Reference: Guideline for Federally Regulated Life Insurance Companies and Fraternal Benefit Societies

November 27, 2015

To: Federally Regulated Life Insurance Companies & Fraternal Benefit Societies

Subject: 2016 MCCSR Guideline

On July 30, 2015, OSFI published a draft version of the 2016 *Minimum Continuing Capital and Surplus Requirements* (MCCSR) guideline for public consultation. The annual review of the MCCSR guideline reflects OSFI's continuing practice of monitoring for, and responding to, emerging issues and issues raised by stakeholders. As a result of the review, revisions have been made to the guideline to ensure it remains effective and reflective of developments in the life insurance industry. The revised guideline will come into effect on January 1, 2016.

OSFI would like to thank all industry stakeholders for submitting comments on the proposed revisions and related matters. All comments and representations were considered in preparation of the final guideline. A summary table of comments received and how they have been addressed by OSFI is enclosed with this letter.

Key changes to the guideline include:

- Requiring that retained earnings be adjusted for a property that is re-classified (between investment and owner-occupied and vice-versa) so that it will be the same as if the property had originally been classified into its re-classified category from the outset;
- Requiring that the deduction of non-life, solvency-regulated financial corporations be floored at zero;
- Addressing the treatment of subsidiaries that write a mixed business consisting of life and property and casualty insurance within the same legal entity;
- Requiring that a 0% credit risk factor for a foreign, public-sector entity be allowed only if the public-sector entity's sovereign is eligible for a 0% factor based on its rating;
- Reflecting the integration of advisories into the guideline[1].

[1] Please refer to appendix B for the list of advisories integrated into the MCCSR Guideline.

The scope of the MCCSR Guideline has been expanded. As a result, effective January 1, 2016, OSFI is amending its Guideline E-19, *Own Risk and Solvency Assessment* and Guideline A-4, *Regulatory Capital and Internal Capital Targets* and is repealing Guideline A-2, *Capital Regime for Regulated Insurance Holding Companies and Non-Operating Life Companies*.

Questions concerning the guideline may be addressed to your OSFI Lead Supervisor or to Henri Boudreau, Managing Director, Capital Division (henri.boudreau@osfi-bsif.gc.ca).

Sincerely,

Mark Zelmer
Deputy Superintendent

Appendix A

Summary of Public Consultation Comments

Related to the Draft 2016 MCCSR Guideline

Industry Comment	OSFI Response
Re-classification of property between owner occupied and for investment purposes	
Note that gains reported in OCI, up to the transfer date on investment property that was previously classified as owner-occupied, result from revaluation surpluses under the revaluation model as per IAS16. For owner-occupied properties using the cost model, revaluation surplus due to a revaluation under IAS 16 is reported in OCI only as a result of a change in use of the property to investment property.	Noted. No change necessary.
Zero floor on the deduction of non-life solvency regulated financial corporations	
We understand OSFI's intent behind this change, and agree that a deduction of a negative equity value for a subsidiary should generally be disallowed. However, we believe that under special circumstances where a negative equity value would stem from a strong performance rather than financial difficulties, no capital support from a parent would be needed for the subsidiary to meet its obligations and therefore a deduction of a negative equity value would be appropriate. We ask OSFI to remain open to consider exceptional cases to the zero-floor requirement as established by footnote 50. Such an approach would provide flexibility if this becomes an issue or if new developments emerge.	OSFI remains of the view that a deduction of a non-life subsidiary's negative equity is not appropriate as it would unduly result in a positive increase in available capital.
In some situations the zero floor is not the most appropriate approach. A reasonable approach would be to aggregate non-life subsidiaries by territory to recognize that for structural reasons a company may choose to keep more/less capital in particular subsidiaries while still having a positive	See above.

Industry Comment	OSFI Response
equity in aggregate.	
Composite subsidiaries that write a combination of Life and P&C business within the same legal entity	
Footnote 51 is written as if the main capital regime was MCT rather than MCCSR. We believe that the overriding guidance should be the MCCSR Guideline with some MCT rules applicable to specific P&C business risks which are not covered in the MCCSR Guideline (specifically, insurance risk). As a result, the MCCSR would apply for all C-1 risks and available capital calculations. The footnote should also specify that for insurance risks where MCT cannot be directly applied, OSFI should be consulted. Our understanding is that MCCSR and MCT will be mostly aligned in 2018 so this may strictly be a question of handling 2016 and 2017 years.	The proposed capital treatment of composite subsidiaries has been revised and footnote 51 amended accordingly. Based on the revised approach, the MCCSR required capital for the subsidiary would equal the sum of the MCCSR and MCT requirements for insurance risk, MCCSR capital requirements for assets supporting CALM liabilities, and the capital requirements for the remaining assets and all other risks based on either the MCCSR or the MCT Guideline, depending on whether the insurance risk capital requirement is larger for life business or P&C business.
OSFI's proposed revision had the appearance of treating the composite subsidiaries as a subsidiary of a main P&C parent with a small life insurance business residual. We believe the underlying principle should be the opposite. The MCCSR rules should apply whenever possible, with some MCT rules applicable to the P&C business that is not covered by the MCCSR rules. Most, if not all, assets should be determined using the MCCSR Asset Default Risk rules. On the asset side, assets could be bucketed into those backing surplus, life insurance liabilities, and P&C liabilities. We would suggest that if not all the assets are following the MCCSR Guideline, then at least the first two buckets would and the third one would follow the MCT requirements. In short, we suggest that since on a consolidated basis the MCCSR	See above.

Industry Comment	OSFI Response
Guideline is applied to Life insurers, the MCCSR Guideline should be the guideline of principal reference. We note that the Credit Risk treatment of these assets is planned to be aligned after 2018 so the absolute dollar of the amount of capital is not the motivation of this request, rather at issue is that the MCCSR be the prevailing capital guideline. This is also attractive since it is operationally much simpler in the interim period leading up to the 2018 planned alignment. We suggest the footnote 51 be amended to state: "The MCCSR required capital is the sum of the MCCSR credit and insurance risk components and MCT insurance risk component." The other aspects of the MCT would be excluded, most notably operational risk as it would otherwise result in a double counting (since minimum and supervisory target MCCSR ratios are 120% and 150% respectively, not 100% and 125%).	
Applicability of the 0% credit risk factor to public sector entities (PSEs) of foreign jurisdictions	
In previous versions of the MCCSR Guideline there were listings of examples of PSEs. We suggest OSFI re-insert those lists to give a context for the definition of PSEs in the non-Canadian context.	Non-Canadian PSEs would be entities receiving mutual recognition based on foreign banking supervisors' designation of entities eligible for 0% capital treatment. OSFI does not intend to provide examples of such entities in the MCCSR Guideline.
Capital treatment of computer software	
In the current 2015 guideline, intangible assets in excess of 5% of gross tier 1 capital are deducted from tier 1 capital, where gross tier 1 capital does not include any intangible assets. In the draft guideline for 2016, it explicitly states "Computer software classified as intangible assets per IAS 38 are not included in the definition of identified intangible assets for determining the excess of 5% of gross tier 1 deduction." Hence, in our view, the proposed changes clarified that computer software does not need to be deducted from	The capital treatment of computer software hasn't changed in the draft 2016 MCCSR Guideline as compared to the 2015 MCCSR. The additional clarification regarding the treatment of computer software with reference to IAS 38 in the draft 2016 MCCSR Guideline was incorporated from the 2009 Advisory *Capital Treatment of Computer Software Intangibles* as part of OSFI's initiative to integrate standalone capital-related advisories into

Industry Comment	OSFI Response
available capital. Please confirm that it is the intention of the proposed changes.	the guideline. This confirms the interpretation of the proposed change to the MCCSR Guideline in that it clarifies that computer software intangibles do not need to be deducted from available capital.
Expanding the scope of application to insurance holding companies and non-operating life companies	
We agree with the inapplicability of Supervisory Targets to regulated insurance holding companies and non-operating life insurance companies.	Noted.

Appendix B

List of OSFI Guidance Integrated in the 2016 MCCSR Guideline

Guidance		Date
Guidance Note:	*Investments by Federally Regulated Financial Institutions in Mutual Fund Entities*	December 1999
Guidance Note:	*Dividend Reset Features in Tier 1 Preferred Shares and Step-ups in Tier 2B Capital*	May 2001
Advisory:	*Tier 1 Capital Clarifications*	April 2003
Advisory:	*Innovative Tier 1 Instruments and Accounting Guideline 15 (AcG 15)*	July 2003
Advisory:	*Section 3860 of the CICA Handbook and the Regulatory Capital Treatment of Preferred Shares and Innovative Tier Instruments*	February 2004
Advisory:	*Moderate Step-ups in Tier 2A Capital; Automatic Conversion Triggers in Tier 2A – Qualifying Debentures*	June 2004
Advisory:	*Enhancing Flexibility and Maintaining Capital Strength*	November 2008
Advisory:	*Innovative Tier 1 Instruments*	December 2008
Advisory:	*Capital Treatment of Computer Software Intangibles*	October 2009