To: Vlasios Melessanakis
Director, Prudential Policy and Strategic Policy Liaison
Office of the Superintendent of Financial Institutions (OSFI)

Date: 18 March 2021

Subject: RE: Draft OSFI Revised Guideline B-2, Property and Casualty Large Insurance Exposures and Investment Concentration

Dear Mr. Melessanakis,

Thank you for the opportunity to provide comments on the draft revised Guideline B-2 relating to property and casualty large insurance exposures and investment concentration. The international insurance industry, as represented by the Global Federation of Insurance Associations (GFIA), supports OSFI's modification of the original proposal to one that largely is principles-based and focused on supervision. However, we would like to highlight several issues raised by the guideline, particularly relating to the treatment of unregistered reinsurance as set forth below. GFIA has provided similar comments in the context of the overall review of OSFI's reinsurance framework over the last several years.

In general, GFIA's members support changes that address OSFI's concerns while ensuring that Canada has a vibrant and healthy insurance industry for the benefit of Canadian policyholders and the Canadian economy. However, we remain concerned about provisions that could undermine the fundamental principle of global risk diversification that is the central premise of the global insurance industry. Overall, GFIA would encourage OSFI to recognize that existence of a rating from a major rating entity is itself an indication that the reinsurer's likelihood of default is low irrespective of the particular credit rating or financial strength rating. Rating agencies will not rate a reinsurer if they conclude that the reinsurer is a high risk for default.

As we have highlighted previously, reinsurance markets are global in nature and depend on the global fungibility and transferability of capital across jurisdictions. Large commercial insurers and reinsurers rely on this globally-accepted, long-standing insurance business model in order to optimally serve local and multinational clients. International regulation has also evolved to serve the global economy, primarily through mutual recognition arrangements amongst regulators. For example, the European Union (EU), the United States (US) and Bermuda have introduced lessened collateral requirements or have completely eliminated them in order to facilitate more efficient cross-border reinsurance arrangements. Similar to OSFI, regulators in these jurisdictions also have the responsibility to protect policyholders and domiciled insurers.

We would urge OSFI to continue to deepen its collaboration with regulators and supervisors in reinsurers' home markets, and to take into account the supervision that is being conducted in home markets. Such an approach

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would reflect the practice suggested by the Organisation for Economic Cooperation and Development (OECD) in its 2018 paper *The Contribution of Reinsurance Markets to Managing Catastrophe Risk*, in which it noted that information exchanges and enhanced cooperation with supervisors in a reinsurer's home jurisdiction would allow a host market to benefit from full access to global reinsurance markets while at the same time adequately addressing any prudential concerns.

International organizations and scholars have recognized the essential benefits of cross-border reinsurance in recent years in the face of measures in some markets that could limit access to global reinsurance markets. The Insurance Core Principles (ICPs) of the International Association of Insurance Supervisors, for example, state that "[g]eographical diversification of risk, which typically involves risk transfer across jurisdictional borders, is a key element of ceding insurer's and reinsurer´s capital and risk management. […] By ceding insurance risk across borders, ceding insurers in the jurisdiction, and the jurisdiction as a whole, can benefit from a reduced concentration of insurance risk exposures at the ceding insurer and jurisdiction level respectively. This may also contribute to the financial stability of the jurisdiction."[1]

The following are our more detailed comments and recommendations.

<u>Treatment of Branches and Subsidiaries</u>

Recognition that branches are legally indivisible from their Home Office is critical. In particular, in case of dispute or bankruptcy, a policyholder or cedent can pursue both the branch, and the home office. In light of this structure, we urge OSFI to provide credit to a branch based on the financial strength of its home office, ensuring that assets are not double-counted. This policy would dovetail with OSFI's guideline on earthquake risk allowing companies to recognize 10% of global capital available through the home office.

In addition, OSFI should acknowledge that subsidiaries of a foreign entity operating in Canada have access not only to the capital pool in Canada but also to the capital resources of the parent. Similarly, subsidiaries of large banking operations in Canada have access to their parent's balance sheet, and we would ask that the guideline be clarified to allow for both types of subsidiaries to reflect 100% of Available Capital in Canada.

<u>Calculation of Insurance Exposure</u>

GFIA respectfully urges OSFI consider a calculation of insurance exposure that is calculated based on Net Retention and Net Counterparty Reinsurance Exposure but does not discriminately add a measure of exposure related to Unregistered Reinsurance. Credit should be given for high-quality reinsurance and the financial strength of the reinsurer.

<u>Definition of "P&C FRI Subsidiaries in Canada" and Clarification of Annex 2 Criteria</u>

The terminology "P&C FRI Subsidiaries in Canada" in the table in Section 8 is ambiguous; however, we acknowledge that OSFI's intent is clarified in Annex 2. We suggest that OSFI add a definition of P&C FRI Subsidiaries in Canada as being "P&C FRIs that are direct or indirect subsidiaries of foreign insurance companies or are otherwise part of foreign insurance company groups." Additionally, we suggest adding a further clarification

[1] IAIS ICP 13, 13.0.2

that references to “parent” and “parent company” in Annex 2 part 2 are direct or indirect parent foreign insurance company or foreign insurance company group.

Annex 2 specifies the criteria that an FRI must satisfy if it is considered to be a P&C FRI subsidiary in order for the 100% of capital limit to apply. We suggest that the following parenthetical be added to Annex 2 part 2(c), “(evidence of being such a source of strength include operational support of material outsourcing, investments (including technology), reinsurance, and a consistent pattern of maintaining capital above minimum standards)”.

Treatment of Affiliated vs. Unaffiliated Unregistered Reinsurers

The “Largest Net Counterparty Unregistered Reinsurance Exposure” does not distinguish between unregistered reinsurance with an affiliated reinsurer and unregistered reinsurance with an unrelated reinsurer. OSFI already has approval and annual reporting processes for unregistered affiliated reinsurers. Additionally, insurance and reinsurance companies are increasingly operating within affiliated groups, particularly insurers with global operations, and these groups use affiliated reinsurance as part of their overall capital-management program. We recommend that the other eligible counterparty risk mitigation techniques listed in Section 10 be expanded to include the use of affiliated unregistered reinsurers and the basis that OSFI already has robust approval and annual reporting processes in place for the use of affiliated unregistered reinsurers.

GFIA appreciates the opportunity to provide the views of the international insurance community and hope that OSFI will keep us involved with the consultations related to the forthcoming guidance on the Canadian reinsurance framework. GFIA and its member associations stand ready to assist by drawing upon the experience of our members in order to assess potential impacts of any proposals on the global (re) insurance business model.

Sincerely,

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 41 member associations and 1 observer association the interests of insurers and reinsurers in 64 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.