Canadian Institute of Actuaries
Institut canadien des actuaires

# Educational Note

# DCAT – Minimum Regulatory Capital Requirement



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# *EDUCATIONAL NOTE*



# DCAT – MINIMUM REGULATORY CAPITAL REQUIREMENT



**COMMITTEE ON PROPERTY AND CASUALTY FINANCIAL REPORTING**

**JULY 2003**



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*Ce document est disponible en français*

**Canadian Institute of Actuaries • Institut Canadien des Actuaires**

# MEMORANDUM

**TO**: All P&C Fellows, Associates and Correspondents of the Canadian Institute of Actuaries

**FROM:** Marthe Lacroix, Chairperson
Committee on P&C Financial Reporting

**DATE:** July 21, 2003

**SUBJECT:** **Educational Note: DCAT – Minimum Regulatory Capital Requirement**

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Please find enclosed a new educational note entitled, "DCAT – Minimum Regulatory Capital Requirement", which has been prepared by the Committee on Property and Casualty Financial Reporting.

All questions and comments should be addressed to me at my *Yearbook* address.

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## DCAT – MINIMUM REGULATORY CAPITAL REQUIREMENT

With respect to DCAT investigations for property & casualty (P&C) insurers, CSOP Section 2530.06 states that the minimum regulatory capital requirement is the requirement imposed by the regulator requiring the actuary's report on the insurer's financial condition. For example, for insurers regulated under the federal *Insurance Companies Act*, the minimum regulatory capital requirement is based upon the Minimum Asset Test (MAT) for a Canadian P&C insurer, and the Test of Adequacy of Deposit (TAD) for a Canadian branch of a foreign P&C insurer.

The June 1999 Educational Note on Dynamic Capital Adequacy Testing – Life and P&C identifies that, unless the regulator has communicated a different minimum regulatory capital requirement, the minimum ratio would be 5% for each of MAT and TAD for the purposes of DCAT investigations.

Most Canadian regulators have recently implemented new regulatory capital requirements, or are in the process of implementing new requirements. For example, beginning with the first Interim Return due in 2003, all federally-regulated Canadian P&C insurers are required to file the Minimum Capital Test (MCT) instead of the MAT, and all federally-regulated Canadian branches of foreign P&C insurers are required to file the Branch Asset Adequacy Test (BAAT) instead of the TAD.

The Office of the Superintendent of Financial Institutions' (OSFI) Guideline, issued in November 2002, indicates that:

> *"Federally regulated P&C insurance companies are required, at a minimum, to maintain an MCT ratio of 100%.*
>
> *…*
>
> *OSFI expects each institution to establish a target capital level, and maintain ongoing capital, at not less than the supervisory target of 150% MCT. However, the Superintendent may, on a case-by-case basis, establish in consultation with an institution an alternative supervisory target level based upon an individual institution's risk profile."*

OSFI's Guideline may be found on OSFI's website at <www.osfi-bsif.gc.ca>.

Company-specific target levels, if any, would be communicated to a company by OSFI, but members should be advised that OSFI would not normally send a copy of such correspondence to the appointed actuary.

As new regulatory requirements are implemented, the actuary would consider them in DCAT investigations. Under the base scenario, the insurer must meet the minimum regulatory requirement (e.g., an MCT or BAAT ratio of 100% for federally-regulated companies, effective in 2003). In situations where the base scenario results in a ratio greater than the minimum requirement but lower than the target level described below, the actuary would comment on the possibility that the regulator would exercise its authority to impose restrictions, thereby affecting the company's ability to successfully execute its business plan.

Regulators may require a company to establish a target capital level, which in most cases would exceed the minimum capital level referred to above. If the company's capital were to fall below the target capital level, if applicable, then the regulator may require the company to work with the regulator to restore its ratio to a level greater than or equal to the target. As a ripple effect on adverse scenarios, the actuary would consider the possibility of regulatory intervention in the event that the company's ratio falls below the target requirement.

For insurers subject to minimum capital requirements under multiple jurisdictions, the actuary would continue to use the most restrictive of these requirements.

In accordance with the Institute's policy for Due Process, this educational note has been approved by the Committee on P&C Financial Reporting, and has received final approval for distribution by the Practice Standards Council.

Educational notes are covered under Section 1220 of the Consolidated Standards of Practice (CSOP).

Section 1220 prescribes that, "The actuary should be familiar with relevant educational notes and other designated educational material." It further explains that a "practice which the notes describe for a situation is not necessarily the only accepted practice for that situation and is not necessarily accepted actuarial practice for a different situation." As well, "educational notes are intended to illustrate the application (but not necessarily the only application) of the standards, so there should be no conflict between them."