

To: Mr. Peter Routledge
Superintendent of Financial Institutions
Office of the Superintendent of Financial Institutions
255 Albert Street, 12th Floor
Ottawa, Ontario K1A 0H2

Date: 08 August 2022

Subject: Global Federation of Insurance Associations comments on OSFI final revised Guidelines B-2 and B-3

Dear Superintendent Routledge,

The international insurance industry, as represented by the Global Federation of Insurance Associations (GFIA), would like to express its appreciation for the amendments to Guideline B-2: Property and Casualty Large Insurance Exposures and Investment Concentration, which has incorporated stakeholder feedback as part of the policy development process.

GFIA notes that the final Guideline B-2 is now determined by the maximum loss of a single insurance exposure as compared to the initial proposal which was based on an insurer's three largest exposures. However, it remains concerned with certain aspects of the final Guideline B-2 and the final Guideline B-3: Sound Reinsurance Practices and Procedures, which could reduce insurance capacity in the Canadian market. Any reduction in capacity in the Canadian market may lead to an increase in the cost of insurance for Canadians and reduce the coverage of risks that depend on access to reinsurers and global commercial insurers. For example, the requirement for the exposure to be based on capital available in Canada does not reflect current business practices and/or the legal relationship between branches and their home offices.

GFIA would like to share with OSFI its specific comments on the final Guidelines B-2 and B-3.

■ Detailed comments on Guideline B-2:

1. Section II *Large Insurance Exposures*, subsection: Insurance Exposure Limit, paragraph 8 states that:
“At no time should any P&C FRI's **Net Retention**, plus its **Largest Net Counterparty Unregistered Reinsurance Exposure**, due to the occurrence of a maximum loss on a Single Insurance Exposure, exceed the following limits:

Insurance Companies	100 per cent of Total Capital Available where any entity in the P&C FRI's control chain is: a widely held company ^{Footnote5} , and/or a regulated financial institution; 25 per cent of Total Capital Available otherwise.
Foreign Branches	100 per cent of Net Assets Available of the foreign branch.”

On a global scale, insurers will insure risks around the world and pool these risks to benefit from global diversification. Capital is then allocated on a post-loss event basis. Insurers rely on global diversification of risk and global capital fungibility. These are established best practices for risk management by branches (of global reinsurers and global commercial insurers) operating in Canada. OSFI's policy decisions to ring-fence capital in Canada does not align with these established risk management practices.

Insurers ensure that capital is available for claims in Canada when they are needed due to a loss event, but not prior to the loss event occurring. When an insurable loss event occurs in Canada, a reinsurance arrangement between the foreign federally regulated insurer (FRI) in Canada and its home office comprises a legal, contractually binding obligation by the home office to cover the loss. In general, branches are not legally indivisible from their home office. Therefore, in the event of a dispute or bankruptcy, a policyholder or cedant can pursue both the branch and the home office. GFIA encourages OSFI to consider the capital available from a foreign FRI's home office and to co-operate with the regulatory authorities in international jurisdictions to facilitate information exchange for prudential purposes in order to better manage counterparty risk related to cross-border reinsurance transactions.

2. Letters of credit

Footnote 6 states that: “The limit on the use of letters of credit for unregistered reinsurance with a given counterparty, or group of Affiliated Company counterparties, including any letters of credit that are part of excess collateral, is 30% and is measured against the value of the insurance exposure.”

Letters of credit are an established, secure counterparty risk-mitigation technique used globally. They are recognised as indispensable for international transactions as they ensure that payments will be received. The US National Association of Insurance Commissioners developed model reinsurance regulation that recognises the current fair market value of assets in trust, including “clean, irrevocable, unconditional and “evergreen” letters

of credit issued or confirmed by a qualified US financial institution”¹. GFIA kindly asks OSFI to review and remove the 30% limit for letters of credit from its regulatory guidelines.

■ Detailed comments on Guideline B-3:

On page 3, in the section *Managing risks through reinsurance*, the guideline states that:

“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.”

Federally regulated foreign insurers (FRFIs) use intra-group reinsurance cessions to their global parent as part of the risk management tools that cover extreme loss and increase insurers’ underwriting capacity. Could OSFI please clarify if the arrangement described above qualifies as an exception to OSFI’s restriction?

In addition, on page 4, the guideline states that:

“The RRMP should establish appropriate ceding limits. A FRI’s ceding limits should be set for its overall book of business, and may also be established by line of business, as appropriate. While reinsurance is an important risk management tool, a FRI should not, in the normal course of its business, cede 100 per cent, or substantially all, of its insurance risks. When setting ceding limits, a FRI should consider counterparty risks, as described below.”

Fronting is a prudent and legitimate approach to insuring risks where traditional insurance would be difficult to source, such as flood risks in coastal areas. In this example, the FRFI would write the coverage, but heavily reinsure it to leverage the expertise of the global FRFI. This allows the local FRFI to benefit from the use of global treaties by allowing the FRFI to manage its risks at a global level and, in turn, leverage the expertise of the global FRFI in insuring particular lines of risk, including catastrophe. This benefit is felt not only by the local FRFI if it is underwriting difficult to insure and/or certain specialty lines, but also by Canadian consumers more broadly through potentially better pricing and global geographical diversification of risks, making these risks more insurable and insurance more accessible to consumers.

¹ NAIC [Model Laws, Regulations, Guidelines and Other Resources – Summer 2019. Credit for Reinsurance Model Regulation](#)



GFIA is concerned that if OSFI prohibits fronting — particularly when conducted within a global insurance group — insurance capacity in the market will be limited while prudential outcomes will not have been improved. Could OSFI please clarify what are acceptable arrangements for insurers that need to engage in fronting and how OSFI will implement a consistent approach to supervising this?

GFIA would welcome the opportunity to discuss these issues with OSFI. On behalf of GFIA, I would be pleased to set-up a meeting to discuss these concerns. I can be reached at +1 202 345 0377 or BradSmith@acli.com

Kind regards,

Brad Smith
Chair of the GFIA Trade Working Group (bradsmith@acli.com)

About GFIA

The Global Federation of Insurance Associations (GFIA), established in October 2012, represents through its 40 member associations and 1 observer associations the interests of insurers and reinsurers in 67 countries. These companies account for 89% of total insurance premiums worldwide, amounting to more than \$4 trillion. GFIA is incorporated in Switzerland and its secretariat is based in Brussels.