reinsurance advisory board

Market access challenges: Canada

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A recent review of the Canadian regulatory framework includes several potential threats to foreign reinsurers that conduct business on a cross-border basis. The RAB is also concerned that the review will increase Canada's protection gap, as reinsurance capacity will significantly reduce and insurance prices will have to rise.

Existing legislation and recent developments

Currently, reinsurance is permitted on a cross-border basis. However, there is a collateral requirement of 115% of ceded policy liabilities plus receivables from the assuming insurer minus the amount of payables to the assuming insurer.

In June 2018, the Canadian regulator — the OSFI — published a discussion paper on reforms to the Canadian reinsurance framework, including several potential threats to the operations of foreign reinsurers. One of the reforms would create an unlevel playing field between non-registered reinsurance (i.e. business written on a cross-border basis) and registered reinsurance (i.e. business written from the branch), in favour of registered reinsurance. It would also lead to additional restrictions and/or increased capital charges on policy limits, significant quota shares, fronting arrangements and the use of unregistered reinsurance. It would tighten requirements for reinsurance security arrangements and transactions with affiliates. The reforms focus mainly on property and casualty (P&C) business (some additional life and health capital requirements are already in place) and the new framework includes a prohibition on ceding reinsurance from branch to parent via an unregistered affiliate. The proposed policy changes would be implemented in phases. Phase 1 was effective at the beginning of 2019, Phase 2 is expected to come into force in 2021 and no timing is yet available for Phase 3.

The OSFI also opened a public consultation on a revised draft guideline B-3 on reinsurance risk management in mid-2019. This draft includes a prohibition on sending reinsurance from a branch via an unregistered affiliate to the parent.

Impact on foreign reinsurers

The proposed reforms would create a barrier to foreign reinsurers doing business on a cross-border basis and would impact the business models of major international insurance and reinsurance players. The insurance industry hired E&Y to compile anonymised results and the indications are that an additional C$20–30bn would be required in Canada in the form of capital and/or collateral to support current business if the discussion paper recommendations are implemented as they stand. This means that registered insurers and reinsurers 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.

Recommendations and preferred outcomes

These developments are clearly not in line with the spirit of the Canada-EU free trade agreement, even though the agreement stipulates that a local regulator can apply separate rules, as the OSFI is doing. It is unclear whether the proposals are in line with the WTO's General Agreement on Trade in Services (GATS).

The proposals are not only detrimental to foreign reinsurers, but also to Canadian insurance buyers and Canada's economy. Reinsurance capacity will significantly reduce in the Canadian market and insurance prices will have to rise. Some Canadian businesses will not be able to purchase the coverage they need, and this will increase the protection gap. If the Canadian (re)insurance market shrinks, this would have negative implications for premium taxes and HST (the local form of value-added tax).

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. Much of the claims burden from large Canadian losses, such as the 2016 Fort McMurray wildfires, has come from recoveries from global reinsurers via payments back to locally registered companies. This is true of both very large man-made commercial losses and natural catastrophe losses.