BRITISH COLUMBIA | Financial Institutions Commission

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To: Respondents of FICOM's Reinsurance Questionnaire

Re: Feedback on Questionnaire and Update on Legislative Changes Addressing Reinsurance in British Columbia

On November 12, 2012, the Financial Institutions Commission (FICOM) issued a questionnaire to participants of the British Columbia (BC) insurance industry to provide feedback on the current status of the reinsurance market in BC. We have received all feedback and would like to thank you for your contribution.

The purpose of this letter is to summarize the findings of the questionnaire and to provide an update of upcoming and newly implemented legislation addressing reinsurance in BC.

We were particularly interested in whether there were any capacity issues, or issues in obtaining reinsurance from the unregistered reinsurance market. The following is a brief summary of the questionnaire responses; see Appendix 1 for a detailed summary.

- The majority of respondents indicated that they do not have any regulatory issues with obtaining reinsurance in the BC insurance marketplace;

- Some respondents expressed that the geographic concentration of earthquake-prone areas in BC may cause future capacity issues for catastrophe coverage, however, this is currently not an issue for the majority of the respondents; and

- The majority of respondents indicated that using certain forms of collateral security to obtain unregistered reinsurance has not posed a problem for their line of business.

Based on the feedback received, the majority of the respondents did not indicate any immediate concerns. However, FICOM will continue to monitor the availability of reinsurance in British Columbia.

The second purpose of this letter is to inform BC insurers of upcoming and newly implemented legislation addressing reinsurance in British Columbia.

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The following is a brief review of these changes:

Insurance Company Reinsurance Limitation Regulation (ICRL Regulation)

Amendments to the ICRL Regulation are finalized and have come into force as of January 30, 2013. Please see Appendix 2 for a copy of the amendments made to the ICRL Regulation.

A key amendment made to the ICRL Regulation is the addition of section 5. This new section provides an opportunity for BC incorporated insurance companies to apply to the Commission for an exemption from the reinsurance limits (no more than 75% ceded to a reinsurer and no more than 25% ceded to a reinsurance company not authorized in Canada).

Given this amendment, a BC incorporated insurer can now seek approval from the Commission for reinsurance against more than the limits set out in the ICRL Regulation. This amendment should permit insurers more flexibility in addressing their reinsurance needs and can potentially provide more access to reinsurance capacity if needed.

OSFI Guideline B-3: Sound Reinsurance Practices and Procedures (Guideline B-3)

FICOM intends to adopt OSFI's Guideline B-3. This guideline sets out OSFI's expectations for effective reinsurance practices and procedures. It also sets out requirements pertaining to reinsurance security arrangements that insurers are to use when obtaining reinsurance from unregistered reinsurers. Insurers should note that some conditions set out in the ICRL Regulation relating to obtaining permission to exceed current reinsurance limits are based on the insurer having sound reinsurance practices and a reinsurance risk management policy as set out in Guideline B-3.

Please note that before adopting Guideline B-3, FICOM will be consulting with industry stakeholders. The consultation will be sent to BC incorporated insurers and posted on our website for comment in the near future.

OSFI Guideline B-9: Earthquake Exposure and Sound Practises (Guideline B-9)

FICOM has completed its consultation with BC insurers on OSFI's Guideline B-9. Effective March 7, 2013, FICOM has adopted Guideline B-9. This guideline sets out OSFI's expectations for policies and procedures applicable to insurers that write business materially exposed to earthquake related losses.

Please note that links to OSFI's Guideline B-9 and the Information Bulletin 13-INS-001 notifying BC insurers that FICOM has adopted Guideline B-9, is posted on our website under insurance bulletins.

Please also note that the earthquake capital and reinsurance requirement calculations have been moved from Guideline B-9 to OSFI's Minimum Capital Test Guideline (MCT Guideline).

As OSFI is in the process of reviewing its MCT Guideline, the earthquake capital requirements have not yet been finalized. FICOM is currently working with OSFI, other regulators and the Insurance Bureau of Canada, to develop these calculations. In the interim, insurers can continue to use their current methodology for calculating earthquake risk. FICOM recognizes that these new standards, particularly the new capital standards, will impact the pricing and availability of reinsurance for insurers with exposure to earthquake risk in BC. However, it is our understanding that these new standards are important to ensure that earthquake risk is being adequately measured and managed by insurers.

Should you have any questions regarding the results of the reinsurance questionnaire or any of the related guidelines, please contact Harry James, Director Policy Initiatives at Harry.James@ficombc.ca.

Yours truly,

Frank Chong

Frank Chong
Executive Director
Supervisory Support, Policy

Attachments (2)

Appendix 1
FICOM Reinsurance Questionnaire - Summary of Responses

Questionnaire:

1) What are the key factors you consider in setting the insurers' reinsurance strategy?

- Cost of reinsurance;
- Financial stability of the reinsurer; and
- Diversification of participating reinsurers.

> *FICOM comments: FICOM intends to adopt OSFI's* **Guideline B-3: Sound Reinsurance Practices and Procedures.** *When it is adopted insurers will be required to have a risk management policy in place that will set out how insurers determine their reinsurance risk strategy and actively manage their reinsurance risks.*

2) What are the determining factors you look for when deciding between registered and unregistered reinsurance?

- Financial strength of the reinsurers;
- Capacity of reinsurance available in the British Columbia insurance market place;
- Collateral conditions for unregistered reinsurance contracts; and
- Relative price of registered vs. unregistered reinsurance.

> *FICOM Comments: See comments for previous question.*

3) What were the regulatory and non-regulatory barriers that most impact the insurers' decision between the use of registered and unregistered reinsurance?

- Additional capital requirements for unregistered reinsurance.

> *FICOM Comments: FICOM intends to consult on the adoption of OSFI Guideline B-3 including the security requirements for unregistered reinsurance.*

4) Since FICOM is researching the effects of reinsurance governance on British Columbia insurers can you think of any features specific to British Columbia that would make it difficult to obtain reinsurance?

- Reinsurance capacity for catastrophe coverage in relation to higher earthquake prone areas in British Columbia; and

- The perceived trend of reinsurers reducing their exposure in high earthquake prone areas in British Columbia.

FICOM Comments: FICOM is working with OSFI, the Autorité des marchés financiers (AMF) and national industry associations regarding appropriate capital standards for earthquake risk. Once the new standards are established, this will provide more certainty for reinsurers and may have a favourable impact on availability. The new amendments to the reinsurance regulation also provide insurers with an opportunity for more flexibility regarding their reinsurance – especially with regards to placing more reinsurance in the unregistered market. These steps should assist with the capacity issues.

5) Have any of the following topics impacted your ability to obtain the desired reinsurance?

   a. Capacity:

      - Capacity, particularly from registered reinsurers, has been challenging and more costly.

   b. Specific lines or types of insurance (For example: A line of property insurance or a type of excess insurance):

      - Pricing is a large determining factor between lines and types of insurance; and
      - Difficulty coming mostly from property catastrophe protection.

   c. Geographic concentration:

      - Mostly in earthquake prone areas.

FICOM Comments: See comments for previous question.

6) Is the need to use certain forms of collateral security causing limitations or restrictions on your ability to obtain necessary unregistered reinsurance?

   a. If so, what are the limitations?

      - Financial and administrative burden of reinsurance security agreements.

   b. Are they related to a form of collateral security?

      - Yes, reinsurance security agreements are complicated, labour intensive, and expensive to administer.

FICOM Comments: See comments for question 3.

7) Any further comments you would like to make?

- Increases in regulatory requirements could have a negative impact on the availability and affordability of earthquake coverage for policy holders in some regions; and
- Given the likelihood that registered reinsurance capacity will continue to shrink for primary markets exposed to high risk regions such as earthquake prone zones, and assuming that prices will continue to escalate, it is imperative that the industry finds methods to work with unregistered markets that are less punitive for unregistered reinsurers, while maintaining the security required for our policyholders.

FICOM Comments: FICOM is aware of the concerns from BC insurers as well as national insurers with regards to maintaining affordable insurance in high risk areas. FICOM welcomes any opportunity to work with industry on solutions to this issue.

Appendix 2
Amendments made to the Insurance Company Limitation Regulation
Effective January 30, 2013

1 Section 3(1) of the Insurance Company Reinsurance Limitation Regulation, B.C. Reg, 324/90, is amended by striking out "An insurance company" and substituting "Subject to section 5, an insurance company).

2 Section 4(1) is amended by striking out "For the purpose" and substituting "Subject to section 5, for the purpose".

3 The following section is added:

Reinsurance

5 (1) Subject to subsection (2), an insurance company may obtain reinsurance against more than the percentages set out in section 3 of the various aggregate amounts described in section 3, as applicable, if the commission is of the opinion that one of the following applies:

(a) the insurance company substantially meets all of the following:

(i) the insurance company has a sound and comprehensive reinsurance risk management policy, subject to oversight of the directors and implementation by senior management, including by means of an annual reinsurance declaration made by a senior officer to the board confirming compliance with principles set out in subparagraphs (i) to (iv) of this paragraph, except as otherwise disclosed in the declaration;

(ii) the insurance company performs a sufficient level of due diligence on its reinsurance counterparties on an ongoing basis to ensure the insurance company is aware of its counterparty risk and is able to assess and manage such risk;

(iii) the terms and conditions of the reinsurance contract provide clarity and certainty on reinsurance coverage;

(iv) the insurance company is not adversely affected by the terms and conditions of the reinsurance contract;

(b) it is reasonable to permit the insurance company to obtain reinsurance for more than the percentages set in section 3.

(2) An insurance company may obtain reinsurance against more than the percentage of the aggregate amount set out in section 4 (1) or the amount described in section 4 (2), as applicable, if the commission is of the opinion that one of the following applies:

(a) the insurance company substantially meets the following:

(i) the insurance company has a sound and comprehensive reinsurance risk management policy, subject to oversight of the directors and implementation by senior management, including by means of an annual reinsurance declaration made by a senior officer to the board confirming compliance with principles set out in subparagraphs (i) to (iv) of this paragraph, except as otherwise disclosed in the declaration;

(ii) the insurance company performs a sufficient level of due diligence on its reinsurance counterparties on an ongoing basis to ensure the insurance company is aware of its counterparty risk and is able to assess and manage such risk;

(iii) the terms and conditions of the reinsurance contract provide clarity and certainty on reinsurance coverage;

(iv) the insurance company is not adversely affected by the terms and conditions of the reinsurance contract;

(b) it is reasonable to permit the insurance company to obtain reinsurance for more than the percentages set in section 4.

(3) If the commission exercises its discretion under subsection (1) or (2), the commission must set the maximum percentage for which the insurance company may obtain reinsurance.