitoring activities, a conference call is conducted with the key supervisors for each entity to discuss results and compare findings. The status of existing issues and developing new issues are shared and efforts are co-ordinated to minimize duplication of work while providing comprehensive analysis and information.</p> <p>Consistent with its Supervisory Framework, OSFI takes the lead in carrying out group-wide supervision as the GWS. It will formulate a group-wide assessment of risks and solvency issues, taking into account various input from host supervisors. Where OSFI is a host supervisor, it will ensure that, at a minimum, it assesses and understands the operations of the entities in the group that operate in Canada, and how those operations could impact the group.</p>
Assessment	Observed.
Comments	OSFI has in place coordination arrangements with other involved domestic and foreign supervisors that facilitate effective supervision. Domestically, OSFI (the Superintendent) chairs the FISC and collaborates closely with FISC members at the federal level, while the CCIR facilitates the coordination amongst OSFI and provincial supervisors. At the international level, OSFI is the GWS for all the large Canadian, internationally-active life insurers and has initiated a variety of supervisory colleges. OSFI also contributes actively to relevant supervisory colleges as a host supervisor.
<b>ICP 26</b>	<p><b>Cross-border Cooperation and Coordination on Crisis Management</b></p> <p>The supervisor cooperates and coordinates with other relevant supervisors and authorities such that a cross-border crisis involving a specific insurer can be managed effectively.</p>
Description	The major international operations of Canadian insurance companies are those of the large L&H insurance groups, in USA, Asia and in Europe. In the P&C sector, foreign

operations are more limited but there is significant participation by branches of foreign companies in the Canadian market. Some Canadian insurance companies have operations in jurisdictions where the operation is small in relation to the group as a whole but material in the local market such that local supervisors may expect a high level of information sharing and cooperation in a crisis.

Although the global financial crisis had a significant adverse impact on the Canadian financial sector, including insurance companies, Canada has not experienced a cross-border crisis to the same degree as some other countries and crisis management arrangements remain largely untested. OSFI's preparedness for a cross-border crisis affecting an FRI is being developed through:

- Ensuring the availability of effective intervention tools and procedures (see ICP10 and 12) that would equip OSFI to manage a cross-border crisis.
- The development of existing mechanisms for supervisory cooperation and coordination, including supervisory colleges and bilateral exchanges, to include crisis management preparation.
- Working with the major L&H insurance companies on the development of recovery plans that address the implications of the extensive international operations of the major L&H insurance groups.

OSFI has extensive powers under the OSFI Act and the ICA to carry out interventions where necessary and has arrangements with the compensation schemes for the execution of interventions in practice. There are provisions in the WURA for liquidators (i.e. once a winding-up action has been started) to take action in relation to the foreign assets of a Canadian insurance company and the assets of a branch of a foreign insurance company in Canada. While a crisis management exercise has been carried out, simulating stress at a major L&H insurance group, the international dimensions have not been tested. The Financial Institutions Supervisory Committee (FISC—see ICP24) has responsibility to “facilitates consultations and the exchange of information among its members on all matters relating directly to the supervision of financial institutions” (*s18 of the OSFI Act*).

OSFI is including the coordination of crisis management preparations through the supervisory colleges which it chairs as home supervisor of the major L&H insurance groups. Basic crisis management arrangements, including availability of contact names and details, have been put in place, but wider interactions on crisis management have been limited pending the development of recovery and resolution planning. OSFI's network of information-sharing MoUs and relationships with foreign supervisory encompasses all the supervisors in respect of whom coordination of a crisis would be the highest priority. OSFI's approach is to involve other supervisors in the coordination of crisis management preparations on an as-needed basis.

OSFI engages in discussions with regulators of foreign insurance companies that operate in Canada. As a signatory of the IAIS MMOU, OSFI has committed to meet obligations of information exchange and cooperation in relation to its responsibilities as a home and as a host supervisor.

OSFI has asked the three largest L&H insurance companies to develop recovery plans,

	<p>which were received in 2011 and 2012. Expectations with respect to resolution planning and the potential role of the compensation schemes is being considered. These plans will have significant implications for supervisory crisis preparedness in some other jurisdictions where there are operations of the major L&amp;H insurance groups. OSFI has not yet shared these plans with members of core supervisory colleges, as they have not been at a sufficiently advanced stage. It will do so when the plans are more advanced, taking account of developing work by the Financial Stability Board in this area.</p> <p>OSFI does not have specific requirements on FRIs generally to maintain contingency plans in case of crisis. The current work on recovery planning is confined to the large L&amp;H insurance groups. OSFI guidelines in other areas, including stress testing capital adequacy (for example, the DCAT requirements) and guidance on the establishment of Internal Targets under the MCCR and MCT frameworks serve to require FRIs to evaluate the impact of potential crisis and the results of their work (including management actions) give OSFI supervisors an insight into their crisis management preparedness.</p> <p>OSFI's actual behavior in a cross-border crisis is untested. It did participate in arrangements, mainly for information-sharing, with US and other global supervisors in the case of the severe problems affecting one global insurance group in 2008.</p>
Assessment	Observed.
Comments	<p>While OSFI's approach to management of a cross-border crisis is untested in practice, it has put in place a network of information-sharing arrangements (in addition to its commitments under the IAIS MMOU) as well as mechanisms for cooperation in practice, including supervisory colleges that provide a basis for effective coordination in a crisis. OSFI is well-advanced, by comparison with other jurisdictions internationally, in applying the framework for recovery planning for banks to its major insurance groups, although it has not shared these plans with foreign supervisors as yet.</p> <p>It is recommended that in developing its approach OSFI should:</p> <ul style="list-style-type: none"> <li>(a) continue to carry out crisis management testing and simulations: extending this to an international group would be an appropriate next stage;</li> <li>(b) ensure that it considers the potential needs in a crisis of supervisors in jurisdictions where the Canadian company is material and anticipates these as far as possible</li> <li>(c) review the need for supplementing its existing requirements in relation to stress testing by explicitly requiring FRIs to establish and maintain contingency plans and procedures for use in a going- and gone- concern situation as set out in the ICP.</li> </ul>