Canadian Institute of Actuaries | Institut canadien des actuaires

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Tara-Lea Herkert
Manager, Prudential Policy
Office of the Superintendent of Financial Institutions (OSFI)
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Ottawa, Ontario K1A 0H2
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Re: CIA Response to OSFI Draft Guideline B-3: Sound Reinsurance Practices and Procedures

Dear Ms. Herkert,

The Canadian Institute of Actuaries (CIA) welcomes this opportunity to offer input to the Draft Guideline B-3: Sound Reinsurance Practices and Procedures issued by OSFI in June 2019 (the "Draft Guideline").

A discussion paper on OSFI's reinsurance framework was released in June 2018 outlining proposals on changes to the supervisory framework over the next three years and beyond. Phase II of those proposals included updates to Guideline B-3. This Draft Guideline reflects these proposals, as well as comments received in response to the discussion paper. The CIA provided comments on the reinsurance discussion paper in September 2018.

The CIA Committee on Risk Management and Capital Requirements (CRMCR) formed a working group to review the Draft Guideline and provide questions and comments to OSFI. The intent is to focus on the Draft Guideline and not repeat comments that we already provided on the discussion paper. The working group has identified two main areas that would benefit from further clarification in the Draft Guideline:

1. Page 3: "*Reinsurance may be used for purposes not directly linked to the mitigation of a FRI's insurance risks. Under such circumstances, OSFI will evaluate the reinsurance arrangements, including the appropriateness of capital credit for such arrangements, based on the risk impact to the FRI. In particular, OSFI will generally not recognize or grant credit for a foreign FRI's reinsurance arrangement(s) when risks insured in Canada are ceded back to the foreign FRI's home office through affiliated reinsurers.*"
2. Page 8: "*OSFI expects reinsurance receivables to be paid directly to a FRI-cedant in Canada, or to a person acting for, or on behalf of, the FRI-cedant in Canada.*"

Point #1: Foreign FRIs ceding risks back to the home office

"Reinsurance may be used for purposes not directly linked to the mitigation of a FRI's insurance risks."

- It is our understanding that capital credit will continue to be granted when the reinsurance purchased provides risk mitigation.

- “*not directly linked to the mitigation of … risks*” is not defined. It would add further clarity if this were defined, as a contract either transfers risk or it does not, and the question is to what degree the risk is transferred.

“Under such circumstances, OSFI will evaluate the reinsurance arrangements, including the appropriateness of capital credit for such arrangements, based on the risk impact to the FRI.”

- For reinsurance “*not directly linked to the mitigation of … risks,*” will there be a pre-approval process? Is it OSFI’s intention to evaluate the appropriateness of each contract before allowing the company or branch to credit for it?
- Presumably all companies and branches should get OSFI’s explicit approval for all such arrangements. Is this the intent of the Draft Guideline?

“In particular, OSFI will generally not recognize or grant credit for a foreign FRI’s reinsurance arrangement(s) when risks insured in Canada are ceded back to the foreign FRI’s home office through affiliated reinsurers.”

- In this statement, OSFI extends the restriction one step further for branches of foreign insurers and will generally not grant credit where a branch cedes to an affiliate and that affiliate cedes the risks back to home office. Questions arise if large quota-shares are ceded to an affiliate and that affiliate only cedes to home office some portion of the risk. Is the entire capital credit related to the cession denied, or only the portion that is retroceded to the home office? The nature of the risk may change as well; for example, if the affiliate is protected by the parent through a stop-loss arrangement. Further clarification on this would be welcomed.
- Would this apply (non-granting of credit for reinsurance on capital requirement) even when proper collaterals are in place? Can the FRI assume reinsurance credit when testing capital requirements in the ORSA and LICAT/DCAT analysis?
- Some reinsurance structures have more risk mitigation impact. Prime examples are per risk excess-of-loss, or property catastrophe excess-of-loss treaties. Can we assume that those types of treaties will be granted credit?

From the original discussion paper on reinsurance issued by OSFI in June 2018: “*OSFI recognizes that such an arrangement may be motivated by valid business and risk management reasons. In some instances, this practice does not raise prudential concerns. For example, intragroup excess-of-loss reinsurance treaties may be established with the objective of consolidating capital at the foreign FRI home office to support catastrophic losses. In this case, the practice may not involve a material reduction to the assets of the FRI available in Canada.”*

As a profession, the CIA encourages a principle-based approach rather than a prescriptive approach. We would therefore encourage OSFI to include an assessment of the third-party financial strength when evaluating the appropriateness of any reinsurance structure proposed by an FRI.

Point #2: OSFI expects reinsurance receivables to be paid directly to an FRI-cedant in Canada

"*OSFI expects reinsurance receivables to be paid directly to a FRI-cedant in Canada, or to a person acting for, or on behalf of, the FRI-cedant in Canada.*"

- Further clarification is needed. Currently, OSFI has specific requirements for payments to be made directly in Canada in case of an insolvency of either a branch head office or of the retrocessionaire. Has this requirement changed with the Draft Guideline?

The CIA appreciates the opportunity to provide feedback on these issues, and we would welcome further discussion with you throughout this process.

If you have any questions, please contact Chris Fievoli, CIA Staff Actuary, Communications and Public Affairs, at 613-656-1927.

Sincerely,

[original signature on file]

Marc Tardif, FCIA
President, Canadian Institute of Actuaries

The Canadian Institute of Actuaries (CIA) is the national, bilingual organization and voice of the actuarial profession in Canada. Our members are dedicated to providing actuarial services and advice of the highest quality. The Institute holds the duty of the profession to the public above the needs of the profession and its members.