Draft Guideline

Subject: **Property and Casualty Large Insurance Exposures and Investment Concentration**

Category: **Prudential Limits and Restrictions**

No: **B-2** **Effective Date:** **TBD**

I. Purpose and Scope of the Guideline

This Guideline applies to all federally regulated property and casualty insurers (P&C FRIs). It applies to insurance companies on an individual and consolidated basis[1] and to individual foreign branches.[2]

The Guideline sets out OSFI's expectations related to large insurance exposures; that is, losses a P&C FRI could suffer from a single large insurance exposure and the sudden failure of an individual unregistered insurance counterparty. It also sets out OSFI's expectations related to investment concentration.

This Guideline complements OSFI's *Supervisory Framework* and *Assessment Criteria*. Excluding hyperlinks, terms that are capitalized and underlined in this Guideline are defined in **Annex 1**.

Please refer to OSFI's *Corporate Governance Guideline* for OSFI's expectations of institution Boards of Directors in regards to operational, business, risk and crisis management policies.

[1] Where a federally regulated P&C insurance company is a subsidiary of another federally regulated P&C insurance company, this Guideline applies to both companies individually and on a consolidated basis.

[2] A foreign branch is a foreign property and casualty company as defined in the *Insurance Companies Act*.

II. Large Insurance Exposures

Gross Underwriting Limit Policy

P&C FRIs should have a comprehensive Gross Underwriting Limit Policy (GUWP)[3] that is consistent with the P&C FRI's Risk Appetite Framework.[4]

1. The GUWP should:
   a. Define what constitutes a Single Insurance Exposure by class of insurance, as appropriate. A P&C FRI could aggregate insurance exposures across multiple coverages and/or classes of insurance;
   b. Establish limits by class of insurance regarding the level of gross insurance risk that the P&C FRI is willing to accept in respect of a maximum loss related to a Single Insurance Exposure; and
   c. Be reviewed by Senior Management of the P&C FRI, at a minimum, annually.

2. P&C FRIs should calculate the maximum loss on a Single Insurance Exposure without regard to the probability of the loss event occurring.

3. With respect to the certain classes of insurance set out below, P&C FRIs should consider the following in respect of determining a Single Insurance Exposure:

Property	The aggregated insurance exposures on in-force policies at a single location, including any exposures subject to the location. This should be, at a minimum, the sum of the location building insurance exposure, location contents insurance exposure, and business interruption insurance exposure. It should also include automobile parking lot risks. The exposure should be determined from the standpoint of the predominant peril(s).
Credit	The aggregated insurance exposures on in-force policies to any one single buyer or group of connected buyers.
Surety	The aggregated insurance exposures on in-force bonds to any one single contractor or group of connected contractors.
Title	The aggregated insurance exposures on in-force policies related to the legal title for a single location. When determining the exposure, the insurer should consider (among other things) the expectations of the policyholder regarding the maximum size of a loss that could be claimed.

3 The GUWP can be one consolidated document or a set of policy documents.
4 The requirements for the Risk Appetite Framework are outlined in OSFI's Corporate Governance Guideline.

4. P&C FRIs should have adequate systems to identify and actively manage insurance exposures.

5. P&C FRIs should have effective monitoring and internal reporting procedures to ensure ongoing operational compliance with the GUWP.

OSFI expects FRIs to develop and establish their own criteria and approach for determining and measuring the maximum loss on a Single Insurance Exposure.

6. P&C FRIs are expected to provide, at OSFI's request, all information with respect to their large Single Insurance Exposures. OSFI may, at its discretion, advise a P&C FRI to use specific criteria or an approach to determine and measure its maximum loss on a Single Insurance Exposure.

Insurance Exposure Limit

7. This section applies to the direct business of P&C FRIs. It also applies to a P&C FRI's assumed business from an Affiliated Company, where that Affiliated Company is a P&C FRI and is a direct writer of that business.

8. 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	25 per cent of Total Capital Available
Foreign Branches	100 per cent of Net Assets Available of the foreign branch provided that the criteria in **Annex 2** are met. Where these criteria are not met, the limit is 25 per cent of Net Assets Available of the foreign branch.
P&C FRI Subsidiaries in Canada	100 per cent of Total Capital Available of the subsidiary provided that the criteria in **Annex 2** are met. Where these criteria are not met, the limit is 25 percent of Total Capital Available of the subsidiary.

9. With respect to the Largest Net Counterparty Unregistered Reinsurance Exposure, P&C FRIs should measure their ceded unregistered reinsurance exposures to a given counterparty, or

group of Affiliated Company counterparties, on both a gross and a net basis. That is, it should be measured before and after the recognition of any eligible Counterparty Risk Mitigation (CRM) technique. Only the aggregate net counterparty exposures for unregistered reinsurance are subject to the limits in Paragraph 8 above.

10. Eligible CRM techniques may include, as applicable:
    a. Excess collateral;
    b. Letters of Credit;
    c. Other CRM techniques deemed acceptable by OSFI. [5]

III. Investment Concentration

P&C FRIs should have policies with respect to the management of investment concentration, which include internal limits. The policies should be consistent with the P&C FRIs' Risk Appetite Framework.

11. A P&C FRI's aggregate market value of Investments in any one Entity or group of Affiliated Companies should not exceed the following limit:

Insurance Companies	5 per cent of the company's Assets
Foreign Branches	5 per cent of the company's Assets in Canada

12. P&C FRIs should consider other Investments or commitments not shown on the balance sheet; for example, options, futures, forward contracts and unfunded portions of committed loans.

13. A P&C FRI should deduct the amount of Investments in excess of the 5 per cent limit from the capital/assets available in calculating the company's Minimum Capital Test (MCT) / Branch Adequacy of Assets Test (BAAT).

[5] A P&C FRI may reduce its required Net Counterparty Unregistered Reinsurance Exposure if the CRM techniques meet the requirements of Guideline A "Minimum Capital Test for Federally Registered Property and Casualty Insurance Companies" and Guideline B-3 "Sound Reinsurance Practices and Procedures".

IV. Guideline Administration

14. Where a P&C FRI is in non-compliance of this Guideline, OSFI may, on a case-by-case basis, take or require the P&C FRI to take corrective measures. OSFI measures may include, but would not be limited to, heightened supervisory activity and/or the discretionary authority to adjust the P&C FRI's capital requirements commensurate with the risks being undertaken by the P&C FRI.

-END-

Annex 1 – Definitions

Single Insurance Exposure

15. P&C FRIs can define what constitutes a Single Insurance Exposure within their GUWP.

Affiliated Companies

16. One entity is affiliated with another entity if one of them is controlled by the other or both are controlled by the same person or entity.

Net Retention

17. The amount of insurance exposure which a P&C FRI retains net for its own account and does not pass on to another insurer (or reinsurer)[6]. Any reinstatement premiums should be included in the Net Retention value.

Largest Net Counterparty Unregistered Reinsurance Exposure

18. The largest amount of ceded unregistered reinsurance on an insurance exposure provided by a (re)insurance group (e.g., Affiliated Company counterparties that are part of a (re)insurance group). This amount should be on a net basis; that is, after recognition of any eligible CRM technique.

Total Capital Available

19. For a P&C FRI that is a company, the consolidated total available capital of a company as defined for the purpose of calculating the MCT.

Net Assets Available

20. For a P&C FRI that is a foreign branch, the net assets available as defined for the purposes of calculating the BAAT.

Investments

21. An asset or item acquired with the goal of generating income or appreciation, excluding loans to, and loans guaranteed or securities issued or guaranteed by the Government of Canada, a Canadian province or a member jurisdiction of the Organisation for Economic Co-operation and Development (OECD).

---

[6] A P&C FRI may reduce its required capital (or "assets" in the case of foreign branches) for ceded reinsurance if it meets the requirements of Guideline B-3 "Sound Reinsurance Practices and Procedures".

Entity

22. As defined in the *Insurance Companies Act*, a natural person, a body corporate, trust, partnership, fund, unincorporated association or organization, an agency of the Crown in right of Canada or of a province, and any agency of a foreign government.

Assets

23. For a P&C FRI that is a company, the total value of assets reported on the balance sheet of the regulatory return filed with OSFI.

Assets in Canada

24. For a P&C FRI that is a foreign branch, the total value of assets under the control of the Minister (vested in trust in Canada), as reported on the balance sheet of the regulatory return filed with OSFI.

Annex 2 – Criteria

Foreign Branches

1. The criteria for P&C FRIs that are foreign branches are:

    a. The home office of the foreign branch has established insurance exposure limits and approval procedures for the branch;

    b. The home office is subject to robust regulation and supervision with regard to capital adequacy, accounting standards and actuarial practices; and

    c. There are no legal, regulatory, statutory or fiscal restrictions in the home office's home jurisdiction to obtaining funds from the home office in the event of losses.

P&C FRI Subsidiaries in Canada

2. The criteria for P&C FRIs that are subsidiaries in Canada are:

    a. The parent company is made aware of and has sanctioned exposures greater than 50 per cent of the Total Capital Available of the P&C insurance subsidiary;

    b. The parent is subject to robust regulation and supervision with regard to capital adequacy, accounting standards and actuarial practices;

    c. The parent company is a continuing source of financial strength for the subsidiary; and

    d. There are no legal, regulatory, statutory or fiscal restrictions in the parent's home jurisdiction to obtaining capital from the parent in the event of losses.