Guideline

Subject: **Annual Disclosures** (Property and Casualty Insurance Enterprises)

Category: **Accounting**

No: **D-1B** **Date:** **December 2001**
Revised: **July 2010**

Introduction

This guideline outlines the disclosures that OSFI expects P&C insurance enterprises[1] to provide in or with their annual financial statements or annual reports in addition to, or in conjunction with, all of the disclosures required by *International Financial Reporting Standards (IFRSs)*.

OSFI expects all P&C insurance enterprises to include required IFRSs disclosures and disclosures required by this Guideline in their OSFI annual return or supplementary management report appended to the annual return.

The disclosures required by this guideline should be kept on file at the Canadian head office or the chief agency of the P&C insurance enterprise. In addition, until such time as a regulation pursuant to Subsection 673.1 (1)(b) is issued requiring all federally regulated P&C insurance enterprises to make their financial reports and associated disclosures including Part 2 available to the public on request, enterprises are strongly encouraged to adopt this practice. The enterprises and their respective financial reports and disclosures include:

- federally regulated property and casualty insurance enterprises, other than branches – their audited annual financial statements and the disclosures expected by this guideline; and
- branches of foreign property and casualty insurance enterprises - the audited portion of their OSFI annual return and the disclosures expected by this guideline.

The disclosures that are required by IFRSs are to be presented in the audited financial statements or annual return.

[1] The term "enterprise" includes domestically incorporated life insurance companies and Canadian branches of foreign life insurance companies.

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Part 1 - Disclosure

This part sets out minimum levels of quantitative and qualitative disclosure for certain financial statement items. Disclosures by sub-category or type need not be made where the amounts are not material. The disclosures should be made in the notes to the annual financial statements or in the audited portion of the annual return in cases where annual financial statements are not prepared.

Investments

OSFI expects the P&C insurance enterprise to disclose the statement of financial position amount and the fair value of its investments showing separately:

a) term deposits and equivalents,
b) bonds and debentures,
c) mortgage loans,
d) preferred shares,
e) common shares, and
f) other investments.

The residual term to maturity of the statement of financial position value of the investments in categories a), b), and c) above, and for preferred shares that specify a fixed redemption date, should be disclosed and should include at least the following time bands:

1) one year or less,
2) over one year and up to five years, and
3) over five years.

Within each of these investment categories, separate disclosure is expected for each sub-category of investments that constitutes 10% or more of the statement of financial position value of the enterprise's investments.

In disclosing the information required by IFRSs, the P&C insurance enterprise is expected to disclose separately, where applicable, the income, expense and gains and losses resulting from each investment category.

Policy Liabilities

For the purpose of this Guideline, "policy liabilities" refers to unpaid claims and adjustment expenses, including incurred but not reported (IBNR), unearned premiums and any premium deficiency. The nature of policy liabilities is expected to be disclosed along with the accounting measurement used. Users of financial statements should be informed that a portion of the amounts recorded as policy liabilities is based on estimates and is subject to revision in future reporting periods.

The nature of the risks and competitive pressures to which a P&C insurance enterprise is exposed can vary significantly by line of business. As such, the composition of policy liabilities is expected to be disclosed for direct, assumed and ceded business by major line of business showing separately:

a) property,

b) automobile,

c) liability,

d) accident and sickness, and

e) other lines of business,

where each of these lines, including any line included in e), above, constitutes 10% or more of the aggregate statement of financial position value of the gross policy liabilities.

Where disclosure is required of the nature of the measurement uncertainty inherent in the computation of policy liabilities; OSFI expects that the actuarial assumptions that have the greatest impact on the computation of policy liabilities will be outlined.

Reinsurance of Short Term Insurance Contracts

The following information on reinsurance transactions should be included in the information disclosed in the notes to the financial statements:

- the nature, purpose and effect of reinsurance transactions on the enterprise's operations including the corporate policies with respect to limits of coverage, reinsurance and net retention;
- a statement that insurance ceded does not relieve the ceding enterprise of its primary obligation to the policyholder;
- the amount of premiums from direct business, reinsurance assumed and reinsurance ceded, on both a written and on an earned basis;
- a statement of the accounting policies governing income recognition on reinsurance transactions;
- the amounts of significant concentrations of reinsurance coverage including the credit risk associated with reinsurance receivables and prepaid reinsurance premiums for individual reinsurers and the details of collateral provided by such reinsurers and the extent to which there is reliance on reinsurers for settlement of claims liabilities;
- the amounts of earned premiums ceded and recoveries (claims and expenses) recognized under reinsurance contracts as separate line items in the income statement or in the notes to the financial statements;
- the nature and effect of any significant non-recurring bulk portfolio or similar reinsurance transactions (both ceded and assumed); and
- the amount and details of deposits or other forms of security or collateral provided by unregistered (unlicensed) reinsurer held as security by the ceding enterprise with respect to reinsurance ceded.

Part 2 - Risk Management and Control Practices

This part outlines the disclosures OSFI expects regarding risk management and control practices adopted by a P&C insurance enterprise. OSFI expects the enterprise to provide the following qualitative disclosures, if not already included in the financial statement notes, in a supplementary management report appended to the annual financial statements or in a supplementary management report appended to the audited portion of the annual return in cases where annual financial statements are not prepared.

Each P&C insurance enterprise is expected to set out the responsibilities of the board of directors, senior management and/or branch management for risk management, including policy setting, implementation, monitoring and review. It should also identify and describe the risks that are significant to its business. These include, but are not limited to, risks associated with insurance risk, interest rate risk, credit risk, foreign exchange rate risk and liquidity risk. The enterprise is also expected to describe how it monitors and controls these risks.

OSFI expects the enterprise to discuss the extent of any significant exposures to areas where there recently has been, or there is the potential for, significant loss due to industry-specific factors or general industry recession, and should outline the steps it has taken to contain risks in these areas.

The enterprise is also expected to discuss methods of measuring and controlling any other market-related risks where they are significant.

Insurance Risk Associated with Policy Liabilities

Since policy liabilities generally constitute some of the largest balances on a P&C insurance enterprise's statement of financial position, OSFI expects there to be disclosure about the management of the risks that significantly affect these balances, including, but not limited to interest rate risk, underwriting risk, catastrophe risk and reinsurance risk.

Underwriting and Liability Risk

Underwriting and liability risk is the exposure to financial loss resulting from the selection and approval of risks to be insured, the reduction, retention and transfer of risks, the reserving and adjudication of claims, and the management of contractual and non-contractual product options.

Catastrophe and Reinsurance Risk

Catastrophe risk is the risk that the enterprise is exposed to major catastrophes, including, but not limited to, earthquakes, floods, tornadoes and hailstorms. Reinsurance risk is the risk that a ceding enterprise could suffer a loss or liability in the event that a reinsurer is unable to meet its obligations to pay claims reinsured under the terms of a reinsurance contract with the ceding enterprise. (See also "Credit Risk", below.)

The enterprise is expected to discuss its risk management policies for each of the above risks, including the role of the board and management in the development, review, approval and implementation of such policies. Disclosure should be provided of the policies and procedures in place to monitor and control each risk effectively. The discussion should include information on the policies that exist for measuring the enterprise's insurance risk exposure, including the frequency of measurement.

The enterprise is also expected to identify and describe the techniques used to analyze the underwriting practices to ensure that there are appropriate risk classification and premium levels, and that there are proper controls placed on the growth of expenses.

Interest Rate Risk

Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates. An enterprise is expected to set out its interest rate risk management objectives and associated business strategy.

The enterprise is expected to discuss its interest rate risk management policies, including the role of the board and management in the development, review, approval and implementation of interest rate risk policies, and the procedures in place to monitor and control the interest rate risk effectively. The discussion should include information on the policies that exist for measuring the enterprise's interest rate risk exposure, including the frequency of measurement.

The enterprise is expected to explain how it uses derivative instruments to manage interest rate risk and should provide quantitative information on the extent to which these instruments are used.

Other Risks

Credit Risk

Credit risk is the risk that one party to a financial instrument will fail to discharge an obligation and cause the other party to incur a financial loss. This risk can relate to recognized and unrecognized financial assets.

The enterprise is expected to discuss its credit risk management policies, including the role of the board and management in the development, review, approval and implementation of credit risk management policies, and the procedures in place to monitor and control the credit function effectively. The discussion of the credit risk management policies should include information on the methods used by the enterprise to identify existing and potential risks inherent in the portfolio and the policies that exist for monitoring and controlling these risks. The enterprise should include a description of its risk measurement and rating classification systems.

Currency Risk

Currency risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates.

The enterprise is expected to discuss its currency risk management policies, including the role of the board and management in the development, review, approval and implementation of currency risk management policies, and the procedures in place to monitor and control the currency risk function effectively.

The enterprise is expected to identify and describe the analytical techniques used to measure currency risk, the limits it imposes, and the frequency of measurement. The enterprise should set out the key sources of currency risk within its portfolio. It should further provide information on how it measures foreign exchange gains and losses.

The enterprise is expected to explain how it uses derivative instruments to manage currency risk and provide quantitative information on the extent to which these instruments are used.

Liquidity Risk[2]

Liquidity risk is the risk that an entity will encounter difficulty in meeting obligations associated with financial liabilities. The enterprise is expected to identify the committees of the board and management responsible for liquidity management, including the development, review, approval and implementation of liquidity management policies, and the procedures in place to monitor and control the function effectively. It should describe the methods used for measuring the enterprise's current and projected future liquidity.

The enterprise is expected to include a description of its policies and performance with respect to:

- controlling any mismatch between recognized and unrecognized financial assets and liabilities; and
- ensuring it has sufficient liquid assets on hand in relation to its daily cash inflows and outflows.

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[2] This section on liquidity risk should be used in conjunction with Guideline B-6 on Liquidity