

General Guidelines for Use of Letters of Credit (LOC's)

Background The purpose of this document is to provide Federally Regulated Insurance Institutions with guidance on OSFI's requirements relating to Letters of credit (LOC) approvals.

OSFI will recognize an approved LOC as security for the purposes of:

- reducing the reserve and required coverage for unregistered reinsurance, and
- admitting Self Insured Retention (SIR) recoverable for the capital test.

Guidelines

- 1 Letters of Credit must adhere strictly to OSFI's standard wording.
- 2 There are two different LOC's that may be used – one for Unregistered Reinsurance and one for Self-Insured Retention ("SIR"). Applicants should instruct the issuing bank which type of LOC is required. Templates are posted on OSFI's website.
- 3 In order for the Insurance Company to obtain a capital credit for an LOC, the LOC must be approved by the Superintendent.
- 4 Any change in the amount of this LOC must be approved by the Superintendent.
- 5 LOC's from foreign banks MUST have a separate confirming letter from a Canadian bank. If the LOC is issued by a foreign bank, the bank address shown in the body of the LOC can be either that of issuing bank or of the Canadian confirming bank (in practice the Canadian bank's address is usually used).
- 6 The letter of credit must be irrevocable and be subject to International Standby Practices (ISP98).
- 7 LOC's must be for a fixed term of at least one year.
- 8 LOC's must be for a stipulated dollar amount.
- 9 LOC's must be evergreen, unconditional and be in the currency of the business reinsured, issued or confirmed by a Canadian financial institution.
- 10 LOC's must be irrevocable except with at least three months notice to the Office of the Superintendent of Financial Institutions. This condition can be satisfied either by a provision in the letter of credit or by confirmation from the issuing bank.

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Process

1. The applicant requests an LOC from the issuing bank (if from a foreign bank, the LOC requires confirmation of a Canadian bank)
2. Issuer (bank) sends originals (or amendments) to **the beneficiary** (either the Canadian insurance company or if the beneficiary is a foreign insurance company, to the trustee, C/O OSFI) for approval.
3. Canadian insurance company forwards documents to OSFI for approval (if LOC is a foreign insurance company, the LOC already bears OSFI's address).
4. Once approved, original documentation is forwarded to the trustee (if a foreign insurance company) or returned to the Canadian insurance company for safekeeping.
5. OSFI will provide notification to the beneficiary that the new LOC or amendment has been approved.
6. If not approved, original documentation is returned to the issuer or to the Canadian insurance company.
7. Of note, OSFI cannot demand that the issuer comply with our request. Further instruction has to come from the applicant and/or the beneficiary, who should also follow up to ensure OSFI requests are complied with. If required changes are not submitted, the LOC and/or amendment remain outstanding and unapproved.

Overview of the Process

