A Regulatory “Walk Down Memory Lane”

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Introduction

Thank you for inviting me to speak to you today. As my time with OSFI draws to a close, I am glad to have the opportunity to meet with you. I fondly remember my first public speech at OSFI, which was to a property and casualty (P&C) insurance audience back in June 2012. Since then OSFI has, with your help, implemented some important enhancements to our prudential requirements for P&C insurance companies under our jurisdiction. Working on those issues with you and my colleagues has taught me a lot about your industry. Thus, I would like to take a regulatory “walk down memory lane” by reviewing some of our key initiatives over the past four years, and mention some issues that you and OSFI are likely to confront in the future.

The last few years have seen a number of regulatory developments. Think of the Own Risk and Solvency Assessment (ORSA), an updated corporate governance guideline and a new capital framework for your industry. I will address these more closely in a moment, but first let me explain why OSFI focussed its efforts in these areas. Certainly, the lessons from the global financial crisis were a contributing factor and sparked a number of regulatory initiatives internationally as well as here at home. However, in the case of your industry, it is important to stress that most of the changes to your prudential requirements were mainly introduced to address domestic developments and help ensure that OSFI guidance keeps pace with your industry. Your ability to deal with the persistent and unprecedented low interest rates, exposures to catastrophe events, and for mortgage insurers, growing household indebtedness and rising house prices, necessitate sound risk management, underwriting and pricing, and governance practices. Hence, our focus on those areas.

ORSA belongs to you, not OSFI

OSFI published a new ORSA Guideline and introduced related changes to internal target capital ratios in November 2013 for implementation on January 1, 2014. In keeping with our preference for principles-based regulation, the ORSA guideline leaves it to each company to consider the nature, scale and complexity of its business lines in developing its ORSA. Some of you told us at the time of implementation that you would have preferred that we be more specific about our expectations. But the “O” in ORSA is the key element of this process and belongs to you, not OSFI. Meanwhile, OSFI supervisors are sensitive to your need for adequate time to develop and implement appropriate processes to conduct an effective ORSA. We are pleased with the ongoing
improvements to ORSA processes as companies work to adjust the application of the guideline to their specific situations.

**The Corporate Governance Guideline anchors OSFI's governance expectations**

An updated Corporate Governance Guideline came into effect in January 2013 following an extensive consultation process. The revisions were based on on-going supervisory observations, the results of a targeted supervisory cross-system review and enhancements to international best practices. The updated guideline sets out OSFI's expectations for corporate governance across all federally regulated financial institutions.

The guideline took a unique approach in that it focused solely on the fundamental aspects of governance pertinent from a prudential regulatory perspective. These include the critical role of the board of directors (its composition and competencies), risk governance (with a requirement for every institution to have a Risk Appetite Framework) and the fundamental role of the Audit Committee. For insurance companies, we went further, updating Guideline E-15 related to the legal requirements, qualifications and peer review of the Appointed Actuary.

In the wake of the updated Corporate Governance Guideline, directors have raised some additional concerns. These include how governance requirements in other guidelines mesh with the new Corporate Governance Guideline and the large volume of information that directors receive and are expected to digest.

OSFI has been listening to the feedback received and is in the process of reviewing the requirements for boards that currently appear in all forms of OSFI guidance, including guidelines, advisories, supervisory correspondence and so on. Ultimately, this work will lead to various amendments to OSFI guidance to ensure alignment with the Corporate Governance Guideline. More information on this front will be provided later this year.

**Capital requirements are more reflective of the risks within the P&C insurance industry**

Of course, no walk down the regulatory memory lane would be complete without me commenting on capital requirements. On that front, with significant help from you and your colleagues in the industry, OSFI undertook a thorough review of risk assessment methodologies to develop a more robust Minimum Capital Test or MCT for the P&C industry. The new capital framework was published in September 2014 and took effect on January 1, 2015. As you know, it resulted in a small decline in capital requirements for the industry as a whole. Of course, individual company ratios have varied given each insurer’s risk profile. OSFI continues to monitor emerging issues and developments in your industry and will continue updating the MCT Guideline on a regular basis to ensure it continues to reflect risks in your industry. For example, earlier this year, we added the capital treatment for equity derivatives and short positions to the guideline.
By the way, we recognize that the situation for private mortgage insurance companies is different from other P&C insurance companies, making the MCT a less effective tool for the former. Thus, we are working on a new capital guideline for private mortgage insurers, which will be released for public consultation in the near future.

**Earthquake risk is an important risk for insurers to manage and capitalize**

Earthquake risk has been another area of focus for OSFI and the P&C insurance industry given that many of your companies underwrite earthquake insurance. As such, OSFI published a revised version of Earthquake Exposure Sound Practices (Guideline B-9) in February 2013. The guideline requires insurers to have comprehensive policies and procedures in place to deal with the complexities of managing earthquake exposures, along with an appropriate level of oversight. Because of the significance of this exposure, companies are required to provide their exposure information to OSFI on an annual basis.

**Industry input is essential**

There have been other regulatory developments in the last five years, which I will not elaborate on today. A very important point I want to make, however, is that the effectiveness of the guidance I have mentioned would not have been possible without the constructive feedback provided by you and your colleagues in the P&C insurance sector. You have been generous with your time and worked with us so that we could develop and refine our guidance. That is why I made it a priority to publish summaries of the feedback we received and how that feedback was taken into account when guidelines are published in final form. I am sure my colleagues will continue this practice after my departure.

**A glance to the future**

So, what about the future? What does OSFI see in store for the P&C insurance sector? There is no question that we will see the emergence of a new international capital standard for internationally active life and P&C insurance companies. As you know, the International Association of Insurance Supervisors (IAIS) is actively working on a new standard and OSFI staff are actively engaged in that work. This new international standard is expected to be in place in 2020, but at this stage we do not expect it will affect capital requirements for the Canadian P&C insurance industry. The progress we have seen so far suggests it is unlikely to improve upon our own MCT requirements.

Very low interest rates continue to be an issue for all parts of the financial sector, including yours. We know that the longer we live with very low interest rates, the more likely they will affect business decisions. Thus, our focus will be on making sure that your governance and risk management practices continue to be commensurate with your investment strategies. More generally, technology, environmental and social issues, changes in catastrophe exposures arising from more extreme weather events, a cyber-related catastrophe, driverless cars, expanded flood coverage are all factors that
will require you and OSFI to be vigilant. As such, I expect that OSFI’s regulatory framework will continue to evolve as your industry evolves. My successors will need to think seriously about what these issues mean in terms of the risks your companies face and the implications for capital and other risk management expectations.

I am very grateful for the knowledge I have gained about your industry during my OSFI tenure. My colleagues have been generous in teaching me, as have many of you. Thank you again for giving me the opportunity to speak with you today. I will be happy to take questions.