

## Market access challenges: Canada

June 2022



*The ongoing review of the Canadian regulatory framework includes several potential threats to foreign/European reinsurers that conduct business on a cross-border basis.*

### Existing legislation and recent developments

#### Reform of the Canadian reinsurance framework

Currently, reinsurance is permitted on a cross-border basis. However, there is a collateral requirement in place, which used to be 115% (of ceded policy liabilities plus receivables from the assuming insurer minus the amount of payables to the assuming insurer) and was increased to 120% in January 2020.

The Canadian regulator, the Office of the Superintendent of Financial Institutions (OSFI), concluded the review of Canada's reinsurance framework, initially started in June 2018. In February 2022, OSFI published two revised guidelines that will come into effect on 1 January 2025, giving federally regulated insurers (FRIs) nearly three years to adjust their business practices.

The guidelines, "B-2, Property and Casualty Large Insurance Exposures and Investment Concentration" and "B-3, Sound Reinsurance Practices and Procedures" introduce a number of measures that the RAB opposes, as they threaten the operations of foreign reinsurers, including European ones. Effectively, these guidelines will create an unlevel playing field between non-registered reinsurance (ie, business written on a cross-border basis) and registered reinsurance (ie, business written by a branch), in favour of registered reinsurance.

Guideline B-3 introduces several restrictions for reinsurance, such as counterparty concentration limits and ceding limits, with insurers not allowed to cede 100% (or substantially all) of their insurance risks to another reinsurer. The Guideline also tightens requirements for reinsurance security arrangements, notably by requiring federally registered reinsurers (FRIs) to regularly assess these arrangements. This may involve stress testing to determine if the reinsurance arrangements adequately mitigate exposures to acceptable levels in accordance with the FRI's appetite. In addition, Guideline B-3 effectively denies recognition of foreign reinsurance arrangements when risks insured in Canada are ceded back to the foreign insurer's home office through affiliated reinsurers. These reforms focus mainly on property and casualty (P&C) business; some additional life and health capital requirements are already in place.

Guideline B-2 sets out OSFI's expectations related to large insurance exposures, namely losses a P&C FRI could suffer from a single, large insurance exposure and the sudden failure of an individual, unregistered insurance counterparty. The guideline will require registered P&C insurers to establish an underwriting limit policy, setting limits by class of insurance for the level of gross insurance risk that the P&C insurer accepts in respect of a maximum loss related to a single insurance exposure. Furthermore, the Guideline defines an insurance exposure limit based on the net retention of a P&C insurer plus its largest net unregistered counterparty reinsurance exposure due to the occurrence of the maximum loss related to a single insurance exposure. It also sets limits on investment concentration within an entity or group.

#### Impact on foreign reinsurers

Once implemented, the reform of the reinsurance framework will create barriers to foreign reinsurers doing business on a cross-border basis and will impact the business models of major international (re)insurance players. Registered (re)insurers would need to obtain additional capital or secure collateral in Canada from unregistered reinsurance counterparties. It is also likely that limits on certain business lines would need to be reduced, as a result of the restrictions.

The RAB therefore strongly opposes the introduction of these restrictive measures, including the introduction of a reinsurance concentration limit for retrocession contracts and limitations on high-risk exposure policies ceded to a reinsurer. The aim of overseeing

counterparty default risk should not result in regulations that eliminate vital reinsurance diversification and free access to cross-border reinsurance.

## **Impact on the Canadian (re)insurance market**

The B-2 Guideline will concentrate reinsurance purchasing in the hands of a relatively small number of registered reinsurers in Canada, as it effectively eliminates access to unregistered reinsurance capacity. This will drive the cost of reinsurance significantly higher. Cedants will have no option but to pass on the burden of higher reinsurance costs to Canadian policyholders. As a result, some Canadian businesses will not be able to afford to purchase the coverage they need and this will increase the insurance gap. If the Canadian (re) insurance market shrinks, there will also be negative implications for premium taxes and HST (the local form of value-added tax).

There is therefore a high risk that these Guidelines, when implemented, will create unintended consequences that may adversely impact the Canadian insurance market and ultimately reduce its (re)insurance capacity. The effective functioning of insurance markets relies on the global nature of the reinsurance market and the ability of writers of large coverages to pool these risks effectively with other risks diversified by geography, line of business, etc. While OSFI may view the acquisition by Canadian cedants of registered reinsurance to be preferable, it ignores the benefits of reinsurer counterparty diversification. The impact of Guideline B-2, when implemented, will be the concentration of reinsurance counterparty credit risk.

### **Restrictions on ease of doing business in Quebec**

In 2021, the Quebec government introduced Quebec Bill 96, "An Act respecting French, the official and common language of Quebec and professional bodies", which would significantly increase the requirement to communicate in French for businesses conducting operations in Quebec.

In its current form, the Bill sets out that contracts and other documents must be drafted in French. It builds on the existing requirement that contracts pre-determined by one party, contracts containing standard clauses and related documents, must be drawn up in French. Businesses will have to provide a French version of these documents before a counterparty expresses a wish to be bound by a version written in another language.

In addition, the proposed Bill introduces explicit requirements for businesses to offer goods and services to consumers, as well as non-consumers, in French. It would extend the current right of consumers to be informed and served in French to non-consumers and explicitly imposes an obligation on businesses to respect such a right.

These proposed requirements would create barriers to doing business in the province of Quebec and is likely to impact (re)insurers' business in Canada.

## **Recommendations and preferred outcomes**

The RAB believes that the recent OSFI guidelines do not adequately take into account how the global reinsurance market operates.

The Canada-EU free trade agreement does state that a local regulator can apply separate rules, as the OSFI is doing, but these developments are clearly not in line with the spirit of the agreement. Whether the proposals are in line with the WTO's General Agreement on Trade in Services (GATS) is unclear.

Insurance Europe's Reinsurance Advisory Board (RAB) is a specialist representative body for the European reinsurance industry. It is represented at chairman or chief executive officer (CEO) level by the seven largest European reinsurance firms: Gen Re, Hannover Re, Lloyd's, Munich Re, PartnerRe, SCOR and Swiss Re, with Insurance Europe providing the secretariat. Through its member bodies, the RAB represents around 60% of total worldwide reinsurance premium income. The RAB promotes a stable, innovative and competitive market environment. It further promotes a regulatory and trading framework that facilitates global risk transfer through reinsurance and other insurance-linked capital solutions.