2019

Flotsam, Financing and Flotation: Is Canada "Resolution Ready" for Insurance Company Insolvency?

Janis P. Sarra
Allard School of Law at the University of British Columbia, sarra@allard.ubc.ca

Citation Details
Janis Sarra, "Flotsam, Financing and Flotation: Is Canada 'Resolution Ready' for Insurance Company Insolvency?" Ann Rev Insolvency L 2018 (Toronto: Carswell, 2019) 973.

Flotsam, Financing and Flotation: Is Canada "Resolution Ready" for Insurance Company Insolvency?

Janis Sarra[*]

Flotsam, gems of the sea
Floating to the surface
When all else is lost
Debris to some
But for others
Treasures recovered

E Pink, 1974[1]

I. INTRODUCTION

Insurance is ubiquitous in Canada. We insure our homes, our businesses, our lives. In some instances, insurance is mandatory — we cannot get a construction mortgage[2] or drive a car in Canada without insurance.[3] There are over 22 million

* Dr Janis Sarra, Presidential Distinguished Professor and Professor of Law, University of British Columbia, Peter A Allard School of Law. My sincere thank you to Mark Zelmer, Gordon Dunning and Gale Rubenstein for their helpful comments on the draft of this article, and to Paul Kovacs for his insights on resolution of P&C insurers.

1 "Flotsam", from the early 17th century, from Anglo-Norman French 'floteson' — 'to float', Oxford University Dictionary.

2 Even home purchases in limited circumstances require insurance; where the loan-to-value ratio is over 80 per cent, where the mortgagee is self-employed or has a poor credit history; Government of Canada, "How much you need for a down payment" (22 November 2017), online: Government of Canada <https://www.canada.ca/en/financial-consumer-agency/services/mortgages/down-payment.html>.

3 Insurance is required in every province for vehicles to be operated, as per: Insurance Bureau of Canada, "Understanding Auto

policyholders of life insurance and 25 million of health insurance in Canada.[4] Premiums paid for property and casualty insurance in Canada totalled more than $48 billion CAD in 2016, and $32 billion CAD were paid out in claims that year.[5] In addition to private companies, provincial governments in some parts of Canada provide motor vehicle insurance and operate the system.[6] Insurance companies provide important services that safeguard against loss of income or assets due to injury, illness or catastrophic events. Forms of insurance have been around since 3000 BC, and there is a long history regarding insurance and its regulatory oversight.[7] Today, insurance represents almost 2 per cent of Canada's gross domestic product ("GDP").[8] Yet we do not often think about the viability of the companies that insure us or about the policyholder protection and resolution regime that underpins the provision of these services.

Insurance" (2017), online: IBC <http://www.ibc.ca/ab/auto>. License and registration are not issued without insurance. However, vehicles can be owned without insurance so long as they are never operated.

4 Canadian Life and Health Insurance Association, "Key Statistics" (2016), online: CLHIA <https://www.clhia.ca/web/CLHIA_LP4W_LND_-Webstation.nsf/page/CCC69F7D565FDA75852581FC005BAF8B!OpenDocument>.

5 Insurance Bureau of Canada, "2017 Fact Book" (2017), online (pdf): IBC <http://assets.ibc.ca/Documents/Facts%20Book/Facts_Book/2017/Fact-Book-2017.pdf>.

6 Provincial governments in British Columbia, Saskatchewan and Manitoba operate auto insurance monopolies. Canada's national healthcare system is a form of insurance offered across the country.

7 Sam Woods, Executive Director of Insurance Supervision, "Embarking on a new voyage? Solvency II in context" (The Insurance Institute of London Lecture delivered at Lloyd's of London, London, UK, 27 January 2016) at 3, online: Bank of England <https://www.bankofengland.co.uk/speech/2016/embarking-on-a-new-voyage-solvency-ii-in-context>.

8 Canada, Statistics Canada, *Table 36-10-0434-05 Gross domestic product at basic prices, by industry, monthly, industry detail, growth rates (x1,000,000)* (Ottawa: Statistics Canada, 2018), online: Government of Canada <https://www150.statcan.gc.ca/t1/tbl1/en/tv.action?pid=3610043405>.

However, several major failures of insurance companies globally[9] have highlighted the importance of effective mechanisms for dealing with the insolvency of insurance companies. The resilience of Canada's insurance sector was evident during the 2008-2010 global financial crisis, where both prudential oversight and policyholder protection stood Canada in good stead. However, as new products and technology develop, and as the complexity of multinational insurance enterprises increases, new risks pose challenges for Canada's oversight and policyholder protection regimes.

"Insurer", for purposes of this article, includes insurance companies as legal entities, insurance holding companies, insurance corporate groups, insurance-led financial conglomerates, and the Canadian branches of foreign insurance companies operating in Canada.[10] In many jurisdictions, insurers, as well as banks, are excluded from corporate insolvency legislation. Canada is no different. It has a separate regime for life and health insurance ("life insurers") and property and casualty ("P&C") insurers, with separate policyholder protection funds. Depending on the nature of the holdings, these policyholder protection funds are dealing with federal or provincial regulators, or both, when an insurer is on the cusp of insolvency or has become insolvent.

To "resolve" an insurer is to use a series of tools to address its financial distress in a manner that safeguards the public interest, including: ensuring continuity of the policies held by customers; restructuring of all or part of the company to allow it to continue operating where that option is viable; facilitating orderly merger with another company; or

---

9 For a discussion, see PACICC, "Why insurers fail: Lessons learned from the failure of HIH Insurance Limited" (2018), online: PACICC <http://www.pacicc.ca/publication/why-insurers-fail/>. HIH was the second largest general insurer in Australia, with more than 200 subsidiaries and extensive worldwide operations, its insolvency affecting two million policyholders.

10 It is used interchangeably with "insurance company" in this article to mean all these insurance businesses operating in Canada.

providing for an orderly winding up of an insolvent insurer. In the Canadian context, it has also been defined as "the ability to restructure a company, which is needed for effective resolution if recovery measures are not feasible or have proven ineffective".[11]

This article provides an overview of the insolvency regime for insurers in Canada. It focuses primarily on the federal regime as the exemplar of how Canadian regulators and the insurance industry have built in policyholder protection and mechanisms for early intervention. Part II examines the causes of financial distress and the kinds of asset values that may be identified and preserved during insolvency. Part III explores the regulatory capital requirements imposed on insurers with the goal of policyholder protection and safety and soundness of the system. Part IV examines policyholder protection and insolvency resolution strategies, including the early intervention system, aimed at keeping companies afloat or enabling them to exit the market with as little disruption as possible. Part V briefly analyses how Canada's supervisory and resolution system measures up against international standards. Part VI then explores aspects of the system that need improvement and suggests priorities for legislative reform, including clear assignment of responsibility for resolution, treatment of derivatives and provisions to facilitate cross-border proceedings. Part VII highlights new complex challenges facing Canadian insurers in terms of solvency risk, including accounting standards changes, climate change risk and cybersecurity. Part VIII concludes.

II. FLOTSAM?

Flotsam is an old maritime term referring to goods that float to the surface of the sea when a ship sinks, salvaged by

11 Assuris, "Second Consultation Submission to Department of Finance" (28 September 2017) at 1, online (pdf): Assuris <https://www.fin.gc.ca/consultresp/pdf-pssge-psefc/pssge-psefc-16.pdf> ["Assuris 2017"].

enterprising individuals.[12] Today we also use it to mean the goods or assets of a company or enterprise that may float to the surface in terms of being realized for the benefit of the failing company's stakeholders. Flotsam can also have a negative meaning, the detritus of a sinking company. The mixed meanings are apt, as the failure of a business, including an insurance business, can be for many reasons, including inadequate capitalization or poor governance, or it can be due to external market conditions even where the company is well-managed and appropriately capitalized. On the failure of an insurance company, many assets are generally in good order and retain their value. The Canadian regime for resolving insurer distress, whether it is solvent recovery/resolution before financial distress becomes insolvency, or restructuring, sale or winding-up and liquidation at the point the insurer is insolvent, is a set of mechanisms to recognize the value that can be preserved and resources reallocated more effectively. The mechanisms allow for transparency and certainty in terms of an orderly process that preserves value.

Most importantly in Canada, the goal on insurer insolvency is to protect the insurance policies held by individuals and businesses. Rather than assets realized after the fact, the Canadian system for insurance policyholders is to offer "life rafts" prior to the ship sinking, bridging their insurance policy to another sea-worthy company where possible, as discussed throughout this article.

At the outset, it is important to understand some of the reasons for insurer financial distress in Canada and the stakeholders affected.

1. Causes of Insurers Sinking

As with all businesses, insurers need to be well managed and sufficiently capitalized or they are likely to encounter financial

12 Martin Norris, *The Law of Salvage* (New York: Baker, Voorhis & Co, 1958). The word comes from Old French "floter", meaning "to float".

distress. If insurers lose the confidence of customers, they are no longer able to write new business, which can lead to insolvency. If they lose the confidence of investors, it can be difficult to stay sufficiently capitalized. Confederation Life suffered a liquidity crisis as a result of being unable to roll over its commercial paper in the mid-1990s.[13] Confederation Life had written questionable business at questionable prices and was overly aggressive in its investment strategy, ultimately compounded by liquidity issues when the market lost confidence in the company.

Insurance companies have some specialized financial risks because their liabilities can have "long tails" in terms of future payouts, and thus their actual liabilities may be underestimated. The long-term nature of many insurance contracts exposes issuers to liability management risk. For example, "life insurers make assumptions regarding the long-term yield when pricing a product, but may not be able to back that assumption with assets of equal duration, exposing them to reinvestment risk years into the future".[14] In addition, changes in mortality and morbidity patterns may make assessing liabilities and capitalization needs difficult. For example, a life insurer may have provided long-term care guarantees related to mortality and morbidity assumptions that prove to be inaccurate over time. Equally, non-tangible assets may be difficult to value at any given time and may be over-valued. These risks are exacerbated where the insurer operates in multiple markets and has multiple products.

A significant reason for failure can be weak corporate governance or inadequate risk management that results in poor pricing of product and poor financial performance, which

---

13 *Canada (Attorney General) v Confederation Life Insurance Co* (1995), 33 CBR (3d) 161, 31 CCLI (2d) 77, 24 OR (3d) 717 (Gen Div), affirmed 1997 CarswellOnt 62, 32 OR (3d) 102, 145 DLR (4th) 747 (CA).

14 Mark Zelmer, Deputy Superintendent of OSFI, "A New Chapter in Life Insurance Capital Requirements" (21 April 2016) at 2, online: OSFI <http://www.osfi-bsif.gc.ca/Eng/osfi-bsif/med/sp-ds/Pages/mz20160421.aspx>.

can cause capital to deteriorate. Inadequate capitalization is one symptom of poor management. Another is a failure to properly diversify.[15]

Low interest rates affect investment results in the P&C sector, as a significant portion of the investment portfolios are in bonds and debentures.[16] A current risk for life insurers is that persistently low interest rates make asset and liability management difficult and place strains on in-force product profitability, given that contractual provisions of products do not allow repricing of many insurance products.[17]

Insurers' financial stability can also be affected by external market conditions, for example, the global financial meltdown in 2008-2010. The Canadian Office of the Superintendent of Financial Institutions ("OSFI") has observed that since the 2008 financial crisis, life insurers have reduced sales of products with high-risk market guarantees, de-risked and re-priced product offerings, increased their hedging of product risks, divested themselves of high-risk blocks of business, and strengthened their risk management practices, in turn decreasing their sensitivity to interest rate and equity fluctuations.[18] While return on equity for the industry was 10 per cent and net income was $9.8 billion in 2016, 75 per cent of the industry's net income is attributable to the three large conglomerate insurers.[19]

---

15 Swiss Re Group, "2018 Sonar Report" (31 May 2018), online: Insurance Canada <https://www.insurance-canada.ca/2018/05/31/swiss-re-sonar-report/> ["Swiss Re Group"].

16 OSFI, *Annual Report 2016-2017* (2017) at 11, online (pdf): OSFI <www.osfi-bsif.gc.ca/Eng/Docs/ar-ra/1617/eng/ar1617.pdf> ["OSFI, *Annual Report 2016-2017*"].

17 *Ibid.*

18 *Ibid.* OSFI observes: "Market volatility and persistently low interest rates have had an effect on in-force product profitability as investment yields have declined below yields anticipated when these products were originally priced. However, companies have set up additional balance sheet provisions to meet their future obligations to policyholders."

19 *Ibid.* 2016 are the statistics most recently available.

A 2017 survey conducted by PricewaterhouseCoopers Inc ("PwC") found that, in Canada, industry participants identify change management, technology and cybersecurity risk as the three greatest risks to the insurance sector.[20] Change management is defined as "rapidly evolving markets, rising customer expectations and new distribution channels that threaten traditional insurance business models", PwC observing that incumbents held back by legacy systems and traditional modes of thinking are trying to innovate in an unfamiliar environment.[21] Technological concerns that have been identified range from driverless cars,[22] issues generated by the Internet, artificial intelligence, algorithms,[23] advances in genetics, telematics and smart homes.[24] Taking autonomous and semi-autonomous cars as an example, while some research suggests that increased use of autonomous driving technology will lead to fewer accidents, the collisions that will occur may result in costlier repairs and some uncertainties regarding driver and manufacturer liability and victim compensation.[25] Pricing such new markets is difficult, as well as the challenges

---

20 PwC and the Centre for the Study of Financial Innovation, "Insurance Banana Skins 2017: What are the top risks facing the insurance industry?" (2017), online: PwC <https://www.pwc.com/gx/en/industries/financial-services/insurance/insurance-banana-skins-2017.html> ["PwC, 'Insurance Banana Skins'"]. 2017 survey was based on 836 responses from practitioners, regulators and observers of the insurance industry in 52 countries. Cybersecurity and climate change are discussed in Part VIII of this article.

21 *Ibid* at 13.

22 See for example, Insurance Canada, "Travelers Outlines Framework for Autonomous Vehicle Insurance" (24 July 2018), online: Insurance Canada <https://www.insurance-canada.ca/2018/07/24/travelers-autonomous-vehicle-framework/> ["Insurance Canada"].

23 Swiss Re Group notes that a growing number of business processes are driven by algorithms, but algorithmic applications are not infallible; they base their actions on human judgment and discriminatory bias may translate into defective modelling and prediction, bringing a two-fold risk to insurance and other industries. Swiss Re Group, *supra* note 15.

24 PwC, "Insurance Banana Skins", *supra* note 20 at 13.

25 Insurance Canada, *supra* note 22.

that legacy company technology has in digitizing its offerings or effectively using big data.[26]

There can be information asymmetries regarding the value of assets and liabilities such that it is unclear to oversight regulators and stakeholders that an insurer is insolvent. There are disputes in capital adequacy calculations, the actuarial valuation, and the asset values that may affect decisions regarding early intervention or even taking control. If the supervisory authority has failed to detect the financial distress or is reticent to act because it believes the company has taken adequate steps to address capital or liquidity inadequacy, the failure to act could hinder the possibility of going-concern recovery of the entity later.

Although insolvency regulation of insurers in Canada is integrated with deposit-taking banks in terms of federal supervisory oversight,[27] insurers differ from banks in that they are not systemically important to the functioning of the financial system and the national economy such that their failure has far-reaching consequences.[28] Yet failure of one of the multinational insurers headquartered in Canada could involve shocks to the economy in terms of uncertainty for policyholders, contagion risk for other insurers, and risk to other sectors in which a large enterprise operates.

There are separate but aligned resolution systems and insurance funds for insurers operating in Canada, divided into the life insurance and P&C insurance sectors.[29] The life

26 PwC, "Insurance Banana Skins", *supra* note 20 at 13.

27 See the discussion in Part III.

28 For a discussion, see Janis Sarra, "Prudential, Pragmatic and Prescient, Reform of Bank Resolution Schemes" (2012) *International Insolvency Review* 1-54, and Janis Sarra, "Bank Groups and Financial Conglomerates, Retooling Resolution Regimes" (2014) 30 *Law in Cont* 7-50.

29 See for example, the industry-funded Assuris, which protects policy holders of life insurance, online: Assuris "Protecting your life insurance" (2018), online: Assuris <http://www.assuris.ca/Client/Assuris/Assuris_LP4W_LND_WebStation.nsf/welcome_en.html?-ReadForm> ["Assuris, 'Protecting your life insurance'"]; and the

insurance sector offers a range of products, such as term life insurance, health insurance and annuities.[30] The P&C insurance industry in Canada provides coverage for all risks other than life, including automobile, property and liability insurance.[31] Mortgage insurance is yet another product that is subject to regulatory oversight.[32] There are different rules for life and P&C companies, depending on whether they are federally or provincially regulated, although, as discussed below, there is some convergence in standards.

---

industry-funded Property and Casualty Insurance Compensation Corporation, "Welcome" (2018), online: PACICC <http://www.pacicc.com/> ["PACICC"].

30 Term life insurance is a relatively inexpensive form of life insurance that provides protection over a pre-defined period of time, becoming more expensive as an individual gets older; permanent life insurance provides guaranteed lifetime protection and premiums remain constant. Universal life insurance in many cases provides consumers with long-term or lifetime protection while at the same time making possible tax-deferred savings. Premium may remain constant or may rise over time and others combine both. Sun Life Assurance, "How to choose the right type of life insurance" (29 August 2017), online: Sun Life Financial. <https://www.sunlife.ca/ca/Learn+and+Plan/Money/Insuring+your+life/How+to+choose+the+right+type+of+life+insurance?vgnLocale=en_CA>.

31 OSFI, "Guide to Intervention for Federally Regulated Property and Casualty Insurance Companies" (March 2018), online: OSFI <http://www.osfi-bsif.gc.ca/Eng/fi-if/rai-eri/sp-ps/Pages/gip.aspx> ["OSFI, 'Guide to Intervention for Federally Regulated Property and Casualty Insurance Companies'"].

32 The mortgage insurance industry in Canada is composed of three participants: two private sector insurance companies regulated by OSFI, and the Canada Mortgage and Housing Corporation ("CMHC"), which is a Crown corporation also subject to OSFI oversight. OSFI, "Advisory Capital Requirements for Federally Regulated Mortgage Insurers" (1 January 2017), online: OSFI <http://www.osfi-bsif.gc.ca/Eng/fi-if/rg-ro/gdn-ort/adv-prv/Pages/cptins.aspx>. The Canadian Council of Insurance Regulators ("CCIR") has completed development of a nationally accepted set of standard insurance classes: Canadian Council of Insurance Regulators, "CCIR Recommends Adopting Streamlined Classes of Insurance" (22 March 2002), online: CCIR <https://www.ccir-ccrra.org/Documents/View/2696>.

There have been very few P&C insurer insolvencies. Only seven of 161 insurers that exited the Canadian P&C market in the 20-year period from 1997 to 2017 were involuntarily closed because regulators lost confidence in their ability to pay future claims.[33] The most common cause of P&C insurer failures in Canada was poor underwriting results and claims reserving.[34]

33 PACICC, "Why insurers fail: Exit strategies of P&C insurers in Canada" (2017), online (pdf): PACICC <http://www.pacicc.ca/wp-content/uploads/2017/11/WIF-2017-Exit-Strategies.pdf> ["PACICC, 'Why insurers fail'"]. PACICC, *supra* note 29. The companies were: Strathcona General Insurance, Pitts Insurance, Cardinal Insurance, Northern Union Insurance, Canadian Great Lakes Surety, Mennonite Mutual Hail Insurance and Northumberland Insurance. There were many mergers during this period, at 1. The companies were: 1) GISCO (ceased 2000), where PACICC assessed members for $3.5 million. Total claims paid to policyholders from the estate totaled $5.3 million; estate was closed in 2016. 2) Alta Surety Company (ceased 2001) — OSFI took control and the Court granted a winding-up and liquidation order; Alta Surety sold policies not covered by PACICC. 3) Canadian Millers' Mutual (ceased 2001): PACICC assessed member insurers for $3 million, claims paid to policyholders totaled $3.7 million; estate closed in 2016, 15 years after the initial winding-up order was issued. 4) Markham General (ceased 2002): PACICC assessed members for $22 million. Claims paid to policyholders totaled more than $21 million; insolvency took 13 years to complete, estate closed in 2016. 5) Reliance Insurer (ceased 2003): solvent Canadian branch of a troubled US insurer; early in the liquidation, PACICC negotiated a loan and service agreement with the liquidator and pledged a portion of PACICC's assessment capacity to allow the liquidator to "thaw" these assets and begin to pay creditors. The liquidator of the estate determined that there was enough money in the estate to pay 100 per cent of money owed to creditors. 6) Home Insurance (ceased 2003): OSFI took control of the Canadian branch in June 2003; and the Ontario Superior Court of Justice subsequently appointed Deloitte & Touche Inc as provisional liquidator of the company, at 6-7.

34 *Ibid* at 6. David Hindley describes claims reserving as: "The process of claims reserving is at the core of the financial management of general insurance organizations. It determines what is held on the balance sheet for claims that are not yet settled, affects the premiums that are charged and impacts on the capital that is held to support the solvency of the organization. Thus, the selection of appropriate reserving methodologies and assumptions, and the application to

In the life insurance sector in Canada, there have been four insolvencies out of a total of more than 75 life insurers.[35]

2. Who is Affected by the Detritus of an Insurer Insolvency?

When an insurer fails in Canada, there are multiple stakeholders implicated. First and foremost are the policyholders. For example, policyholders that have been paying premiums for many years likely cannot purchase life insurance at the same price or benefit levels. They may not be able to pass a medical examination with a new insurer that they passed when they were 30 years younger, given that they are aging and their health may be deteriorating, and they may be uninsurable. Hence protection and continuation of the existing policy is critically important. For P&C policyholders, most will have prepaid for insurance for the year and thus there is value at risk as creditor policyholders if the insurer is wound up and the policyholder faces another round of upfront costs to purchase replacement insurance. Replacement insurance may be difficult to find if the P&C market has changed or "hardened". Further, the policyholder may suffer a loss if a claim is in excess of the coverage provided by the P&C policyholder protection fund. The *Winding-Up and Restructuring Act (WURA)* sets out the priorities given to policyholders' claims.[36]

---

practical situations, often with imperfect data, are of critical importance to the operations of an insurance organization." David Hindley, *Claims Reserving in General Insurance*: *International Series on Actuarial Science* (Cambridge: Cambridge University Press, 2017) at 34.

35 Assuris, "2017 Annual Report" (2017) at 31, online (pdf): Assuris <http://annualreport2017.assuris.ca/wp-content/themes/annual_-report_theme/pdf/Assuris_AR_2017_EN.pdf> ["Assuris, '2017 Annual Report'"]. They were: Les Coopérants, Sovereign Life, Confederation Life and Union of Canada Life; Assuris, "Past Insolvencies" (2018), online: Assuris <http://www.assuris.ca/Client/Assuris/Assuris_LP4W_LND_WebStation.nsf/page/Past+Insolvencies!OpenDocument&audience=member> ["Assuris, 'Past Insolvencies'"].

36 *Winding-Up and Restructuring Act*, RSC 1985, c W-11, as amended

The employees of an insurer are a second group of important stakeholders. Here, the risks they face are similar to any other failing business. On insolvency, employees will suddenly be looking for work, competing with hundreds, if not thousands, of terminated employees in the same sector. For older workers in particular, it is difficult to find replacement work at a commensurate level of pay and benefits. For pensioners receiving pension benefits from the insurer as former employer or employees of the insolvent insurer receiving injury, illness and disability benefits, there is risk of discontinuation of their benefits. Employees do not have protection for their wages and benefits under the federal *Wage Earner Protection Program Act (WEPPA)* because the insolvency of their employer insurer does not come within the definition of bankruptcy or receivership under the statute.[37] The *WURA* does give priority for up to three months of wages that are unpaid.[38] That preference is only under specified conditions, such as the employee being unpaid at the time of the making of a winding-up order of the insurer, not exceeding the arrears that have accrued during the three months immediately preceding the date of that order.[39] One important reform would

[*WURA*]. Section 161 specifies that the order of claims payments are the costs of liquidation, employee preferred claims, and then claims of policyholders in a specified order. See also Assuris, "Past Insolvencies", *supra* note 35, discussion of Les Coopérants' insolvency.

37 *Wage Earner Protection Program Act*, SC 2005, c 47, as amended [*WEPPA*]. An insurer insolvency does not come under the bankruptcy provisions of the *Bankruptcy and Insolvency Act*, RSC 1985, c B-3, as amended [*BIA*], or the definition of receiver under the *WEPPA,* which is "receiver means a receiver within the meaning of subsection 243(2) of the *Bankruptcy and Insolvency Act*".

38 *WURA*, *supra* note 36, s 72: "Clerks or other persons in, or having been in the employment of, a company, in or about its business or trade, shall be collocated in the dividend sheet by special privilege over other creditors, for any arrears of salary or wages due and unpaid to them at the time of the making of a winding-up order in respect of the company, not exceeding the arrears that have accrued to them during the three months immediately preceding the date of that order."

39 *Ibid*. In the Confederation Life insolvency, employees who were

be to amend the *WURA* to provide employees of insurers at least the same protection as employees and pensioners receive under Canadian bankruptcy legislation and the *WEPPA*.

Failed insurers also have a range of creditors such as bondholders, operating lenders, subordinated debt holders, trade suppliers, landlords, and other creditors that have both secured and unsecured claims on the assets of the insolvent company.

Directors can also be affected stakeholders in respect of an insurer's insolvency. Directors of insurers may be at risk of personal liability if they have failed to meet *Insurance Companies Act (ICA)* and employment standards requirements for notice, severance and termination pay for employees,[40] although they have a due diligence defence under the *ICA*.[41] Where a director of an insurance holding company pays employee compensation debts that are proven in liquidation or bankruptcy proceedings, the director is entitled to any preference to which the employee would have been entitled, and, where a judgment has been

retained to help with the winding-up received "stay bonuses" and some employees were paid on termination shortly after liquidation proceedings commenced, but there is some question as to whether employees who are terminated after the date of a liquidation order have any rights to severance under the *WURA* provisions.

40 *Insurance Companies Act*, SC 1991, c 47, as amended [*ICA*], online: Government of Canada <http://laws-lois.justice.gc.ca>. Section 844, *ICA*, specifies that directors of an insurance holding company are jointly and severally, or solidarily, liable to each employee of the insurance holding company for all debts not exceeding six months wages payable to the employee for services performed for the insurance holding company while they are directors. There are conditions precedent to a finding of liability.

41 *Ibid*, s 845: "(1) A director, officer or employee of an insurance holding company is not liable under section 841 or 844 and has fulfilled their duty under subsection 795(2) if they exercised the care, diligence and skill that a reasonably prudent person would have exercised in comparable circumstances, including reliance in good faith on (a) financial statements of the insurance holding company that were represented to them by an officer of the insurance holding company or in a written report of the auditor of the insurance holding company fairly to reflect the financial condition of the insurance holding company; or (b) a report of a person whose profession lends credibility to a statement made by them."

obtained, the director is entitled to an assignment of the judgment.[42]

Two additional stakeholder groups are the policyholder protection funds, Assuris, for life insurers, and the Property and Casualty Insurance Compensation Corporation ("PACICC") for property and casualty insurers.

Assuris, founded in 1990, is designated by the federal Minister of Finance under the *ICA*, and specified in the Québec "Règlement d'application de la Loi sur les assurances" and similar provincial legislation.[43] Assuris is an industry-funded not-for-profit corporation that offers protection to Canadian policyholders for benefits under products issued by life insurers in Canada if a life insurer fails.[44] Its objective is to protect policyholders by minimizing the loss of benefits and ensuring a quick transfer of their policies to a solvent company, to allow benefits to continue.[45]

Assuris' Memorandum of Operation sets out categories and components of coverage:

> a. Components of coverage
>
> > Benefits are covered under five components of coverage: Death Benefit Coverage, Cash Value Coverage, Accumulated Value Coverage, Monthly Income Coverage and Health Expense Coverage.
>
> b. Categories of coverage
>
> > Under each component of coverage there are four categories of coverage: Individual Benefit, Individual Registered Benefit, Group Benefit, and Group Registered Benefit.
> >
> > For the Accumulated Value Coverage component there are two additional categories: Individual Tax Free Savings Account and Group Tax Free Savings Account.[46]

---

42 *Ibid*, s 844(5). The directors may also be indemnified by the insurance holding company, *ibid*, s 846.

43 Assuris was formerly called CompCorp. "Règlement d'application de la Loi sur les assurances", RLRQ, c A-32, r 1.

44 Assuris, "2017 Annual Report", *supra* note 35.

45 Assuris, "Protecting your life insurance", *supra* note 29.

46 See Assuris, "Articles 2.06-2.10, Memorandum of Operation, as

Assuris works to transfer the policies to a solvent company, and on transfer, Assuris guarantees that policyholders will retain at least 85 per cent of the insurance benefits they were promised. Accumulated values deposit-type products would also be transferred to a solvent company, and Assuris guarantees that policyholders will retain 100 per cent of their accumulated value up to $100,000.[47] Assuris has the dual role of protecting policyholders and working towards strengthening the system to ensure effective mechanisms are in place for recovery and resolution of all life insurers operating in Canada.[48] Its objective in improving the current process is to ensure a stable, effective and timely resolution process, control of the

---

amended and restated" (23 May 2013) [on file with author] ["Assuris, 'MOO'"]. Article 2.14 Maximum coverage per Covered Person: "Death Benefit Coverage is 85%, but not less than 100% of the first $200,000, of aggregate Benefits. Monthly Income Coverage is 85%, but not less than 100% of the first $2,000 per month, of aggregate Benefits. Health Expense Coverage is 85%, but not less than 100% of the first $60,000, of aggregate Benefits. Cash Value Coverage is 85%, but not less than 100% of the first $60,000, of aggregate Benefits. Accumulated Value Coverage is 100% up to $100,000 of aggregate Benefits. If aggregate Accumulated Value Benefits are over $100,000, the Corporation will ensure that each Covered Person receives at least $100,000." Article 2.16, MOO: "The Coverage Date is the effective date of calculation and implementation of coverage under the terms of this Memorandum of Operation. This date will be determined by the Board of Directors and will normally be either the date on which the Regulator took control of the Member or its assets or the date of the Winding-Up Order against the Member." Article 2.30 MOO, Hardship Cases: "Where the Board of Directors is satisfied that the loss suffered by a Covered Person, policyholder or beneficiary as a result of the insolvency of a Member constitutes a hardship case, the Board of Directors may authorize the Corporation to increase or extend coverage or provide alternative compensation."

47 *Ibid* at 6. "Assuris provides separate protection for individual, group, registered and non-registered benefits. Assuris also provides separate protection for individual Tax Free Savings Accounts and group Tax Free Savings Accounts invested in accumulation annuities."

48 Assuris, "2017 Annual Report", *supra* note 35 at 2, Chair's Message.

costs of resolution, minimization of losses to policyholders, and maintaining confidence in the system.[49] To date, Assuris has protected the policies of almost three million Canadians.[50]

The second policyholder insurance fund is PACICC, also an industry-funded not-for-profit organization. Its stated mission is "to protect eligible policyholders from undue financial loss in the event that a member insurer becomes insolvent".[51] It works to minimize the costs of insurer insolvencies and maintain a high level of consumer and business confidence in Canada's P&C insurance industry through the financial protection to policyholders.[52] PACICC is responsible for dealing with the claims of policyholders under most policies issued by P&C companies.[53] P&C insurers fund the program to protect policyholders and claimants in the event of a collapse of a P&C insurer in Canada.[54]

Assuris and PACICC are stakeholders in the sense that they can be the largest contingent creditors at the point that an insolvency proceeding commences. That role as creditor crystallizes once Assuris or PACICC contribute financially to support payments to policyholders, in which case, they become a preferred creditor, either contractually or by court order.[55]

III. FINANCING — CAPITAL ADEQUACY REQUIREMENTS FOR CANADIAN INSURERS

One objective of regulation of the insurance sector is to protect policyholders by ensuring that insurers are adequately

49 *Ibid.*
50 *Ibid* at 31.
51 PACICC, "Mission Statement" (2018), online: PACICC <http://www.pacicc.ca/about-us/mission-statement/>.
52 *Ibid.*
53 PACICC, *supra* note 29.
54 PACICC, "Why insurers fail", *supra* note 33 at 4.
55 For example, for the four insolvencies in which Assuris was involved, it entered into a loan agreement with the liquidator to "top up the policyholders", the agreement containing a clause that specified that Assuris' claim ranked below that of policyholders but ahead of other unsecured creditors.

capitalized, by setting requirements for capitalization that are clear and certain for industry participants. Capital adequacy is aimed at ensuring that insurers can absorb significant unforeseen losses without risk to their solvency. The federal *ICA*[56] and provincial insurance statutes set out the legal process for insurance companies to enter and exit the marketplace.

The federal and provincial governments share jurisdiction over both life insurers and P&C insurers.[57] Federally, that oversight authority is OSFI, which has oversight of 67 life insurance companies, 13 fraternal benefit societies,[58] and 153 P&C insurers, as well as other federally-regulated financial institutions such as banks.[59]

The objectives of OSFI, as set out in its constating statute, the *Office of the Superintendent of Financial Institutions Act (OSFIA)*, are to: (a) supervise financial institutions in order to determine whether they are in sound financial condition and are complying with their governing statute law and supervisory requirements; (b) to promptly advise the management and board of directors of a financial institution in the event the institution is not in sound financial condition or is not complying with its legal or supervisory requirements and, in such a case, to take, or require the management or board to take, the necessary corrective measures in an expeditious manner; (c) to promote the adoption by directors and officers of financial institutions of policies and procedures designed to control and manage risk; and (d) to monitor and evaluate system-wide or sectoral events or issues that may have a

56 *ICA*, *supra* note 40.

57 OSFI, "Who We Regulate" (2018), online: OSFI <http://www.osfi-bsif.gc.ca/Eng/wt-ow/Pages/wwr-er.aspx?1> ["OSFI, 'Who We Regulate'"].

58 *Ibid*. A fraternal benefit society is an institution that has a representative form of government and is operated for fraternal, benevolent or religious purposes, including the insurance of members, or the spouses/common law partners or children of members, against accident, sickness, disability or death.

59 *Ibid*.

negative impact on the financial condition of financial institutions.[60] In pursuing these objectives in respect of insurers, OSFI strives to protect the rights and interests of policyholders and creditors, having due regard to the need to allow insurers to compete effectively and take reasonable risks.[61]

The provincial governments regulate the licensing of insurance companies operating within their jurisdictions as well as the marketing of insurance products.[62] Provincially, the authorities have a number of different names;[63] for example, the Autorité des marchés financiers ("AMF") in Québec[64] and the Financial Services Commission of Ontario ("FSCO") in Ontario regulate the solvency and financial soundness of insurers incorporated or formed under provincial legislation.[65]

60 *Office of the Superintendent of Financial Institutions Act*, RSC 1985, c 18 (3rd Supp), as amended, s 4(2), online (pdf): OSFIA <http://laws-lois.justice.gc.ca/PDF/O-2.7.pdf> [*OSFIA*]. The purpose of the *OSFIA* is: "3.1 The purpose of this Act is to ensure that financial institutions and pension plans are regulated by an office of the Government of Canada so as to contribute to public confidence in the Canadian financial system."

61 *Ibid*, s 4(3).

62 OSFI, "Who We Regulate", *supra* note 57.

63 Regulation of member insurance companies is also performed by the CCIR, and all the provincial governments.

64 Autorité des marchés financiers, "Deposit Insurance in Québec 1967 to 2017", (2017), online: Bibliothèque et Archives nationales du Québec <https://lautorite.qc.ca/en/general-public/publications/amf-publications/briefs-reports-or-documents/>. The AMF can constitute a legal person or a partnership under a statute of Québec to carry out the winding-up of the assets acquired from a registered institution, it can acquire any security issued by a registered institution and it can apply to the Superior Court for an order to force the sale or amalgamation of a registered institution whose permit has been suspended or cancelled.

65 Financial Services Commission of Ontario, "Insurance" (2018), online: FSCO <http://www.fsco.gov.on.ca/en/insurance/Pages/default.aspx>. In the insurance sector, FSCO is primarily a market conduct regulator, supervising the treatment of consumers and the conduct of business of insurance companies, agents, adjusters, and service providers. Independent general insurance brokers in Ontario are regulated by the Registered Insurance Brokers of Ontario, a self-

The AMF has regulatory supervision over 64 life insurance companies,[66] 130 P&C insurance companies,[67] four Québec-chartered companies that sell life, health and P&C insurance,[68] and 16 reinsurers.[69] As with OSFI, the AMF is responsible for regulating and monitoring Québec registered insurers, and intervening if an insurer fails to exercise sound and prudent management practices and sound commercial practices, or experiences difficulties, or if its solvency is threatened or seriously compromised.[70] It also monitors federally-regulated

---

regulatory body for insurance brokers in Ontario. Prudential regulation of insurance companies is primarily performed by the OSFI. FSCO, *Annual Report 2016-2017* (2017), online: FSCO <http://www.fsco.gov.on.ca/en/about/annual_reports/Pages/ar2016-insurance.aspx>.

66 The number includes, as of August 2018, nine Québec-chartered companies, five insurers chartered in other provinces, 32 federally-chartered life and health companies and 18 chartered in other countries, licensed to operate in Québec; Autorité des Marchés Financiers, "Breakdown of insurers authorized to carry on business in Québec" (29 August 2018), online: AMF <https://lautorite.qc.ca/en/professionals/insurers/breakdown-number-of-licensed-insurers/. In addition, it supervises 12 life and health mutual benefit associations> ["AMF, 'Breakdown of insurers authorized to carry on business in Québec'"].

67 *Ibid*. Including, as of August 2018, 20 Québec-chartered companies, five insurers chartered in other provinces, 55 federally-chartered P&C insurers and 50 chartered in other countries, licensed to operate in Québec.

68 *Ibid*. See also Autorité des Marchés Financiers, "Intervention Guidelines for Québec-chartered Life Insurers and Assuris Member Companies" (April 2013), online (pdf): AMF <file:///C:/Users/sarra/OneDrive/Documents/1%20insurance%20resolution%20paper%202018/AMF%20life%20intervention%20modalites_intervention_amf_assuris_an.pdf>.

69 *Ibid*, including, as of August 2018, one Québec-chartered company, four federally-chartered reinsurance companies and 11 chartered in other countries, licensed to operate in Québec; AMF, "Breakdown of insurers authorized to carry on business in Québec", *supra* note 66.

70 *Ibid*. See also Autorité des Marchés Financiers, "Guideline on Capital Adequacy Requirements, property and casualty insurance" (effective 1 January 2018) at 3, online (pdf): AMF <https://lautorite.qc.ca/fileadmin/lautorite/reglementation/lignes-directrices-assurance/20180101-ligne-directrice-tcm_an.pdf>.

life insurance companies licensed to operate in Québec.[71] The oversight authorities monitor the financing of insurers in the life and P&C sectors, and set guidelines for how companies measure and report on their capital adequacy.

As discussed earlier, insurers face a myriad of risks, including: risks relating to the actuarial and/or statistical calculations used in estimating liabilities; market, credit, liquidity and operational risk from their investments and financial operations; and risks associated with products of life cover with a savings content and long-term pension products.[72] The regulatory and supervisory system of insurers is important to maintaining a fair, safe and stable insurance sector for the benefit and protection of the interests of policyholders.[73]

1. Federal Oversight of Capital Management

OSFI's "supervisory framework" that guides its oversight of federally-regulated financial institutions ("FRFI"), including life and P&C insurers, combines a risk assessment-based approach with capital adequacy oversight.[74] OSFI is funded primarily through assessments on the financial institutions.[75]

71 In 2018, there are 14 Assuris member companies that are Québec registered and the rest are federally registered or registered in other provinces but have a license to operate in Québec.

72 International Association of Insurance Supervisors ("IAIS"), "Insurance Core Principles" (2017), online: IAIS <https://www.iaiswe-b.org/page/supervisory-material/insurance-core-principles//file/70028/all-adopted-icps-updated-november-2017> ["IAIS, 'Insurance Core Principles'"].

73 *Ibid* at 4.

74 For a discussion of bank resolution in Canada, see Janis P Sarra, "A Bridge Over Troubled Waters — Resolving Bank Financial Distress in Canada", in Janis P Sarra & Barbara Romaine, eds, *Annual Review of Insolvency Law 2017* (Toronto: Carswell, 2018) at 255 ["Sarra, 'Bridge Over Troubled Waters'"]. OSFI, "The Supervisory Framework" (2014), online: OSFI <http://www.osfi-bsif.gc.ca/eng/fi-if/rai-eri/sp-ps/pages/sff.aspx> ["OSFI, 'Supervisory Framework'"]. The Supervisory Framework is designed to assist OSFI in meeting its statutory obligations set out in the *OSFIA*, *supra* note 60, and other governing legislation regarding the supervision of FRFI.

75 OSFI, *Annual Report 2016-2017*, *supra* note 16, as well as the private

OSFI's supervision of insurers encompasses insurers incorporated or continued under the *ICA*, as well as foreign insurance companies that have been granted an order to insure in Canada.[76] The federally-regulated life insurance industry consists of three conglomerate institutions and more than 70 domestic companies and foreign branches.[77] The conglomerates account for over 90 per cent of the assets for the sector and have operations in Canada, the United States ("US"), Europe, and Asia. These multinational insurers sell a broad range of wealth management, life and health insurance products through a number of distribution channels, whereas domestic insurers tend to be more restricted in product breadth and distribution.[78]

OSFI's supervision involves assessing the safety and soundness of insurers, and using its authority for timely intervention where necessary. Given that its primary goal is to safeguard policyholders from loss, the focus of supervisory work is determining the impact of current and potential future events, both internal and from the external environment, on an insurer's risk profile.[79] The oversight and monitoring are really one of monitoring capital management, which OSFI defines as:

> Capital management is the on-going process of determining and maintaining the quantity and quality of capital appropriate to support

pension plans it regulates and a user-pay program for legislative approvals and other select services.

76 OSFI, "Who We Regulate", *supra* note 57.

77 OSFI, *Annual Report 2016-2017*, *supra* note 16 at 10.

78 *Ibid* at 1.

79 OSFI, "Supervisory Framework", *supra* note 74. Section 4(3) of the *OSFIA*, *supra* note 60 specifies: "(3) In pursuing its objects, the Office shall strive (a) in respect of financial institutions, to protect the rights and interests of depositors, policyholders and creditors of financial institutions, having due regard to the need to allow financial institutions to compete effectively and take reasonable risks; and (b) in respect of pension plans, to protect the rights and interests of members of pension plans, former members and any other persons who are entitled to pension benefits or refunds under pension plans."

> an insurer's planned operations. Capital should be managed to maintain financial strength, absorb losses so as to withstand adverse economic conditions, allow for growth opportunities and meet other risk management and business objectives. It should also be managed in order to provide, in extreme cases such as imminent failure or insolvency, sufficient assets to transfer or run-off policyholder obligations and pay creditor claims.[80]

The *ICA* requires federally-regulated life insurance companies and societies, holding companies and companies operating in Canada on a branch basis to maintain adequate capital or to maintain an adequate margin of assets in Canada over liabilities in Canada.[81] The *ICA* sets limits on equity acquisitions and investments;[82] limits on total property interest;[83] aggregate limits on the purchase or improvement

---

80 OSFI, "Regulatory Capital and Internal Capital Targets" (2018), online: OSFI <www.osfi-bsif.gc.ca/Eng/fi-if/rg-ro/gdn-ort/gl-ld/Pages/a4_gd18.aspx> ["OSFI, 'Regulatory Capital'"].

81 *ICA*, *supra* note 40, ss 515(1), 992(1) and 608(1). OSFI, "Guideline, Life Insurance Capital Adequacy Test" ("LICAT") (effective 1 January 2018), online (pdf): OSFI <http://www.osfi-bsif.gc.ca/Eng/Docs/LICAT18.pdf> ["OSFI, 'Guideline, LICAT'"].

82 *ICA*, *ibid* s 507 specifies: "A company shall not, and shall not permit its prescribed subsidiaries to,

(a) purchase or otherwise acquire any participating shares of any body corporate or any ownership interests in any unincorporated entity, other than those of a permitted entity in which the company has, or by virtue of the acquisition would have, a substantial investment, or (b) acquire control of an entity that holds shares or ownership interests referred to in paragraph (a), if the aggregate value of (c) all participating shares, excluding participating shares of permitted entities in which the company has a substantial investment, and (d) all ownership interests in unincorporated entities, other than ownership interests in permitted entities in which the company has a substantial investment, beneficially owned by the company and its prescribed subsidiaries exceeds, or the purchase or acquisition would cause that aggregate value to exceed, an amount determined in accordance with the regulations."

83 *ICA*, *ibid*, s 506, which specifies: "A company shall not, and shall not permit its prescribed subsidiaries to, purchase or otherwise acquire an interest in real property or make an improvement to any real property in which the company or any of its prescribed subsidiaries has an interest if the aggregate value of all interests of the company in real property exceeds, or the acquisition of the

of property;[84] and other provisions and regulations that ensure portfolio decisions do not negatively affect capitalization. Capital adequacy is assessed based on the appropriateness of its level and quality, both currently and prospectively, and under both normal and stressed conditions.[85] OSFI has determined industry minimum and target capital levels.

i. P&C insurer capital requirements

For P&C insurers, OSFI has issued the "Minimum Capital Test for Federally-Regulated Property and Casualty Insurance Companies" ("MCT") Guideline,[86] which outlines the capital framework, using a risk-based formula, for target and minimum capital/margin required, and defines the capital/assets that are available to meet the minimum standard.[87] OSFI assesses whether a P&C insurer maintains adequate capital and

---

interest or the making of the improvement would cause that aggregate value to exceed, an amount determined in accordance with the regulations."

84 *ICA*, *ibid*, s 508.

85 OSFI, "Key Principles" (2014), online: OSFI <http://www.osfi-bsif.gc.ca/eng/fi-if/rai-eri/sp-ps/pages/sff.aspx> ["OSFI, 'Key Principles'"]. In the case of foreign branches, OSFI considers the adequacy of capital equivalency deposits and vested assets.

86 OSFI, "Minimum Capital Test for Federally Regulated Property and Casualty Insurance Companies" (effective 1 January 2018), online (pdf): OSFI <http://www.osfi-bsif.gc.ca/Eng/Docs/mct2018.pdf>. Subsection 608(1) of the *ICA* requires foreign P&C companies operating in Canada on a branch basis (foreign property and casualty companies) to maintain an adequate margin of assets in Canada over liabilities in Canada, *ICA*, *supra* note 40 at 1. MCT Guideline. Chapter 3, *Foreign Companies Operating in Canada on a Branch Basis*, defines assets available for foreign P&C companies operating in Canada on a branch basis. The capital available also refers to assets available for "branch adequacy of assets test" ("BAAT") purposes, capital required refers to margin required for BAAT purposes and capital adequacy refers to margin adequacy for BAAT purposes.

87 *Ibid* at 1: "This MCT determines the minimum capital/margin required and not the level of capital/margin required at which property and casualty companies must operate."

whether a foreign P&C company maintains an adequate margin pursuant to the *ICA*.[88]

P&C insurers are required to meet the MCT capital requirements at all times.[89] They are required to maintain an MCT ratio of at least 100 per cent, and OSFI has established an industry-wide supervisory target capital ratio of 150 per cent, which provides a cushion above the minimum requirement capacity to absorb unexpected losses.[90] The MCT is a harmonized capital adequacy solvency test that is intended to apply throughout Canada to P&C insurers, developed to ensure consistency among federal and provincial jurisdictions by applying the same capital framework to P&C insurers operating in Canada.[91]

---

88 For example, consistent with Canadian P&C insurance companies, Canadian branches of foreign P&C insurance companies are required to use a specified amount of the company's worldwide capital and surplus in the calculation of their capital requirements for earthquake risk, a component of the supervisory target. "Both Canadian P&C insurance companies and Canadian branches of foreign P&C insurance companies may include such amounts, to the extent permitted in the MCT, in the determination of their internal target". OSFI, "Regulatory Capital", *supra* note 80.

89 *Ibid* at 4. The minimum capital requirements are calculated as follows: sum of: i.) Capital required for insurance risk: a. Capital required for unpaid claims and premium liabilities; b. Margin required for reinsurance ceded to unregistered reinsurers; and c. Catastrophe reserves. ii.) Capital required for market risk: a. Capital required for interest rate risk; b. Capital required for foreign exchange risk; c. Capital required for equity risk; d. Capital required for real estate risk; and e. Capital required for other market risk exposures. iii.) Capital required for credit risk: a. Capital required for counterparty default risk for balance sheet assets; b. Capital required for counterparty default risk for off-balance sheet exposures; c. Capital required for collateral held for unregistered reinsurance and self-insured retention. iv.) Capital required for operational risk. Less diversification credit, divided by 1.5. *Ibid* at 5.

90 *Ibid* at 6.

91 Financial Services Commission of Ontario, "Superintendent's Minimum Capital Test Guideline", online: <http://www.fsco.gov.on.ca/en/insurance/mincapitaltest/Pages/default.aspx>.

Notwithstanding that a P&C company may meet the MCT standards, OSFI may direct it to increase its capital[92] or the foreign P&C insurance company to increase its margin of assets in Canada over liabilities in Canada.[93] The MCT is the capital metric for Canadian P&C insurers, while the "branch adequacy of assets test" ("BAAT") is used for foreign-owned P&C branch operations in Canada, whereby foreign P&C insurers must vest assets in accordance with the BAAT in Canada.[94] OSFI reports that the P&C sector is well capitalized, with a relatively stable capital ratio of 269 per cent in 2016, well above its supervisory target of 150 per cent.[95]

Given record levels of household debt in Canada, combined with active residential real estate markets, OSFI has enhanced its supervisory oversight of mortgage insurance.[96] In 2017, OSFI issued an advisory, "Capital Requirements for Federally

92 *ICA*, *supra* note 40, under s 515(3).

93 *ICA*, *ibid*, under s 608(4). OSFI states: "Foreign property and casualty companies are reminded that the MCT is only one element in the determination of the required assets that must be maintained in Canada by foreign property and casualty companies."

94 As prescribed in the "Assets (Foreign Companies) Regulations", SOR/2002-450, *ICA*, online: <http://laws-lois.justice.gc.ca/eng/regulations/SOR-2002-450/page-1.html>. Section 3 specifies: "In addition to the margin of assets in Canada over liabilities in Canada required by section 608 of the Act, and subject to sections 6 and 7, every foreign life company shall, in relation to the classes of life insurance, accident and sickness insurance, credit protection insurance and other approved products insurance, maintain assets in Canada the total value of which, when determined in accordance with the accounting principles referred to in subsection 331(4) of the Act, is at least equal to the aggregate of (a) the amount of the reserve for actuarial and other policy liabilities of the company in respect of those classes, determined on the same basis as the reserve included in the company's annual return, minus the amount of all advances that were made by the company on the security or against the cash surrender value of its life policies included in its annual return, (b) the amount of the provision for claims incurred by the foreign life company in respect of those classes that are unpaid, and (c) the total amount of the other liabilities of the foreign life company in respect of those classes.

95 OSFI, *Annual Report 2016-2017*, *supra* note 16 at 11.

96 *Ibid* at 2.

Regulated Mortgage Insurers", which defined a new, more risk-sensitive approach to the regulatory capital requirements for mortgage insurance, incorporating measures such as borrower creditworthiness, outstanding loan balance, loan-to-value ratio, and remaining amortization.[97] OSFI initiated enhanced industry-wide stress tests for mortgage insurers.[98]

ii. Life insurer capital requirements

For life insurers, the minimum capital test is referred to as the "base solvency buffer" in the "Life Insurance Capital Adequacy Test" ("LICAT").[99] The LICAT, effective 1 January 2018,[100] and accompanying OSFI guidelines provide the framework within which OSFI assesses whether a life insurer maintains adequate capital or an adequate margin pursuant to the *ICA*.[101] Canada's LICAT standard reflects developments internationally regarding solvency standards, aimed at enhancing investor and policyholder confidence.[102] The OSFI guidelines establish criteria and limits for determining the amount of an insurer's qualifying regulatory capital, referred to as "available capital plus surplus allowance and eligible deposits in the LICAT" for life insurers.[103] The LICAT measures the capital adequacy of an insurer and is one of several indicators used by OSFI to assess an insurer's financial condition.

There has been an effort by some provincial regulators to align with federal capital adequacy requirements for life insurers.

97 *Ibid.*
98 *Ibid* at 4.
99 OSFI, "Regulatory Capital", *supra* note 80.
100 OSFI, "Guideline, LICAT", *supra* note 81. LICAT replaces Minimum Continuing Capital and Surplus Requirement ("MCCSR") ratio as the key metric used to assess capital adequacy for Canadian supervisory purposes: OSFI, *Annual Report 2016-2017*, *supra* note 16 at 10.
101 OSFI, "Regulatory Capital", *supra* note 80; plus ss 515(1), 992(1) and 608(1), *ICA*, *supra* note 40.
102 OSFI, "Regulatory Capital", *ibid.*
103 *Ibid.*

For example, FSCO adopted LICAT for the fraternal benefit societies for which it has oversight, also effective 1 January 2018.[104] The British Columbia Financial Institutions Commission and Alberta Treasury Board and Finance have also adopted LICAT for life insurers incorporated in those provinces.[105]

The OSFI "Guideline on Regulatory Capital and Internal Capital Targets" sets out OSFI's expectations with regard to the capital and solvency assessment of federally regulated insurers.[106] OSFI evaluates the inherent risk within each significant activity of a federally-regulated insurer and the quality of risk management applied to mitigate these risks. OSFI's guideline establishes standards, using a risk-based approach, for measuring specific life insurer risks and for aggregating the results to calculate the amount of a life insurer's regulatory required capital to support these risks. It also establishes criteria for determining the amount of qualifying regulatory available capital.[107] LICAT is only one component

104 Financial Services Commission of Ontario ("FSCO"), "2016 Annual Return Instructions to Ontario incorporated insurers and reinsurers, fraternal societies, and reciprocal insurance exchanges" (2017), online: FSCO <https://www.fsco.gov.on.ca/en/insurance/annual-returns/Pages/2016-letter-instructions.aspx>. Its posting says that it also adopted LICAT for life insurance companies, but there appear to be none currently registered in Ontario. Its most recent Annual Report states that it regulates 319 insurance companies, but as of 2017, none were life insurers: FSCO, *Annual Report 2016-2017* (2017) at 33, online: FSCO < http://www.fsco.gov.on.ca/en/about/annual_reports/Pages/ar2016-credit-caisses.aspx>.

105 British Columbia Financial Institutions Commission, "Adoption of the Life Insurance Capital Adequacy Test (LICAT)" (20 December 2017), online (pdf): Government of British Columbia <https://www.fic.gov.bc.ca/pdf/fid/correspondence/17-0802-ltr.pdf>. Alberta Treasury Board and Finance, Superintendent of Insurance, "Overview — Guidelines for Provincially Regulated Insurance Entities" (28 August 2018), online: Government of Alberta <https://finance.alberta.ca/publications/insurance/insurers/osfi-guidelines/index.html>.

106 OSFI, "Regulatory Capital", *supra* note 80.

107 *Ibid* at 5. The Total Ratio focuses on policyholder and creditor protection, assessing "Available Capital + Surplus Allowance +

of the required assets that foreign life insurers must maintain in Canada; these companies must also vest assets in Canada as required by the *ICA* and its regulations.[108] Even where a life insurer meets capital standards, OSFI may direct the life insurer to increase its capital, although this authority is unlikely to be exercised, absent other concerns about governance or financing of an insurer.[109]

OSFI also assesses an insurer's liquidity risk and the quality of its liquidity management.[110] Liquidity risk arises from an insurer's potential inability to purchase or otherwise obtain the necessary funds to meet its on- and off-balance sheet obligations as they come due. OSFI then develops a composite risk rating ("CRR") for each insurer, after assessing earnings and capital in relation to the overall net risk from its significant activities, and the assessment of liquidity,[111] which is OSFI's assessment of the insurer's risk profile.[112] The CRR is OSFI's assessment of the safety and soundness of the insurer with respect to its policyholders.[113]

Eligible Deposits" Base Solvency Buffer, the Core Ratio focuses on financial strength. The formula used to calculate the Core Ratio is: Tier 1 Capital + 70 per cent of Surplus Allowance + 70 per cent of Eligible Deposits Base Solvency Buffer.

108 "Assets (Foreign Companies) Regulations", *supra* note 94, *ICA*, *supra* note 40.

109 OSFI, "Guideline, LICAT", *supra* note 81. The Superintendent's authority is pursuant to ss 515(3), 992(3) or 608(4), *ICA*, *supra* note 40.

110 OSFI, "Supervisory Framework", *supra* note 74 at 6.

111 OSFI, "Regulatory Capital", *supra* note 80, reporting that "While regulatory capital is an important factor in OSFI's capital assessment, other factors are also considered. OSFI's Capital Assessment Criteria include, for example: adequacy of capital to support the insurer's risk profile and business plan, including risks that are not fully captured in the regulatory capital guidelines; ability to access capital at reasonable rates to meet projected needs; quality of capital; quality or strength of the insurer's capital management policy, including its capital management processes; and director and officer roles, responsibilities and effectiveness with respect to the insurer's capital management processes."

112 OSFI, *Annual Report 2016-2017*, *supra* note 16 at 12.

113 *Ibid.*

There are four ratings for composite risk: "low", "moderate", "above average" and "high", guided by a set of assessment criteria that were developed in consultation with the industry.[114] OSFI considers elements of capital that contribute to financial strength through periods when an insurer is under stress, as well as elements that contribute to policyholder and creditor protection during wind-up, such as subordinated debt.[115] OSFI expects the level and quality of an insurer's capital and its capital management to be commensurate with its circumstances, including its risk profile, appetite for risk and operating environment.[116]

OSFI reports that "the number, severity and overall quality of the stress scenarios used by an insurer to assess its capital adequacy in relation to all relevant regulatory and internal capital expectations are important considerations for OSFI when it assesses the strength of an insurer's capital".[117] It assesses the processes an insurer has in place to monitor and manage risk, business strategy, potential stress situations and future changes, as well as the company's ability to meet, on a continuous basis, regulatory and internal capital expectations.[118]

The CRR determines whether intervention by OSFI is needed.[119] OSFI supervision can include limited off-site reviews or extensive on-site reviews, including regular review of information and testing where necessary. OSFI also undertakes benchmarking reviews to identify standard and best industry practices.

---

114 *Ibid.*

115 *Ibid.*

116 *Ibid*, reporting that "Past and emerging trends, including the outlook for capital, earnings and liquidity, as well as the insurer's preparedness to deal with potential capital deficiencies, are relevant in assessing the adequacy of an insurer's capital position."

117 OSFI, "Regulatory Capital", *supra* note 80 at 2.

118 *Ibid.*

119 OSFI, "Composite Risk Rating and Assessment Criteria", online: <http://www.osfi-bsif.gc.ca/Eng/fi-if/rai-eri/sp-ps/Pages/crr.aspx>.

Annually, or as appropriate, OSFI sends a supervisory letter to each insurer summarizing OSFI's key findings, recommendations and/or requirements, if necessary, and discloses the insurer's CRR. There can be interim letters also sent as issues arise. Findings and recommendations are discussed with the insurer before the letter is issued.[120] The insurer is usually asked to provide a response within 30 days regarding actions it has taken in response.[121]

Similar to OSFI, the provincial regulatory authorities undertake monitoring of capital adequacy and liquidity for insurers registered in their jurisdiction. For example, AMF sets guidelines and standards for insurers to which the *La Loi sur les assurances*[122] applies, particularly with regard to solvency (capital adequacy) and sound and prudent management practices.[123] It has issued more than 20 guideline documents for the life and P&C sectors alone.[124] AMF's "Ligne directrice sur les exigences de suffisance du capital, Assurance de personnes" outlines the minimum capital requirements that, as with the federal requirements,

120 OSFI, "OSFI's Supervisory Ratings", online: < http://www.osfi-bsif.gc.ca/Eng/fi-if/rai-eri/sp-ps/Pages/01-CEO_letter.aspx>. The letter is generally issued within 45 calendar days of the completion of a review.

121 *Ibid*.

122 *La Loi sur les assurances*, CQLR, c A-32 [*La Loi sur les assurances*].

123 Autorité des Marchés Financiers, "Guidelines for Insurers" (2018), online: AMF <https://lautorite.qc.ca/en/professionals/insurers/guidelines/>. Autorité des Marchés Financiers, "Ligne directrice sur les exigences de suffisance du capital: assurance de personnes" (1 Janvier 2018), online (pdf): AMF <https://lautorite.qc.ca/fileadmin/lautorite/reglementation/lignes-directrices-assurance/20180101-ligne-directrice-suffisance-capital-ass-personnes_V-FO.pdf> ["AMF, 'Lignes directrice'"].

124 For example, *ibid*, and *La Loi sur les assurances*, *supra* note 122. See also, Autorité des Marchés Financiers, "Guideline on Capital Adequacy Requirements: Property and casualty insurance" (effective 1 January 2018), online (pdf): AMF <https://lautorite.qc.ca/fileadmin/lautorite/reglementation/lignes-directrices-assurance/20180101-ligne-directrice-tcm_an.pdf>.

include the amount and type of minimum capital required for an insurer to operate.[125]

2. Effective Governance

Part of OFSI's supervisory authority is to assess the effectiveness of a federally-regulated insurer's corporate governance framework. The *ICA* and companion statutes set out the responsibilities of board members.[126] In exercising their powers and discharging their duties, directors and officers of an insurer must act honestly and in good faith with a view to the best interests of the company, and exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances.[127] Every director, officer and employee of an insurer must comply with the statutes, the regulations, the company's incorporating instrument, and the by-laws of the company.[128] Directors are to manage or supervise the management of the business and affairs of the company, as well as establish audit committees and conduct review committees with a majority of independent directors.[129]

These duty of care and fiduciary obligation provisions mirror Canadian corporate legislation, and thus decisions of the Supreme Court of Canada that have held that directors, in acting in the best interests of the company, must act as good corporate citizens, and may consider the views of all stakeholders,[130] by analogy, translate into a fairly high obligation for insurer directors to act prudentially.

125 AMF, "Ligne directrice", *supra* note 123 at 5. Chapitre 1 présente un sommaire des Exigences de suffisance du capital en assurance de personnes (l'« ESCAP »). AMF observes "La gestion du capital constitue un processus très large qui englobe non seulement la mesure de la suffisance du capital, mais également l'ensemble des stratégies, politiques et procédures par lesquelles une institution détermine et planifie l'utilisation de son capital."

126 See Division II, Directors and Officers, ss 165-196, *ICA*, *supra* note 40.

127 *ICA*, *ibid*, s 166(1).

128 *ICA*, *ibid*, s 166(2).

129 *ICA*, *ibid*, s 165(1) and (2).

130 *Peoples Department Stores Inc (Trustee of) v Wise*, 2004 SCC 68,

Pursuant to the *ICA*, directors and officers must disclose to the board any conflict of interest that may arise in connection with their responsibilities,[131] and directors can be held personally liable, jointly and severally, for failing to comply with the insurance statutes.[132] A director who fails to disclose a conflict, or knowingly attends a meeting of directors where the contract or transaction in which the director has an interest is being considered or voted on, can be disqualified from holding a position as director of any federally-incorporated financial institution for five years.[133]

One study has observed that an area of governance that could be improved would be to require directors to have at least a certain minimum level of knowledge about the insurance business in question, including the fundamental principles and key risk variables with respect to the insurer, suggesting that currently, although independent directors will almost always have achieved considerable success in their main field of interest, they may not have specialized skills or experience in the insurance sector.[134]

IV. FLOTATION — POLICYHOLDER PROTECTION AND INSOLVENCY RESOLUTION STRATEGIES

"Flotation" is a *jeu de mot* in the sense that the early intervention and resolution system for insurers in Canada offers a number of tools to assist an insurer to address early signs of financial distress, and then at increasing states of financial distress, helping it to stay afloat before any decision is made to let the company sink.

[2004] 3 SCR 461 at para 32; *BCE Inc v 1976 Debentureholders*, 2008 SCC 69, [2008] 3 SCR 560 at para 99.

131 *ICA*, *supra* note 40, ss 211-215.

132 *ICA*, *ibid*, ss 216-219.

133 *ICA*, *ibid*, s 212.

134 Lawrie Savage, "From Trial to Triumph: How Canada's Past Financial Crises Helped Shape a Superior Regulatory System" (29 May 2014) SPP Research Paper No. 7-15 at 51, online: SSRN <https://ssrn.com/abstract=2446676>.

OSFI's supervisory target capital levels provide a signal that triggers early intervention by OSFI to require insurers to act to address difficulties. OSFI's approach is "trust, but verify".[135] An insurer's failure to maintain capital resources above the supervisory targets is "indicative of material safety and soundness concerns and a vulnerability to adverse business and economic conditions that require immediate attention".[136] An insurer is to notify OSFI if its capital resources levels are anticipated to fall below its internal targets and to provide plans on how it expects to manage the risks and/or restore its capital resources levels to its internal targets within a relatively short period of time.[137] When an insurer's capital resources approach or fall below the supervisory targets, OSFI will increase its intensity of supervision.[138]

OSFI assesses material risk of loss to policyholders on a forward-looking basis to identify problems early in order to intervene in a timely way. One of its principles is that risk assessment relies on sound, predictive judgment and that insurers must understand the drivers of material risk to the company and continuously manage that risk.[139]

A critically important risk assessment concept within the OSFI supervisory framework is that of a "significant activity", a

135 Jeremy Rudin, OSFI Superintendent, "Away from the Lamppost: Culture, Conduct and the Effectiveness of Prudential Regulation" (17 June 2015), online (pdf): OSFI <http://www.osfi-bsif.gc.ca/Eng/Docs/jr20150617.pdf>.

136 OSFI, "Regulatory Capital", *supra* note 80.

137 *Ibid.*

138 *Ibid.* OSFI: "Insurers are expected to determine an Internal Target of total capital. Life insurers are expected to determine, in addition to the Internal Target of total capital, an Internal Target of core capital. OSFI should be notified when an insurer changes its Internal Targets. Internal Targets should be set above Supervisory Targets. To determine whether Internal Targets are above Supervisory Targets, insurers should compare their total and core capital Internal Targets to the total and core Supervisory Targets, respectively."

139 OSFI, "Key Principles", *supra* note 85. OSFI reports that "The application of the Supervisory Framework culminates in a consolidated assessment of risk to a FRFI."

defined term.[140] OSFI assesses key risks for each significant activity. "Inherent risk" is the probability of a material loss for policyholders due to exposure to, and uncertainty arising from, current and potential future events.[141] OSFI assesses inherent risk on the basis of: credit risk, market risk, insurance risk, operational risk, regulatory compliance risk, and strategic risk, assigning a value of high, above average, moderate or low to each significant activity.[142] OSFI assesses the quality of risk management at both the operational level, including the risk of probability of material loss due to exposure to and uncertainty arising from current and future potential events, and in terms of oversight function. OSFI assigns a rating by comparing the nature and levels of the insurer's controls or oversight to OSFI's expectations developed when assessing the levels of the key inherent risks.[143] The net risks of the significant activities are combined, based on relative importance, to arrive at the "overall net risk" of the insurer, a consolidated rating or assessment of the potential adverse impact that the significant activities collectively could have on the insurer's earnings performance and adequacy of capital.[144]

When an insurer starts to experience financial distress, early intervention by the regulator can mitigate potential damage. OSFI's early intervention system includes a "pre-stage", after which there are four stages of intervention. As at 31 March 2017, there were 20 staged institutions, most in the Stage 1 early warning category, although OSFI does not disclose the names or sectors of these institutions.[145]

---

140 *Ibid.* A significant activity is a line of business, unit or process that is fundamental to the FRFI's business model and its ability to meet its overall business objective.

141 *Ibid.*

142 *Ibid.*

143 *Ibid.*

144 *Ibid.*

145 OSFI *Annual Report 2016-2017*, *supra* note 16 at 12 (most recent data available).

1. Life Savers for Life Insurance Companies

The reference here to "life savers" is to the flotation devices thrown in the water to assist distressed and potentially drowning people, not the popular candy that has been around since 1912.[146] Arguably, the various points of intervention are devices to assist a financially troubled insurer to address its capital or other risk management issues prior to the point at which the company begins to sink. The OSFI intervention process has the goal of identifying areas of concern at an early stage and intervening so as to minimize losses to policyholders and other creditors.[147] The *ICA* authorizes OSFI to intervene to address concerns that may arise with federally-regulated life insurers.[148]

OSFI cooperates with Assuris at all stages of monitoring and intervention, but the extent of cooperation deepens as a life insurer becomes more financially distressed. When a life insurer is designated as being pre-stage, monitoring reveals normal activity and no significant problems.[149] Here, OSFI assesses whether the life insurer's policies and practices, controls and circumstances are sufficient through both continuous assessment and formal discussion on an annual basis.[150] It assesses the financial condition and operating performance of the institution, reviews information obtained from statutory filings, financial reporting requirements, and management reporting to the board.[151] OSFI also undertakes cross-sector

146 Created by chocolatier Clarence Crane, who wanted a sweet treat that could stand up to the summer heat: Life Savers, "Sweet Beginnings" (2016), online: Life Savers <http://www.life-savers.-com/anniversary>.

147 OSFI, "Guide to Intervention for Federally Regulated Life Insurance Companies" (2013), online (pdf): OSFI <http://www.os-fi-bsif.gc.ca/Eng/Docs/sup_guide_life.pdf> ["OSFI, 'Guide to Intervention for Federally Regulated Life Insurance Companies'"].

148 *Ibid.*

149 For a detailed discussion, see Sarra, "Bridge Over Troubled Waters", *supra* note 74.

150 OSFI, "Supervisory Framework", *supra* note 74.

151 *Ibid.* OSFI reports to the Minister of Finance on an annual basis.

reviews for specific issues involving multiple institutions, in some cases, across banking and insurance sectors. As noted previously, the CRR is OSFI's overall assessment of an institution's safety and soundness.[152]

If OSFI determines that the life insurer's financial condition, policies and procedures are sufficient and do not indicate significant problems, the company will not typically be staged.[153] Essentially, OSFI has determined that the combination of the company's overall net risk, capital and earnings makes the company resilient to most normal adverse business and economic conditions.[154]

Assuris' role in the intervention process is to protect policyholders by minimizing loss of benefits and ensuring a quick transfer of their policies to a solvent company where their benefits will continue to be honoured.[155] At the "pre-stage", Assuris analyzes information it obtains directly from member companies and OSFI, discussing the results of its analysis with OSFI and sharing any concerns.[156]

If a life insurer is categorized as Stage 1, OSFI has identified deficiencies in the company's financial condition, policies, procedures or practices, conditions and circumstances that could lead to the development of problems.[157] Examples include: the combination of the company's overall net risk and its capital and earnings compromises the company's resilience; or the company has issues in its risk management or has control deficiencies. However, there is not yet a threat to solvency.[158] OSFI will formally notify management, the board of directors and the external auditor of the company by way of a

---

152 *Ibid*. OSFI can request that management provide a copy of the supervisory letter to external auditors.
153 *Ibid* at 3.
154 *Ibid*.
155 OSFI, "Guide to Intervention for Federally Regulated Life Insurance Companies", *supra* note 147 at 1-2.
156 Assuris 2017, *supra* note 11 at 3.
157 *Ibid* at 5.
158 *Ibid*.

supervisory letter that the company is at Stage 1 and require the company to take measures to mitigate or rectify the identified deficiencies. It will usually meet with directors and managers and/or the external auditor to discuss remedial actions. It may send a notice of assessment surcharge to the company.[159]

At this first stage, OSFI can also require more frequent and extensive reporting, and it can direct the life insurer's internal specialists to conduct reviews that focus on particular areas of concern, such as asset valuations or policy liability valuations.[160] It may enter into a prudential agreement with the company for the purposes of implementing any measure to improve the safety and soundness of the company, and it can require the life insurer to increase its capital.[161] The prudential agreement can include requiring the life insurer to implement any measure designed to protect the interests of its policyholders and creditors in respect of its insurance business in Canada.[162] OSFI may also enter into a prudential agreement with an insurance holding company for the purposes of implementing any measure designed to protect the interests of policyholders and creditors of any federal financial institution affiliated with it.[163] In some circumstances, OSFI may impose business restrictions and/or issue a direction of compliance. OSFI will notify Assuris that the company has been staged and will meet with it to update information and expected solutions. At stage 1, Assuris also analyses all relevant

159 *Ibid.*
160 *Ibid* at 5-6.
161 *Ibid* at 6. Section 675.1 of the *ICA*, *supra* note 40 specifies: "675.1 The Superintendent may enter into an agreement, called a 'prudential agreement', with a company, society or provincial company for the purposes of implementing any measure designed to maintain or improve its safety and soundness or with a foreign company for the purposes of implementing any measure designed to protect the interests of its policyholders and creditors in respect of its insurance business in Canada."
162 *ICA*, *ibid,* s 675.1.
163 *ICA*, *ibid*, s 1002.

public information and information obtained directly from the member insurer or from OSFI.[164]

At Stage 2, "risk to financial viability or solvency", OSFI has concluded that the life insurer has material safety and soundness concerns and is vulnerable to adverse business and economic conditions, and that there are problems that could deteriorate into a serious situation if not addressed promptly. At this stage, the problems are still not serious enough to present an immediate threat to financial viability or solvency.[165] OSFI can order immediate remedial measures aimed at rectifying problems within a specified time frame, more extensive supervisory reviews, require the company to incorporate the remedial measures in its business plan, require the company's external auditor to enlarge the scope of its review of the financial statements and/or to perform other procedures and prepare a report, or require a special audit to be performed by an independent auditor.[166] OSFI will inform Assuris of data obtained from enhanced supervisory reviews and expanded audits. OSFI will commence contingency planning in consultation with Assuris to enable OSFI to be ready to take control of the life insurer or its assets in case of rapid deterioration.[167] Assuris analyzes the data, may develop possible scenario analysis for the insurer's recovery, and may hire consultants to provide in-depth analysis of critical areas. It may commence developing a preliminary restructuring plan.[168]

Assuris utilizes a designation of "company of concern" when it becomes concerned about the financial viability of a life insurer. An insurer can be designated as a company of concern "where there are plausible events that would result in the company not being able to meet its policyholder obligations".[169] Once declared a company of concern, Assuris engages in additional

164 Assuris 2017, *supra* note 11 at 6.
165 *Ibid* at 7.
166 *Ibid* at 8.
167 *Ibid* at 8.
168 *Ibid* at 8.
169 Stephanie Greer, Senior Vice President, Risk & Resolution, Assuris,

resolution analysis and has more frequent discussions with the regulatory supervisors. The company of concern designation would typically be an OSFI Stage 2 company.

At this stage, OSFI is focused on working with the company to restore it to financial going-concern health. Assuris is focused on preparing for a potential resolution, including considering the valuation of the policyholder liabilities if they are transferred to another company.

The best resolution option for life insurance is to transfer the policyholders to a solvent company where their policies will continue to be honoured. This strategy maintains the most value in the company and is usually the least cost option for the industry.

The transfer value of policyholder liabilities may be significantly higher than the book value in the financial statements and could lead to losses to policyholders on insolvency, particularly true for long-term guaranteed business where prospective buyers will not assume aggressive non-fixed income asset yields to back these long-term cash flows. This risk became evident as a concern for Assuris after the insolvency of Union of Canada. The loss to policyholders was related to understated policyholder liabilities for transfer purposes, which is different from the past experience with insolvencies in the early 1990s, where the loss was related to declines in asset values.[170]

At Stage 3, "future financial viability in serious doubt", OSFI has concluded that the life insurer has failed to remedy problems identified at Stage 2 and the situation is worsening. There are severe safety and soundness concerns.[171] At least one of the following conditions are present: the combination of the company's overall net risk and its capital and earnings poses a

---

email correspondence, 1 August 2018, cited with approval, on file with author.

170 *Ibid.*

171 OSFI, "Guide to Intervention for Federally Regulated Life Insurance Companies", *supra* note 147 at 9.

serious threat to financial viability or solvency unless effective corrective action is promptly undertaken; and/or the company has serious issues in risk management or control deficiencies, which present a serious threat to its financial viability.[172]

At this stage, in addition to requiring the actions set out in Stages 1 and 2, OSFI may direct external specialists to assess quality of assets, liquidity, sufficiency of reserves, policy liabilities, and reliability of reinsurance arrangements; may impose greater business restrictions on the company; may require even more detailed information; and may place OSFI staff at the company to monitor the situation on an ongoing basis.[173] OSFI will communicate to management and the directors the importance of considering resolution options such as restructuring the life insurer or seeking a purchaser.[174] It is at this stage that Assuris would consider supporting a solvent resolution.

If a life insurer is categorized as Stage 4, OSFI has determined that it is experiencing severe financial difficulties and has deteriorated to such an extent that the company has failed to meet regulatory capital and surplus requirements and failed to immediately rectify the situation; the statutory conditions for taking control have been met; and/or the company has failed to develop and implement an acceptable business plan.[175]

At Stage 4, OSFI has determined that the life insurer will become non-viable on an imminent basis. OSFI will consult with Assuris regarding the steps to be taken, such as proceeding to liquidation, implementing the liquidation contingency plan prepared during Stage 3, and identifying a liquidator and/or appointment of a standby agent.[176] If the statutory conditions

172 *Ibid* at 9.
173 *Ibid* at 9.
174 *Ibid* at 9-10.
175 *Ibid* at 11.
176 *Ibid* at 12. OSFI also reports that at this stage it would consult about taking temporary control, arranging for interim management, and planning for the conclusion of the control period, although taking these actions would appear to be unusual as OSFI

for taking control of assets exist, OSFI may assume temporary control of the assets of the company and the assets under its administration, or in the case of a foreign company, control of its assets in Canada.[177] It may take control of the company itself. In either case, the Minister of Finance may advise OSFI if the Minister is of the view that it is not in the public interest to do so.[178]

Assuris and OSFI will engage in frequent in-depth discussions regarding the life insurer and Assuris will declare the company to be a "troubled member", which triggers certain oversight functions for Assuris' directors and officers. Assuris' bylaw defines troubled member as:

> "Troubled Member" means any Member that is an Insolvent Member, and any other Member as to which the board has determined that there is a serious possibility that the Member may become an Insolvent Member.[179]

When making a determination in connection with a proposed financial commitment by Assuris, its board may determine that an insurer is troubled notwithstanding that the possibility of insolvency will be reduced or avoided by the making of the proposed financial commitment.[180] Assuris will also assist in developing a detailed restructuring plan, estimate its coverage exposure, and evaluate whether to make a financial commitment to support a restructuring plan, depending on the circumstances, in order to reduce its potential exposure.[181] Assuris' liquidity fund provides it with a source of liquid assets to provide immediate support to the policyholders of a member

---

has in the past sought to take control and ask to apply for a winding-up order.

177 Together with its other assets held in Canada under control of its chief agent, including all amounts received or receivable in respect of its insurance business in Canada. *Ibid* at 11.

178 *Ibid* at 11-12.

179 Assuris, "By-Law No 1" (24 May 2018) at 5 [on file with author] ["Assuris, 'By-Law No 1'"].

180 *Ibid* at 5.

181 *Ibid* at 9.

insurer determined by the Assuris board of directors to be a troubled member.[182]

Assuris can financially assist a troubled member insurer under specified circumstances set out in its Memorandum of Operation and Bylaw, where its board concludes that it is reasonably necessary to give effect to Assuris' objectives.[183] Financial commitments may include loans by Assuris, back-up guarantees with respect to asset sales, guaranteeing or funding a transfer or sale of the business,[184] or commitments of other types, such as the purchase by Assuris or an affiliate of shares or other assets or the assumption of liabilities.[185] The commitments may be in favour of a troubled member insurer, or of the liquidator of an insolvent member insurer, or of persons or other entities dealing with any of them.[186] Where an insurer is insolvent, Assuris' bylaw states:

> Where a Member is an Insolvent Member, the Board of Directors may cause the Corporation to enter into financial commitments with respect to that Member if the Board of Directors is satisfied that the commitments are consistent with the objectives of the Corporation and likely to reduce the total cost to the Corporation of the insolvency.[187]

Where the troubled member is not insolvent, Assuris works with OSFI or the relevant supervisor in developing any financial support, including the supervisor providing information on the troubled insurer relevant to Assuris' decision.[188] On entering into such financial commitments, Assuris' Memorandum of Operation specifies that

> 3.04(b) The terms on which the Proposed Commitments are to be made include assurances that the Troubled Member will not continue the insurance business under the same control as when it became a Troubled Member. Such assurances shall comprise:

182 Assuris, "2017 Annual Report", *supra* note 35 at 21. Also, Assuris, "By-Law No 1", *supra* note 179 at 25-27.
183 Assuris, "MOO", *supra* note 46, Article 3.01.
184 Assuris 2017, *supra* note 11 at 5.
185 Assuris, "MOO", *supra* note 46, Article 3.02.
186 *Ibid.*
187 *Ibid*, Article 3.03.
188 *Ibid,* Article 3.04.

> (i) the sale of control of the Troubled Member;
>
> (ii) the sale of the insurance business of the Troubled Member; or
>
> (iii) the orderly winding down of the insurance business of the Troubled Member, preceded if appropriate by the sale of a portion of the business.
>
> Where a sale of control or of all or a portion of the insurance business is contemplated the Board of Directors shall be satisfied that the sale is on terms established through a process reasonably designed in all the circumstances to identify the best available transaction.[189]

There are other conditions specified in the Memorandum of Operation. If the Assuris board authorizes Assuris to make a financial commitment to a troubled member, a separate fund will be established to account for the costs and obligations to that member company.[190] Assuris will formulate a detailed contingency plan for managing liquidation and funding its coverage commitments.[191]

i. Winding-up the life insurer

OSFI can request the Attorney General of Canada to apply for a winding-up order in respect of a life insurer it has placed under control or the life insurance business in Canada of a foreign company where the assets in Canada of the foreign company are under its control.[192] The *WURA* authorizes the court to approve transfer of the business of the insolvent life insurer to another life insurer and/or wind-up the insurer, liquidating its assets.

Once a liquidator has been appointed, the liquidator will determine the most effective way of winding-up the life insurer. Options include completing a sale or merger transaction that was agreed to prior to the winding-up order but could not be completed without approval of the court; holding a bidding

---

189 *Ibid.*

190 *Ibid.*

191 OSFI, "Guideline to Intervention for Federally Regulated Life Insurance Companies", *supra* note 147 at 9.

192 *Ibid* at 12.

process for the sale of the entire business of the failed company; holding multiple bidding processes for parts of the business, as was done in the Confederation Life insolvency;[193] or closing the company, realizing its assets, and paying off claims as they are made.[194] Often the best solution is to sell the business, preserving its goodwill, enhancing the recovery prospects for all stakeholders and allowing the continuation of benefits to all policyholders, particularly important for those policyholders who are no longer insurable due to deterioration in their health.[195]

The liquidator will recommend a winding-up that protects policyholders as much as possible and protects the safety of the system, whether that process involves an auction, a pre-packaged sale of the business that is brought to the court for approval, or liquidation of assets on a piecemeal basis. For the four insolvencies of life insurers that have occurred, all the Canadian policies were transferred to solvent life insurance companies.[196] A court-appointed liquidator under the *WURA* is responsible to the court, taking into account the interests of all stakeholders.

While the management of Assuris will keep its board of directors alerted to a company considered troubled, it will obtain its board's commitment to provide coverage in the event of liquidation.[197] In some circumstances, Assuris will assist in

193 *Canada (Attorney General) v Confederation Life Insurance Co*, *supra* note 13. The UK operations were sold to Sun Life, the US operations and the Canadian group life and health business were sold to Great-West Life; and the Canadian residual "Oldco" remained as a mutual company, selling par insurance for the most part.

194 Janis Sarra and Gordon Dunning, "Assuring the Future: Reform of the Insolvency Framework for Insurance Companies and other Financial Institutions under the Canadian *Winding-up and Restructuring Act*", in Janis P Sarra, ed, *Annual Review of Insolvency Law 2010* (Toronto: Carswell, 2011) at 132 ["Sarra and Dunning"].

195 *Ibid.*

196 Assuris 2017, *supra* note 11 at 1.

197 *Ibid* at 11.

planning for an orderly liquidation with the proposed or appointed liquidator, including: preparing a closure manual designed to assist with issues and procedures arising immediately on liquidation; training information officers to handle public inquiries; establishing funding and reporting arrangements during liquidation; and developing strategies with the liquidator for operating the company in liquidation.[198]

Assuris has a current liquidity fund of $129 million, available to meet policyholder coverage, to a cap, in any insolvency.[199] If a life insurer fails and the liquidity fund does not have sufficient capital, Assuris has the authority to assess member companies to contribute to the cost of providing protection to policyholders. Assuris is currently working with the industry to double its liquidity fund to a base level of $200 million by 2021.[200] Assuris can make specific assessments to cover funding needs in connection with particular troubled members and to fund its liquidity fund, and it can levy an extraordinary assessment under specified circumstances.[201]

ii. Resolution

There has been a shift in recent years, with both governments and industry specialists looking to solvent resolution or other going-concern solutions to insurer financial distress or capital deficiencies. Previously, OSFI's practice was that, once it took control of a life insurer, it would apply to the Minister for a winding-up order. This narrow view of OSFI's authority meant

---

198 *Ibid* at 11-12.

199 Assuris, "Assuris Funding" (2018), online: Assuris <http://www.assuris.ca/Client/Assuris/Assuris_LP4W_LND_WebStation.nsf/page/Assuris+Funding!OpenDocument&audience=member>. Assuris, "2017 Annual Report", *supra* note 35 at 13.

200 Assuris, "2017 Annual Report", *ibid* at 2. In 2017, a Specific Assessment of $15.2 million was collected from Members, being the first of the five installments to increase the Base Level to $200 million: *ibid* at 13.

201 Articles 14.2 and 14.3, Assuris, "By-Law No 1", *supra* note 179, as well as Loan Assessments and Administrative Assessments.

that value may be lost on winding-up, as well as causing unnecessary disruption for policyholders.

While liquidation of an insurer under the *WURA* may appear to be the most straight-forward strategy for an insolvent insurer, it may not be the best resolution for the insurer's policyholders, creditors and other stakeholders. If there are a number of legacy liabilities, it may be difficult to find a market for selling them. If the valuation of assets and policyholder liabilities is complex and cross-jurisdictional, it may take considerable time to value the assets and liabilities, create an auction or other market to sell them and ultimately complete the winding-up of the insurer. Asset values and policyholder liabilities may diminish where liquidation processes are complicated or untimely. There is also an anti-selection issue: when a liquidation takes a long time, policyholders may become concerned that the company may ultimately not honour their benefits. Healthy policyholders may surrender their policies and buy life insurance from another company, but policyholders who are uninsurable due to poor health will be unable to get alternative insurance or it may be prohibitively expensive, and thus keep their insurance with the failed company. The liabilities then become unattractive to a potential purchaser of the insurance business, as it may contain too many high-risk policyholders.

Moreover, the going-concern value of a business is often greater than the liquidation value realized by piecemeal sale of the assets, as potential purchasers see value in future business or in intangible assets such as customer lists and goodwill. Distribution capability is often lost in liquidations, as well as customer loyalty, two important reasons that going-concern value may be higher.

With the evolution of international resolution practices, there are now several tools that can be used to resolve the financial distress of a life insurer that do not result in an immediate winding-up of the insurer's entire business. Sometimes a restructuring solution can increase both policyholder and creditor confidence in the life insurer itself and in the industry more generally, and can ultimately contribute to greater financial stability within the sector.

One option is an "operational resolution plan", which is a detailed restructuring plan developed by a restructuring professional that can include a recapitalization strategy, transfer of the company or blocks of the business to new owners or other existing life insurers, or merger of the distressed life insurer with a solvent insurer, which may benefit from the assets, goodwill and customer lists of the insolvent business.[202] Assuris would have significant input in working with the restructuring professional to assess proposed resolution plans during both their conceptualization and implementation.

Maintaining operation of the life insurer for a limited period in order to determine the best way of resolving the financial distress could mean leaving directors and officers in control but with the guidance of an insolvency professional; placing a chief restructuring officer ("CRO") at the helm of the insurer; or the supervisor or its designated liquidator or insolvency professional taking control of the insolvent life insurer. Each of these governance strategies have benefits and some limitations.

OSFI can take control of a life insurer pursuant to the *ICA*, essentially replacing the board or appointing an insolvency professional to replace the board.[203] OSFI may take control when it has identified governance problems such as board unresponsiveness to previous directions at the early intervention stages or a lack of skills and experience by directors and senior officers to guide the insurer through a resolution process, be it restructuring, merger or liquidation. Taking control may also assist OSFI or its designate in protecting the Canadian insurance operations of a multinational company or corporate group from contagion

202 Assuris 2017, *supra* note 11 at 4.
203 *ICA*, *supra* note 40, s 679(1).

from international operations or from creditors of the company in foreign jurisdictions.

As with bank resolution,[204] one option to resolve life insurer financial distress is to restructure by separating and transferring the "good assets" and the policyholder liabilities to a new company ("newco"), leaving behind the assets and liabilities that are problematic in terms of ability to sell them in the market in the original company ("oldco"). One advantage is that it may continue the insurance policies, resulting in no losses for policyholders. Such a strategy may also encourage further investment in the newco, facilitating recapitalization of the business. In the case of multinational insurers, the Canadian branch of an insurance conglomerate may be viable as a standalone, separate entity, and continuation of the insurer's business in the newco could protect going-concern value. The valuable assets placed in the newco could also protect the Canadian assets from claims, at least for a period, from foreign policyholders. Moreover, secured creditors of the insolvent insurer may be willing under this strategy to compromise their claims or make other arrangements that allow a going-concern solution to the life insurer's financial distress.

Assuris has established CompCorp Life, a special purpose life insurer that is able to act as bridge institution if needed for resolution. An example of using a bridge institution was the Sovereign Life liquidation.[205]

2. A Casualty of Financial Distress: P&C Insurer Intervention and Resolution

As with the life insurance sector, the objective of OSFI's early intervention process for federally-regulated P&C insurers is to enable OSFI to identify areas of concern at an early stage and intervene effectively in order to minimize losses to

204 For a discussion, see Sarra, "Bridge Over Troubled Waters", *supra* note 74.

205 Assuris 2017, *supra* note 11.

policyholders and other creditors.[206] Early intervention in a P&C insurer can control losses to policyholders and thus costs to other insurers; and could mean that policyholders receive full compensation for losses, rather than just the current cap on P&C claims.[207] The same *ICA* intervention powers discussed previously for life insurers allow OSFI to intervene to address any concerns with a P&C company. As with life insurers, OSFI has primary responsibility for regulating and supervising federally-regulated P&C companies, conducting risk-based assessments of the safety and soundness of these companies. The pre-stage and four stages of intervention by OSFI are the same as discussed previously for life insurers, the "Guide to Intervention for Federally Regulated Property and Casualty Insurance Companies" outlining the types of involvement of OSFI and PACICC in terms of the circumstances under which certain intervention measures may be taken.[208] The new March 2018 OSFI guide allows PACICC to have discussions with regulators at an earlier point in the process and have greater access to information than was available in previous insolvencies.[209]

To protect policyholders' rights, the supervisory authority of a P&C insurer has the authority to force an insolvent insurer

---

206 OSFI, "Guide to Intervention for Federally Regulated Property and Casualty Insurance Companies", *supra* note 31.

207 PACICC, "Submission to Department of Finance Canada on Positioning Canada's Financial Sector for the Future" (15 November 2016), online (pdf): Government of Canada <https://www.fin.gc.ca/consultresp/pdf-ssge-sefc/ssge-sefc-48.pdf> ["PACICC 2016"]. PACICC claims limits are: "Auto and commercial insurance policies — up to $250,000; home insurance policies — up to $300,000 per policy. Policy deductibles are applied to the total amount of the insured loss." PACICC, "Coverage" (2018), online: PACICC <http://www.pacicc.ca/industry-information/coverage/>.

208 OSFI, "Guide to Intervention for Federally Regulated Property and Casualty Insurance Companies", *supra* note 31.

209 PACICC, "Solvency Matters" (June 2018), online (pdf): PACICC <http://www.pacicc.ca/wp-content/uploads/2018/06/SM2_June_English.pdf>.

out of the market by seeking a winding-up order from a court, and usually replacing the insurer's management with a court-appointed liquidator.[210] The court freezes the assets of the insurer to give the liquidator time to assess the financial resources of the company compared to its liabilities.[211] Consumers are directed to find a new insurer within a reasonable time period, generally 45 days, after which time, their insurance contracts cease to protect them.[212] The liquidator hires independent actuaries to review the adequacy of the insurer's claims reserves and it reviews the insurer's reinsurance contracts. [213] PACICC also works with liquidators both before and after their appointment.

In a P&C insurance business, the best solution may be to pay off the claims as they are made. Property and casualty insurance, typically, is renewable each year; there is less goodwill associated with the business; and the majority of policyholders can also usually obtain alternative coverage.

One difference is that OSFI's and PACICC's Pre-insolvency Regulatory Liaison Committee ("PIRL" committee) will meet to discuss any remedial measures that OSFI has requested a P&C insurer to undertake.[214] On the life insurer side, it is the board of Assuris that meets directly with OSFI. The difference exists because PACICC's board of directors is partially composed of members affiliated with P&C insurance companies, whereas the PIRL committee members are not affiliated with any PACICC member company and can discuss and share sensitive information with regulators.[215] Once an insurance regulator decides that a P&C insurer is experiencing

210 PACICC, "Why Insurers Fail", *supra* note 33.

211 *Ibid.*

212 *Ibid.*

213 *Ibid.*

214 *Ibid* at 2, specifying that the PIRL committee members are exclusively public directors that are not affiliated with any PACICC member companies.

215 Autorité des Marchés Financiers, "Intervention Guidelines for Quebec Chartered P&C Insurers and PACICC Member Companies" (April 2016) at 4, online (pdf): AMF <https://lautorite.qc.ca/

extreme financial distress, it invites PACICC to participate in the process, but decision authority rests with the regulator. PACICC staff and board members from the PIRL committee will provide suggestions to the company and the regulator, including how PACICC could become involved to support recovery or resolution options for the troubled company. Decisions to support a liquidation or other resolution must be made by the full PACICC board. The regulator can explore ideas with members of the PIRL committee but will need to engage the full board if the company and the regulator seek to secure a financial commitment by PACICC. If a troubled insurer is put into liquidation, PACICC's primary objective is to protect policyholders.

PACICC has authority to assist if regulators and PACICC's board of directors determine that policyholders are at risk. Specifically, Part XI of PACICC's Memorandum of Operation states that PACICC can take a number of steps prior to a member insurer becoming a controlled P&C insurer or prior to a winding-up order.[216] PACICC can monitor, discuss and gather information in respect of its member companies, subject to maintaining the confidentiality of all information.[217]

---

fileadmin/lautorite/professionnels/assureurs/PC_Intervention_Guidelines.pdf> ["AMF, 'Intervention Guidelines'"].

216 PACICC, "Memorandum of Operation" (2007), online (pdf): PACICC < http://www.pacicc.ca/wp-content/uploads/2017/11/Memo-of-Operation.pdf> ["PACICC, 'MOO'"].

217 PACICC, "Why insurers fail", *supra* note 33 at 16. PACICC, "MOO", *ibid*: "However ... this duty of confidentiality shall not apply to any information which (i) was lawfully in the public domain at the time of communication to the Corporation, (ii) lawfully enters the public domain through no fault of the Corporation subsequent to the time of communication to the Corporation, (iii) was lawfully in the Corporation's possession free of any obligation of confidence at the time of communication to the Corporation, (iv) was lawfully communicated to the Corporation free of any obligation of confidence subsequent to the time of initial communication to the Corporation, or (v) was lawfully communicated to any person free from any obligation of confidence subsequent to the time of communication to the Corporation."

To quote from PACICC:

> PACICC's Memorandum of Operation (Section XI, paragraph 40) permits the Board of Directors to take "reasonable steps" prior to a member being ordered into wind-up if such steps are consistent with the Corporation's objectives. The Memorandum of Operation further clarifies that "reasonable steps" include, "without limitation, assisting in the sale, transfer or reinsurance of a book of business written by a member company," and/or "issuing guarantees or otherwise providing financial support."[218]

It is unclear the extent to which the PACICC board could take such steps if it does not have the information regarding a financially distressed P&C insurer. Presumably the PIRL could make a request to the board, but until the distress or insolvency becomes known to the board, it may not have sufficient information to make a decision to assist with guarantees or other financial support. Even when there is public knowledge, the board may not be able to access the confidential information necessary to make an informed decision on financial support. PACICC is currently in discussions with the federal government to clarify its role.

While this article focuses primarily on federally-regulated insurance companies, the provincial intervention regimes operate similarly. For example, the AMF has an intervention program for Québec regulated P&C insurance companies, which is operated in collaboration with PACICC.[219] The intervention guidelines set out measures that can be implemented by the AMF or PACICC when a Québec chartered P&C insurer experiences difficulties that may jeopardize its ability to meet its commitments to its policyholders, claimants and other beneficiaries.[220] The stages of intervention are similar to OSFI's except that OSFI's pre-stage is AMF's stage 1. The stages of intervention are: Stage 1 "No Significant Problems", Stage 2 "Early Warning", Stage 3 "Watch Condition", Stage 4 "Solvency

218 PACICC, "Why insurers fail", *supra* note 33 at 18: Exit strategies of P&C insurers in Canada.

219 AMF, "Intervention Guidelines", *supra* note 215.

220 *Ibid* at 3.

Seriously Compromised", and Stage 5 "Insufficient Assets or Insolvent".[221] AMF's guidelines apply to all P&C insurance companies licensed to transact insurance business in Québec and holding a charter issued by the province of Québec or by another Canadian jurisdiction. These same levels of intervention are applied by the AMF to life insurers, the regulator working with Assuris in the same way as described previously.

V. HOW CANADA'S INSURANCE SUPERVISORY REGIME MEASURES AGAINST INTERNATIONAL STANDARDS

In Canada, there is no one resolution authority nationally for all financial institutions, as has been recommended by the Financial Stability Board ("FSB").[222] The FSB best practice recommends that each jurisdiction should have a designated administrative authority or authorities responsible for exercising resolution powers over financial institutions;[223] and that where there are multiple resolution authorities within a jurisdiction, their respective mandates, roles and responsibilities should be clearly defined and coordinated. The FSB also specifies that where different resolution authorities are in charge of resolving entities of the same group within a single jurisdiction, the resolution regime of that jurisdiction should identify a lead authority that coordinates the resolution of the legal entities within the jurisdiction. The FSB has reported that one gap in the Canadian system is that there is the lack of explicit power to

221 *Ibid* at 3.

222 Financial Stability Board, "Key Attributes of Effective Resolution Regimes for Financial Institutions" (15 October 2014) at 5-6, online: FSB <http://www.financialstabilityboard.org/2014/10/r_141015/4> ["FSB, 'Key Attributes'"]; FSB, "Second Thematic Review on Resolution Regimes" (18 March 2016), online: FSB <http://www.fsb.org/2016/03/second-thematic-review-on-resolution-regimes/4> ["FSB, 'Second Thematic Review'"]: part of the commitment by FSB member countries to undergo periodic peer review.

223 FSB, "Key Attributes", *supra* note 222.

ensure continuity of shared services and functions by other entities, whether or not regulated, within the same financial group in resolution.[224]

The International Association of Insurance Supervisors ("IAIS") Insurance Core Principles ("ICP") provide a globally accepted framework for the supervision of the insurance sector.[225] The ICP objectives are to contribute to the improved supervision of the insurance industry for the protection of policyholders worldwide, to promote the development of well-regulated insurance markets, and to contribute to global financial stability.[226]

The core principles include powers that supervisors should have to support the process of providing insurers with an orderly exit from the market. The regulatory framework should address the increasing number of insurance groups and financial conglomerates, and supervisors should collaborate internationally to ensure that policyholders are protected, markets remain stable, risk of contagion is reduced, and supervisory gaps are avoided.[227]

OSFI has adopted the IAIS ICP as its source for detailed supervisory standards and criteria. In particular, ICP 12 specifies that the legal framework should give priority to the protection of policyholders and have, as a primary objective, minimizing disruption to the timely provision of benefits to

224 FSB, "Second Thematic Review", *supra* note 222.

225 IAIS, "Insurance Core Principles", *supra* note 72. See also IAIS, "About the IAIS" (2018), online: IAIS <https://www.iaisweb.org/page/about-the-iais/highlight=voluntary%20membership%20organization>: "The International Association of Insurance Supervisors (IAIS) is a voluntary membership organization of insurance supervisors and regulators from more than 200 jurisdictions in nearly 140 countries. The mission of the IAIS is to promote effective and globally consistent supervision of the insurance industry in order to develop and maintain fair, safe and stable insurance markets for the benefit and protection of policyholders and to contribute to global financial stability."

226 IAIS, "Insurance Core Principles", *ibid.*

227 *Ibid* at 4.

policyholders.[228] This objective is reflected in both OSFI constating legislation and its supervisory framework, as discussed earlier. While Canada measures relatively well against the ICP, it is missing a few important elements. The ICP state that the authority responsible for insurance supervision and the objectives of insurance supervision must be clearly defined.[229] OSFI has powers to supervise, to issue and enforce rules by administrative means and take immediate action, and OSFI promotes the maintenance of a fair, safe and stable insurance sector for the benefit and protection of policyholders. However, the scope of its resolution authority could be better defined, as it has not really acknowledged its responsibility for solvent recovery/resolution, as discussed in the next part.

The second core principle is that "the supervisor, in the exercise of its functions and powers: is operationally independent, accountable and transparent, protects confidential information, has appropriate legal protection, has adequate resources and meets high professional standards".[230] OSFI generally meets this principle. It is unclear, based on the publicly available information, whether there is effective communication and prompt escalation of significant issues to appropriate levels within OSFI such that required action is immediately addressed, as recommended in ICP 2.1. OSFI does exchange information with other relevant supervisors and authorities subject to confidentiality requirements.[231] It

228 *Ibid*, ICP 12 at 109-110.

229 *Ibid*, ICP 1 at 15-16.

230 *Ibid*, ICP 2 at 17-21. It also meets ICP 4 that legal entities that engage in insurance activities must be licensed before they can operate in Canada and the procedures for licensing must be clear, objective and public, and consistently applied: *ibid* at 28; and ICP 5, which requires that: "The supervisor requires Board Members, Senior Management, Key Persons in Control Functions and Significant Owners of an insurer to be and remain suitable to fulfil their respective roles": *ibid* at 35.

231 *Ibid*, ICP 3 at 23. IAIS reports that "Agreements such as the IAIS Multilateral Memorandum of Understanding (MMoU) or bilateral Memoranda of Understanding (MoU) facilitate information exchange

approves proposals to acquire significant ownership or control changes through merger or other means.[232]

OSFI meets the IAIS core principle of requiring insurers to establish and implement a corporate governance framework that provides sound and prudent management and oversight of the insurer's business and adequately recognizes and protects the interests of policyholders.[233] OSFI requires insurers to have in place effective systems of risk management and internal controls, including effective functions for risk management, compliance, actuarial matters and internal audit, as recommended in ICP 8.[234] As with the core principle on supervisory review and reporting, OSFI has a risk-based approach to supervision that uses both off-site monitoring and on-site inspections to examine the business of each insurer, evaluate its condition, risk profile and conduct, the quality and effectiveness of its corporate governance and its compliance with relevant legislation and supervisory requirements.[235]

IAIS ICP10 suggests that:

> The insurance supervisor has sufficient authority and ability, including the availability of adequate instruments, to take timely preventive and corrective measures if the insurer fails to operate in a manner that is consistent with sound business practices or regulatory requirements. There is a range of actions or remedial measures which include allowing for early intervention when necessary. Preventive and corrective measures are applied commensurate with the severity of the insurer's problems.[236]

As noted earlier, OSFI meets this principle, also enforcing corrective action where needed.[237] OSFI has established

---

because they provide the basis for a two-way flow of information and the basis on which supervisors can rely on the information they exchange with other supervisors being treated as confidential."

232 *Ibid*, ICP 6 at 43.
233 *Ibid*, ICP 7 at 46.
234 *Ibid*, ICP 8 at 70.
235 *Ibid*, ICP 9 at 93.
236 *Ibid*, ICP 10 at 105.
237 Based on clear and objective criteria that are publicly disclosed: ICP 11, *ibid* at 107. ICP 12 specifies: "The legislation defines a range of options for the exit of insurance legal entities from the market. It

requirements for the valuation of assets and liabilities for solvency purposes.[238] Both the *ICA* and OSFI establish requirements for solvency purposes on the investment activities of insurers, in order to address the risks faced by insurers; and Canada's supervisory framework establishes enterprise risk management requirements for solvency purposes that require insurers to address relevant and material risks.[239] OSFI meets the core principle of establishing capital adequacy requirements for solvency purposes and provides for degrees of supervisory intervention.[240]

---

defines insolvency and establishes the criteria and procedure for dealing with insolvency of insurance legal entities. In the event of winding-up proceedings of insurance legal entities": *ibid* at 109. ICP 13: "The supervisor requires the insurer to manage effectively its use of reinsurance and other forms of risk transfer. The supervisor takes into account the nature of reinsurance business when supervising reinsurers based in its jurisdiction": *ibid* at 111.

238 *Ibid,* ICP 14 at 126.

239 *Ibid,* ICP 15 and 16 at 145 and 160.

240 *Ibid,* ICP 17 at 193. OSFI also meets ICP 18: "The supervisor sets and enforces requirements for the conduct of insurance intermediaries, in order that they conduct business in a professional and transparent manner": *ibid* at 264. ICP 19 specifies: "The supervisor requires that insurers and intermediaries, in their conduct of insurance business, treat customers fairly, both before a contract is entered into and through to the point at which all obligations under a contract have been satisfied": *ibid* at 287. ICP 20 states: "The supervisor requires insurers to disclose relevant, comprehensive and adequate information on a timely basis in order to give policyholders and market participants a clear view of their business activities, performance and financial position. This is expected to enhance market discipline and understanding of the risks to which an insurer is exposed and the manner in which those risks are managed": *ibid* at 313. ICP 21: "The supervisor requires that insurers and intermediaries take effective measures to deter, prevent, detect, report and remedy fraud in insurance:" *ibid* at 337. ICP 22: "The supervisor requires insurers and intermediaries to take effective measures to combat money laundering and the financing of terrorism. In addition, the supervisor takes effective measures to combat money laundering and the financing of terrorism": *ibid* at 344.

OSFI has adopted a number of other IAIS ICP. In cooperation and coordination with other supervisors domestically and internationally, OSFI identifies multinational insurance groups and the appropriate scope of group supervision.[241] OSFI identifies, monitors and analyses market and financial developments and other environmental factors that may impact insurers and insurance markets and shares this information with other relevant authorities subject to confidentiality requirements.[242] Further, OSFI cooperates and coordinates with other relevant supervisors and authorities such that a cross-border insolvency of an insurer can be managed.[243]

However, the FSB has recommended that national governments grant broad powers to a national resolution authority to resolve systemically important financial institutions ("SIFI"), including systemically important insurers.[244] While no insurer in Canada has yet to be declared one of the global SIFI, there are, as noted earlier, three major conglomerates that account for the vast majority of insurer activity in Canada, and the failure of any of these insurers would be significant. Thus, the resolution authority must be as clear as possible.[245] Yet there is a lack of clarity on how multiple resolution and policy protection authorities in Canada would coordinate oversight and intervention with the failure of a major financial conglomerate that had insurance brokerage and other cross-sector businesses.

---

241 *Ibid,* ICP 23 at 354.

242 *Ibid,* ICP 24 and 25 at 361 and 365.

243 *Ibid,* ICP 26 at 401.

244 Financial Stability Board, "Addressing SIFIs" (2017), online: FSB <http://www.fsb.org/what-we-do/policy-development/systematically-important-financial-institutions-sifis/>: "Systemically important financial institutions (SIFI) are financial institutions whose distress or disorderly failure, because of their size, complexity and systemic interconnectedness, would cause significant disruption to the wider financial system and economic activity." For a discussion, see Sarra, "Bridge Over Troubled Waters", *supra* note 74.

245 See the discussion in the next part of possible legislative reform.

There are 26 IAIS core insurance principles and more than 400 pages of recommendations and sub-principles, as well as the appendices of the FSB *Key Attributes* that apply to insurers. While it is beyond the scope of this article to assess OSFI against all of them, it is evident that Canada's supervisory framework measures relatively well when compared to the primary core principles. However, there are gaps in Canada that should be addressed.

VI. WHAT PART OF "FLOTATION" OF THE RESOLUTION REGIME FOR INSURERS STILL REQUIRES LEGISLATIVE REFORM?

The insurance supervisory and policyholder protection regimes in Canada are relatively comprehensive. Assuris observes that experience with the previous four failures of life insurers demonstrates that the tools exist to resolve the failure of any size of life insurer in Canada.[246] PACICC has also observed that the system can respond to failures in which claims could amount to up to $25 billion with no impact expected on the solvency of well-run healthy insurers.[247]

However, there are gaps in the resolution regime that could easily be remedied with legislative reform. The *WURA* is in need of an overhaul to bring it into a modern insolvency framework. There have been many suggestions for its reform over the years.[248] PACICC observes, for example, that the

246 Assuris, "Submission to Department of Finance Canada on Positioning Canada's Financial Sector for the Future" (9 November 2016), online (pdf): Government of Canada <https://www.fin.gc.ca/consultresp/pdf-ssge-sefc/ssge-sefc-07.pdf>. Assuris, "Submission to Department of Finance Canada on Positioning Canada's Financial Sector for the Future" (2017), online (pdf): Government of Canada <https://www.fin.gc.ca/consultresp/pdf-pssge-psefc/pssge-psefc-16.pdf> ["Assuris, 'Positioning Canada's Financial Sector for the Future 2017'"].

247 PACICC 2016, *supra* note 207.

248 See for example, Assuris 2017, *supra* note 11; PACICC 2016, *supra* note 207; Sarra and Dunning, *supra* note 194; Gordon Dunning, James D Gage and Geoff R Hall, "A Matter of Life and Death: Life

WURA was not designed to address catastrophic events, such as a major earthquake, which could pose solvency risks for numerous P&C insurers and hinder payments to policyholders.[249] This part addresses three of the most urgent areas in need of reform: clarifying the resolution authority, improving treatment of derivatives, and facilitating cross-border insolvencies.

1. Reform of *OSFIA* and *WURA* to Enshrine Resolution Objectives and Mechanisms

The largest gap is with solvent resolution, in terms of who has authority and the transparency of the process. Assuris has observed that "there is no authority in Canada with a clearly defined role to assess and improve the resolvability of life insurance companies in Canada".[250] PACICC has reported that the "process of liquidating a failed insurer can take 15 to 20 years to complete, and is expensive to administer", calling for reform of *WURA* to create timelier processes.[251] Improving resolvability of financially distressed insurers will enhance the system's overall objectives of a timely and effective resolution process, and will protect against unnecessary losses to policyholders and creditors.

Arguably, OSFI already has sufficient authority under the *ICA*, *WURA* and its own constating statute, *OSFIA*, to resolve insurer financial distress on a solvent basis or on an insurer's insolvency, but to date it has said that it does not have that authority for solvent recovery/resolution, leaving a legislative gap.[252] Unlike the Canada Deposit Insurance Corporation ("CDIC"), an arm's-length government-

---

Insurance Companies and the Meaning of 'Insolvency' under the *Winding-Up Act and Restructuring Act*", in Janis P Sarra and B E Romaine, eds, *Annual Review of Insolvency Law 2012* (Toronto: Carswell, 2013) at 335.

249 PACICC 2016, *supra* note 207.

250 Assuris 2017, *supra* note 11.

251 PACICC 2016, *supra* note 207.

252 *OSFIA*, *supra* note 60. Assuris 2017, *supra* note 11 at 2.

appointed body that has been designated as the resolution authority for federally-regulated banks,[253] there is no authority in Canada that is responsible for assessing and deciding whether or not an insurer is resolvable.[254] The system depends on co-operation between multiple bodies, the process of which is not always transparent or certain. Assuris has expertise in insurer resolution and, through court order, can be granted some powers to resolve.[255] The lack of clarity of the statutory language is problematic. For example, Confederation Life had a trust company subsidiary. In the months before Confederation Life's failure, assets were transferred between the life company and the trust company to rebalance the capital position of the companies. These transfers changed the potential recovery rate between the policyholders and depositors. Without clear guidelines on which pre-insolvency transactions were reviewable, there was considerable uncertainty, delay, and a high risk of protracted litigation.[256]

The lack of clarity between the respective roles of the supervisor and the policy protection funds could easily be remedied by designating OSFI as the sole resolution authority for federally-regulated insurers. Assuris and PACICC can offer their expertise in assessing recovery/resolvability plans, not unlike senior secured lenders do in corporate resolution and restructuring plans, but the industry funded and nominated boards of Assuris and PACICC are not the appropriate bodies

253 *Canada Deposit Insurance Corporation Act,* RSC 1985, c C-3, as amended [*CDICA*]. *Canada Budget Implementation Act, 2017, No 1*, SC 2017, c 20, amending the *Canada Deposit Insurance Corporation Act,* RSC 1985, c C-3, as amended and the *Bank Act,* SC 1991, c 46. Canada Deposit Insurance Corporation, "CDIC is formally designated as Canada's resolution authority" (22 June 2017), online: CDIC <http://www.cdic.ca/en/newsroom/newsreleases/Pages/cdic-is-formally-designated-as-canada-resolution-authority.aspx>.

254 Assuris 2017, *supra* note 11 at 2.

255 Assuris, "Positioning Canada's Financial Sector for the Future 2017", *supra* note 246 at 5.

256 Sarra and Dunning, *supra* note 194 at 165-166.

to make responsible for resolution. A sole authority is also better for the stability of the system, in that distressed insurers have certainty regarding supervisory oversight.

The provisions of the *ICA* and the *WURA* could be strengthened by setting out a range of resolution strategies that OSFI could utilize and by clarifying the roles of Assuris and PACICC at various key points in the process.[257]

Another aspect is to make clear that an insolvency professional can be appointed under either the *ICA* or the *WURA* to facilitate going-concern or solvent recovery/resolution. Such provisions have been very successfully deployed in processes pursuant to the *Bankruptcy and Insolvency Act (BIA)* and the *Companies' Creditors Arrangement Act (CCAA)*, with the express objectives of facilitating, where possible, a viable going-forward business plan for the distressed company and maximizing the value of the company for the benefit of all stakeholders.[258]

There is a highly-skilled professional community in Canada already, with accountancy, valuation, restructuring and liquidation skills. The statutory language should allow for timely appointment of such professionals, with the ability of the court to order priority charges to cover the fees and disbursements of the professional. The insolvency/restructuring professional, as a court-appointed officer, would have the obligation to balance the interests of all the stakeholders, as well as the public interest, in discerning strategies to address the insurer's financial situation.[259] The professional can provide the debtor insurer's directors, OSFI, Assuris and/or PACICC with an independent and informed assessment of the likelihood of successful resolution or the need for winding-up and liquidation. Use of such professionals can

257 Assuris 2017, *supra* note 11 at 2.

258 *BIA*, *supra* note 37; *Companies' Creditors Arrangement Act*, RSC 1985, c C-36, as amended [*CCAA*].

259 For a discussion of this role in the corporate contest, see Janis P Sarra, *Rescue! The Companies' Creditors Arrangement Act*, 2nd ed (Toronto: Carswell, 2013).

facilitate timely resolution of insurer financial distress or insolvency, which in turn minimizes negative impact on the industry and helps maintain confidence in the soundness and stability of insurers and the policyholder protection scheme.[260]

Elsewhere, I have suggested that there is a risk of fragmentation in approaches to resolution where the distressed financial institution is part of a conglomerate with multiple entities and financial services, as there is no one authority that can expeditiously monitor and resolve financial conglomerates covering several types of financial institutions.[261] One change that Parliament could enact now is to clarify which entity is the lead macroprudential authority when there is a conglomerate failure.[262]

Several measures could enhance the insurance resolution regime and align it more directly with international standards. It is important to appreciate the difference between recoverability planning, meaning strategies to remedy the deficiencies identified by OSFI and Assuris or PACICC, and resolution plans, which are the more formal intervention by supervisory authorities when the insurer has not remedied deficiencies and insolvency is present or imminent. In both instances, it is very important that both the insurer and the oversight authority understand the risks associated with recovery or resolution strategies.

Recommendations

1. OSFI could be expressly declared the recovery and resolution authority for insurers under the *ICA* and/or *WURA* for both solvent and insolvent insurers. Such authority should include:

    i. issuing a clear guide to the process of assessing and improving resolvability of insurers, including

260 Assuris 2017, *supra* note 11 at 2.
261 Sarra, "Bridge Over Troubled Waters", *supra* note 74 at 329-330.
262 *Ibid.*

revising the intervention stages to facilitate solvent recovery and resolution plans;[263]

ii. authorizing OSFI to require an insurer to prepare and disclose information regarding risks in resolution;[264]

iii. authorizing OSFI to assess recoverability/resolvability of Canadian insurers and take timely and corrective action to resolve insurers where needed, in order to minimize losses to policyholders;

iv. authorizing OSFI to require an insurer to prepare and disclose information that will enable assessment of resolvability, and if needed, prepare a resolution plan;[265]

v. authorizing OSFI to require an insurer to appoint a restructuring professional to monitor progress of a recovery plan or to coordinate a solvent resolution if a recovery plan fails, to be undertaken in consultation with, on recommendation of, Assuris or PACICC;[266]

vi. authorizing OSFI to seek appointment of a chief restructuring officer where the circumstances warrant, to implement a resolution plan;

vii. authorizing appointment of the same insolvency or restructuring professional to serve as liquidator if the attempt at going-concern resolution fails, in order to save the time and expense of

263 Essentially expanding the scope and clarity of OSFI's OSFI, "Guide to Intervention for Federally Regulated Life Insurance Companies", *supra* note 147.

264 Assuris 2017, *supra* note 11 at 15, which observes: "OSFI does not currently require insurers to plan for contingencies based on their risks in resolution".

265 Assuris 2017, *supra* note 11 at 2.

266 *Ibid* at 4.

converting the process from recovery to liquidation;[267] and

viii. ensuring procedural safeguards for the financially distressed or insolvent insurer in terms of notice and the ability to object to the court.

2. The *WURA* could be amended to clarify the role of Assuris and PACICC, as major stakeholders, in identifying financial distress and being consulted on the best options for recovery, solvent resolution or winding-up. Both policyholder protection funds have considerable contingent liabilities on failure of an insurer and have acquired considerable skill and expertise in monitoring their member insurer institutions. While cooperation currently exists, it would be enhanced by clarifying their access to information, consultation within the decision process role, and any limits on that role in an enhanced resolution regime.

3. Internationally active insurance groups ("IAIG")[268] should be required to prepare recovery plans that would give supervisors the information required to assess whether or not a corporate group could be resolved rather than liquidated. Assuris and PACICC should be consulted when the OSFI or another supervisor is assessing the resolvability of an IAIG.[269]

267 *Ibid* at 3.

268 Defined by the IAIS to be "a large, internationally active group that includes at least one sizeable insurance entity": IAIS, "Frequently Asked Questions for The IAIS Common Framework for the Supervision of Internationally Active Insurance Groups (ComFrame)" (21 July 2017), online: IAIS <https://www.iaisweb.org/file/67671/ics-frequently-asked-questions-21-july-2017>; see also IAIS, "IAIS releases overall ComFrame including ICS Version 2.0 for public consultation" (31 July 2018), online: IAIS <https://www.iaisweb.org/news/iais-releases-overall-comframe-including-ics-version-20-for-public-consultation> ["IAIS, 'ComFrame Consultation'"].

269 Assuris, "Positioning Canada's Financial Sector for the Future 2017", *supra* note 246 at 2.

4. All insurers should provide critically important resolution information that can allow the supervisors and the policyholder protection organizations to assess resolvability, including the market value of assets and liabilities, material inter-company agreements and the jurisdictional location of assets.[270]

5. Where issues are identified, insurers should be required to improve their recoverability or resolvability well in advance of being staged by OSFI for more aggressive intervention.

6. If either total loss-absorbent capacity or resolvability is in doubt, companies should be required to prepare a resolution plan.[271]

7. A liquidator should be allowed to apply to the court to abridge the notice period to allow sale of the insolvent insurer's business portfolio to another insurer, where sale of the whole book of business early in the liquidation process protects policyholders and the stability and confidence in financial markets.[272]

8. The *WURA* should be amended to provide at least the same protections as employees and pensioners receive under Canadian bankruptcy legislation and the *WEPPA*.

2. Derivatives and Other Eligible Financial Contracts

Derivatives are used frequently by insurers to hedge risk and to undertake portfolio management.[273] They are beneficial

270 *Ibid*.

271 *Ibid*, Assuris suggesting that resolution plans should not be routinely required because of the time and expense and because it may detract from insurers' core business.

272 Insolvency Institute of Canada, "Report of the Task Force on Derivatives" (2013) at 11, online (pdf): IIC <https://www.insolvency.ca/en/iicresources/resources/IIC_Derivatives_Task_Force_Report_November_2013.pdf> ["IIC Task Force"].

273 IAIS and World Bank, "ICP 22B: The Use of Derivatives by Insurers" (2006) at 2-3, online (pdf): IAIS <https://www.iaiswe-

where they lower the cost of transferring or hedging risk and alleviate high concentrations of risk in an insurer's business. The liquidity of interest rate swaps make them a cost-effective tool for risk transfer; and derivatives can facilitate the netting of risks across financial institutions and financial markets.[274] Interest rate swaps can be used to increase or decrease interest rate exposures, to hedge specific balance sheet assets and liabilities, to expand investment opportunities, and/or to manage an asset portfolio.[275] Insurers often hedge risk exposures as a result of price fluctuations that are incidental to their business operations by using derivatives to fix the price of future purchases and sales and future exchange rates.[276]

The risks of derivatives are linked directly to the size and price volatility of the cash flows that the derivatives occasion on settling, and only indirectly to the face amount of the underlying asset or index; and derivative risks can be offsetting, which is not immediately apparent when looking at the face value of the derivative.[277] The IAIS has observed:

> Prudent derivative best practices will vary from insurer to insurer, depending on the range and complexity of derivative products and strategies employed and the frequency, volume, and objectives of their usage. The board and senior management must be actively involved with derivative risk management. Permitted derivative strategies and usage must be tightly constrained to ensure that derivative transactions are always suitable. Prudential derivative risk management is tied to and

b.org/modules/cciais/assets/files/pdf/061002_ICP_22B_The_U-se_of_Derivatives_by_Insurers.pdf>.

274 *Ibid.*

275 *Ibid* at 14. See also *ibid* at 8: "Bond futures may be bought to hedge the interest rate risk associated with future premiums that will be received in an interest rate environment different from that in which the liability was priced and sold."

276 *Ibid* at 5. This article does not address the issues associated with using derivatives as speculation or for arbitrage purposes, which raise a number of concerns.

277 *Ibid* at 19: "[A]n insurer's derivative exposures are frequently expressed in terms of the dollar amount of the underlying asset or index to which the derivative is linked (the face amount, contract amount, or amount of notional principal). Face amount measures transaction volume, not credit or market risk."

> integrated with prudential risk management of cash-market investments. The prudent credit, market, and other risk management practices and policies of end users differ from those of market makers.[278]

The IAIS observes that derivatives "can be used prudently to manage risk, or they can be used imprudently to leverage risk" and that "derivative policies and practices should be designed to ensure compliance and audited to confirm compliance and the accuracy and reliability of reports and financial accounts".[279] "In monitoring the activities of insurers involved in derivatives, the supervisory authority must satisfy itself that insurers have the ability to recognize, measure, and prudently manage the risks associated with their use."[280] The core principles suggest that "the supervisory authority requires that insurers have in place adequate internal controls to ensure that derivatives activities are properly overseen and that ... rigorous audit procedures ... ensure the timely identification of internal control weaknesses and/or operating system deficiencies".[281]

278 *Ibid* at 21. It suggests: "Supervisors should ensure that insurers manage their derivative credit exposures consistently with how they manage their cash-market credit exposures. Specifically, the credit decision process, procedures, controls, limits, review, and reports for derivatives should be both consistent and integrated with those for cash-market investments."

279 *Ibid* at 29.

280 *Ibid* at 33, citing ICP 22, explanatory note 5.

281 *Ibid* at 30-31, citing ICP 22, essential criteria f and i: "ICP 22, essential criterion i, says, 'The supervisory authority requires that insurers have in place rigorous audit procedures that include coverage of their derivatives activities'". See also *ibid* at 33: "ICP 22, explanatory note 5, says, 'In monitoring the activities of insurers involved in derivatives, the supervisory authority must satisfy itself that insurers have the ability to recognize, measure, and prudently manage the risks associated with their use. The supervisory authority should obtain sufficient information on insurers' policies and procedures on the use of derivatives and may request information on the purpose for which particular derivatives are to be used and the rationale'"; *ibid* at 33, citing ICP 22, explanatory note 5, also encourages supervisors to "request information on the purpose for which particular derivatives are used and the rationale for undertaking particular transactions". See also *ibid* at 37: "The

Derivatives raise many issues, but two are critically important when thinking about insurers in Canada. The first is to ensure that regulators are appropriately supervising their use and the second is to consider enacting a statutory stay on their settling for a limited period when an insurer enters insolvency proceedings.

Derivatives fall within the definition of eligible financial contracts ("EFC") in Canada. EFC are not stayed on insurer insolvency.[282] Concern was expressed after the height of the global financial crisis that the initiation of a resolution process could trigger the simultaneous closing out of large volumes of derivative contracts.[283] The exercise of such contractual rights, often under the ISDA Master Agreement,[284] could destabilize financial markets and undermine the orderly resolution of financial institutions.

---

supervisor should pay close attention to the suitability of derivatives, if a high volume or large, complex, and unusual derivatives are involved."

282 Nor are they stayed under corporate insolvency because "safe harbours" under the *BIA* and *CCAA* exempt EFC from the stay of proceedings to permit the termination of EFC by the solvent counterparty. The IIC observes that the main purposes of the EFC safe harbours are to protect non-defaulting counterparties from the risk of increasing exposure to the insolvent counterparty under the EFC and to reduce systemic risk in Canadian and global financial markets. Non-defaulting counterparties may be at risk because, in certain instances, the amounts under the EFC are very substantial and the value of the underlying products subject to EFC are volatile in nature and can change dramatically during an insolvency proceeding. Safe harbours can delay certain liabilities of the insolvent entity from being crystallized. IIC Task Force, *supra* note 272 at 2-3.

283 For a discussion, see Sarra, "Bridge Over Troubled Waters", *supra* note 74. See also Basel Committee on Banking Supervision ("BCBS"), "Report and recommendations of the Cross-border Bank Resolution Group" (March 2010) at 40-41, online: Bank for International Settlements <http://www.bis.org/publ/bcbs169.htm>.

284 International Swaps and Derivatives Association, Inc, "ISDA Master Agreement" (2002), online: ISDA <https://www.isda.org/book/2002-isda-master-agreement-english/>.

The introduction of central counterparties ("CCP") as intermediaries, aimed at guaranteeing that the obligations of derivatives trades will be honoured, even if one participant defaults, may have reduced the risks associated with heightened counterparty risk in the market. CCP interpose themselves between sellers and purchasers of derivatives, reducing risk by becoming the counterparty to all transactions. CCP, if well-funded, with standardized over-the-counter ("OTC") derivatives contracts, strict risk-control systems, and appropriate regulatory oversight, can assist in reducing counterparty exposures, creating more certainty. CCP can impose some discipline in the market in terms of valuation, enhance netting and closing out of derivatives. At the same time, greater use of central counterparty clearing, including mandatory clearing of standardized OTC derivatives, is leading to a significant increase in the volume of trades cleared and creating much larger exposures for certain CCP to manage. The Bank of Canada has observed that CCP must have robust risk-management controls that cover expected losses and liquidity shortfalls with a very high degree of confidence, and pre-funded resources should be in place to cover the losses arising from the default of the single largest participant.[285] There are many

285 If these resources are exhausted, the CCP will implement its recovery plan and call on its participants to contribute additional resources, as defined in this plan, and may also contribute additional resources itself. The Bank of Canada is the resolution authority for financial market infrastructures ("FMI") such as CCP. The powers and tools available to the Bank are aimed at allowing it to take timely actions to continue to provide the FMI's critical payment clearing and settlement services to its participants and the financial system more broadly; facilitate the timely settlement of obligations of the FMI; allocate any losses that have not yet been covered; and replenish the FMI's resources to meet its regulatory requirements. Bank of Canada, "Establishing a Resolution Regime for Canada's Financial Market Infrastructures", Bank of Canada Financial System Review, June 2018, online (pdf): <https://www.bankofcanada.ca/wp-content/uploads/2018/06/fsr-june18-woodman.pdf>. See also M Mueller and A Usche, "Toward More Resilient Markets: Over-the-Counter Derivatives Reform in Canada", Bank of Canada Financial System Review, December

issues raised by these developments, including Canada reliance on off-shore CCP and over-concentration of risk in single CCP. While beyond the scope of this article, these issues are incredibly important for the safety and soundness of the insurer recovery/resolution regime and deserve further public policy attention.

The closing out of EFC can prejudice an insolvent insurer if it is "in-the-money", as it could realize on the value of the EFC for the benefit of policyholders and creditors. Even where the insurer is out-of-the-money, it is important to crystallize claims against the estate of the insurer as part of an effective and timely liquidation and winding-up process.

One solution is to authorize resolution authorities to temporarily stay the operation of early termination clauses in order to complete transfer of derivatives to a bridge institution or another solvent entity. Any stay needs to balance protection of both counterparties to the derivatives as well as consider any systemic risks to an inability to close-out the contracts.[286]

EFC are temporarily stayed on an extremely limited basis for insolvent banks in Canada.[287] Such a stay is aimed at

---

2016, 53-65. Canadian-dollar OTC derivative contracts have a notional outstanding value of just under $9 trillion; T Lane, "Curbing Contagion: Options and Challenges for Building More Robust Financial Market Infrastructure", Bank of Canada, 2011, online: <https://www.bankofcanada.ca/2011/09/curbing-contagion-options-and-challenges/>.

286 If the stay is too long, there is risk of rapid deterioration of the value of the contract: IIC Task Force, *supra* note 272 at 3.

287 A counterparty of an EFC cannot terminate, amend, accelerate or forfeit a term under the contract by reason only of the bank's insolvency or deteriorated financial condition during the period beginning when an order is made appointing the CDIC as receiver of the distressed bank or an order is made directing incorporation of a bridge bank, and ending on the following business day at 5:00 pm. Sections 39.15(7), (7.01), (7.1), *CDICA*, *supra* note 253. Any stipulation in an EFC is of no force if it has the effect of providing for or permitting anything that is contrary to provisions of *CDICA*, with the exception that it does not apply in respect of an EFC between the bank and a clearing house. The stay does not prevent a

encouraging a going-concern resolution where possible, but even during a liquidation process, a liquidator can use the period of the stay to realize on some valuable assets for the benefit of creditors and other stakeholders. While this stay is for a very short period,[288] it does allow CDIC, as resolution authority, a very brief period to determine which EFC it will adopt, where the bank is in-the-money, which EFC to assign to a bridge bank or third party, and which to terminate.[289]

---

member of the Canadian Payments Association from ceasing to act as a clearing agent for a federal member institution in accordance with the *Payment Clearing and Settlement Act*, SC 1996, c 6, ss 39.15(3.2), (3.3) and the *Canadian Payments Act,* RSC 1985, c C-21, s 39.15(3). However, where CDIC gives an undertaking to provide the financial assistance that the institution needs in order to discharge its obligations to the clearing house as they become due, the clearing house is to continue to act in that capacity for the bank. If an EFC is assigned to or assumed by a bridge bank or a third party, CDIC must assign all of the bank's obligations arising from the EFC, and the bridge bank or third party must assume those obligations. The failed bank's interest or right in property that secures its obligations under the EFC is transferred to that bridge institution or the third party; ss 39.15(7), (7.2), (7.3), *CDICA*, *supra* note 253.

288 *Ibid.*

289 For a discussion, see Sarra, "Bridge Over Troubled Waters", *supra* note 74.

Section 39.15 of *CDICA*, *supra* note 253 specifies:

(7) Nothing in subsection (1), (2) or (2.1) prevents the following actions from being taken in accordance with the provisions of an eligible financial contract: (a) the termination or amendment of the contract; (b) the accelerated payment or forfeiture of the term under the contract; (c) the exercise of remedies for a failure to satisfy an obligation under or in connection with the contract, including the payment of an amount payable — or the delivery of property deliverable — under or in connection with the contract; (d) the netting or setting off or compensation of an amount payable under or in connection with the contract; (e) any dealing with financial collateral (i) to satisfy an amount payable — or the delivery of property deliverable — under or in connection with the contract, (ii) for the purpose of calculating an amount payable under or in connection with the contract by way of netting, setting off or compensation of the financial collateral or application of the proceeds or value of the financial collateral, or

There is also common law precedent for a stay — during the Confederation Life liquidation in 1994, the liquidator obtained court approval of a one-week stay on EFC, which allowed it to collect $400 million in value from counterparties.[290] However, this decision predated the amendment that excluded EFC from the stay provisions of the *WURA* and likely precipitated the amendment.

(7.01) For the purposes of paragraphs (7)(e) and (f), dealings with financial collateral include (a) the sale or foreclosure or, in Quebec, the surrender of financial collateral; and (b) the netting, setting off or compensation of financial collateral or the application of the proceeds or value of financial collateral.

(7.1) If an order is made under subsection 39.13(1), the actions referred to in paragraphs (7)(a), (b) and (f) are not to be taken by reason only of (a) the insolvency or deteriorated financial condition of the federal member institution, any of its affiliates or any of its providers of credit support or guarantors in respect of the institution's obligations under the eligible financial contract; (b) the assignment or assumption of the eligible financial contract to or by a bridge institution or a third party; (c) the making of the order or any change of control or ownership of the federal member institution or any of its affiliates that is related to the making of the order; (d) a conversion under subsection 39.2(2.3) in respect of the federal member institution; or (e) a conversion of any of the federal member institution's shares or liabilities in accordance with the contractual terms of those shares or liabilities.

(7.101) If the Corporation considers that all or substantially all of the federal member institution's assets will be transferred to a third party and that an eligible financial contract of that institution will not be assigned to a third party, it may give notice to that effect to the parties to that contract, in which case paragraphs (7.1)(a) and (c) cease to apply in respect of that contract at the date and time the notice is issued.

290 *The Attorney General of Canada and Confederation Life Insurance Company*, Court File RE 4315/94, Order of Justice Houlden, Ontario Court of Justice (Gen Div) 15 August 1994 at para 22(d). *In the Matter of Confederation Life Insurance Company*, Court File RE 4315/94, Order of Justice Houlden, Ontario Court of Justice (Gen Div) 15 August 1994. Interview, 21 August 2017, liquidator KPMG, [on file with author].

Potential reforms

1. Consider amending the *WURA* to impose a limited stay period on counterparties to EFC held by insolvent insurers to allow a court-appointed officer (restructuring professional or liquidator) time to assess the value of the EFC, whether the debtor insurer is in- or out-of-the-money, and whether EFC should be transferred to one or more third parties,

2. Consider amending the *WURA* to allow a restructuring professional or a liquidator appointed pursuant to *WURA* 30 days to apply to court to disclaim an EFC on notice to the solvent counterparty.

   i. The right to disclaim would not apply to any EFC transactions that have been cleared.

   ii. The disclaimer of EFC should be permitted only where all EFC with the same solvent counterparty are also disclaimed, and *WURA* could be amended to align in this respect with the *CDICA*[291] to prevent the insolvent insurer from terminating only in-the-money contracts with the solvent party and impair the netting of obligations under other EFC with the same counterparty.

   iii. The solvent counterparty should be able to object in court to the disclaimer on the same grounds as

291 *CDICA*, *supra* note 253, s 39.15(7.2) "Subject to subsection (7.21), the Corporation may assign to a bridge institution or a third party eligible financial contracts — including any claim under such contracts — that are between a federal member institution and an entity or any of the following entities if the Corporation assigns all of those eligible financial contracts to the bridge institution or the third party: (a) another entity that is controlled — directly or indirectly — by the entity; (b) another entity that controls — directly or indirectly — the entity; or (c) another entity that is controlled — directly or indirectly — by the entity referred to in paragraph (b)."

for the disclaimer of other contracts under the *BIA*.[292]

3. Consider amending the *WURA* to allow the liquidator of an insolvent insurer, on notice to the counterparty, to apply to the court for an order assigning an EFC pursuant to the process provided for the assignment of contracts in the *CCAA* and *BIA*.[293]
    i. Assignment of EFC should be permitted only where all EFC with the same solvent counterparty are assigned.[294]
    ii. The right to seek court approval of an assignment of an EFC would not apply to any EFC transactions that have been cleared.[295]
4. Consider amending the *WURA* to allow the sale of EFC in an enhanced sale process as suggested in the previous recommendation on sales.
5. Consider amending the *WURA* to render ineffective any provisions in an EFC that have the effect of providing for or permitting anything that is, in substance, equivalent to a walk-away clause.[296]

---

292 IIC Task Force, *supra* note 272 at 5.

293 *Ibid* at 6; the Task Force recommending that the "non-defaulting counterparty should not be permitted to terminate an EFC from the date the court makes an order assigning the EFC or such later date as may be set by the court" and "Cherry-picking of EFCs to be assigned should be expressly forbidden and all contracts associated with an assigned EFC should be required to be assigned as well".

294 *Ibid* at 11.

295 *Ibid*.

296 *Ibid* at 12: a walk away clause, relatively rare, affords one counterparty to an EFC the right to walk away from a termination payment that would otherwise be due to the other counterparty when the second counterparty commits certain specified defaults, including becoming subject to insolvency proceedings. The Task Force reports: "OSFI's capital adequacy requirements require certain financial institutions to disregard EFC that include walk-away clauses for purposes of measuring the financial institution's regulatory capital and calculating netting". The Task Force notes at

3. Enact Cross-Border Resolution Provisions

Another important issue is in respect of the lacuna in cross-border resolution provisions. Where a Canadian resolution authority is seeking endorsement of insurer resolution in a foreign jurisdiction, it cannot take advantage of the UNCITRAL Model Law on Cross-border Insolvency,[297] as financial institutions have been excluded from those provisions in the majority of jurisdictions that have enacted the Model Law. Canadian courts recognized the need for comity and cooperation before adopting provisions of the Model Law in Canada, and it is likely that they would advance those objectives where a cross-border insolvent insurer sought recognition, but the legislation could be clarified in this respect, particularly as some of Canada's largest trading partners are shifting to a much more nationalistic approach to cross-border relations.

On the "in-bound side" of an insolvency of a multinational insurer, where a Canadian court is being asked to recognize a foreign or cross-border insurer resolution plan, there may be an issue as to who would serve in a role similar to a court-appointed officer, to provide the Canadian court with an informed opinion as to the fairness and reasonableness of what the court is being asked to approve.

The IAIS is engaged in a process of trying to develop a "Common Framework for the Supervision of Internationally Active Insurance Groups" ("ComFrame"), which establishes

---

13: "Even if the capital adequacy rules are sufficient to prevent certain financial institutions from inserting walk-away clauses in their EFC, many derivatives dealers and other persons carrying on business through trading or entering into derivatives may not be subject to the same or similar capital adequacy rules. A standard rule for all EFCs should apply."

297 United Nations Commission on International Trade Law ("UN-CITRAL"), *UNCITRAL Model Law on Cross-Border Insolvency with Guide to Enactment* (30 May 1997), online: UNCITRAL <http://www.uncitral.org/uncitral/en/uncitral_texts/insolvency/1997Model.html> ["Model Law"].

supervisory standards focusing on the effective group-wide supervision of IAIG.[298] Canada has three IAIG.

ComFrame is aimed at encouraging cross-border cooperation by supervisors to address group-wide activities and risks; identify and remedy supervisory gaps; and coordinate supervisory activities, building on the insurance core principles discussed earlier.[299] Its consultation document suggests that a "group-wide supervisor takes responsibility for the supervision of the IAIG as a whole, on a group-wide basis".[300] Essentially, supervisors would be responsible for the supervision of the IAIG's individual insurance legal entities in their respective jurisdictions, but take into account the effect of their supervisory actions on the rest of the IAIG.[301] Adoption of the ComFrame globally, once it has been fully developed, has the potential to enhance the cross-border cooperation and perhaps prevent significant loss of value. Such international tools are very important, and Canada is actively involved, but these processes take years to put in place. Parliament should consider amending the *WURA* now to explicitly protect Canadian policyholders and creditors, while advancing the goals of comity and international cooperation.

The *WURA* should be amended to adopt language similar to the *BIA* and *CCAA* provisions, to the effect of granting the court authority to make any order appropriate, if it is satisfied that it is necessary for the protection of the debtor insurer's property or the interests of stakeholders. While a purposive interpretation of the statute already arguably grants the court this authority, express provisions would make that power more transparent and certain.

---

298 IAIS, "ComFrame Consultation", *supra* note 268 at 9.

299 *Ibid*. As part of ComFrame, the IAIS is developing a risk-based global insurance capital standard: "ICS Version 2.0" to be used for monitoring and confidential reporting to group-wide supervisors.

300 *Ibid*.

301 *Ibid* at 10.

On the "out-bound side" of a cross-border insolvency of an insurer, the court under its broad statutory authority under *WURA* could authorize a liquidator to act as a representative in respect of any proceeding under the statute for the purpose of having it recognized in a jurisdiction outside Canada. However, express language such as that adopted in the *CCAA* and the *BIA* would make clear this authority. Although there was extensive cooperation between the liquidator and the rehabilitator in the Confederation Life proceedings, there was no formal court cooperation until an agreement was reached on asset realization and "true up" between the estates.[302] This agreement was then sanctioned by both Canadian and the US courts.[303]

Section 164(2) of the *WURA* currently provides the option of turning over funds to the Canadian liquidator or retaining them in the foreign jurisdiction and being deemed to have abandoned any claims in the Canadian proceeding. There should also be express provisions that, where creditors have recovered in other jurisdictions, if an order is made under *WURA*, the court can take account of that distribution in the distribution to Canadian creditors. Here again, a purposive reading of the current statutory language would indicate that the court already has this authority, but provisions would make it more transparent for both domestic and foreign stakeholders.

Suggested legislative changes could include:

1. amending the *WURA* to grant the court authority to make any order appropriate in a cross-border proceeding, if it is satisfied that it is necessary for the protection of the debtor's property or the interests

302 *Confederation Life Insurance Company*, Order of Rehabilitation issued by Circuit Court for Ingram County, 11 August 1994, Case Number 94-78300-CR Settlement Agreement between the Commissioner of Insurance for the State of Michigan and The Superintendent of Financial Institutions, dated 11 June 1996 at 39. Agreement was approved by the Court effective 27 November 1996.

303 For a discussion see Sarra and Dunning, *supra* note 194.

of policyholders, creditors and other stakeholders of the insurer, including according recognition and relief to a foreign representative in Canada and authorizing a Canadian insolvency or restructuring professional to represent the interests of the Canadian debtor insurer and other stakeholders in foreign proceedings; and

2. amending the *WURA* to expressly set criteria for recognition, stay and remedies regarding cross-border proceedings for insolvent insurers and other financial institutions, drawing on existing provisions of the *BIA* and *CCAA* where appropriate.

There are new challenges as both technology and best practices develop, and there should be public policy discussion as to how the current insurer resolution system could be enhanced to address these new challenges. The next part briefly describes six such challenges.

VII. NEW CHALLENGES FOR INSURER SOLVENCY

There are a number of issues that may have an impact on insurer soundness or solvency in the coming period.

1. IFRS 17 effective 2022

First, is the shift to International Financial Reporting Standard 17 *Insurance Contracts* ("IFRS 17"), which will become effective for annual periods beginning on or after 1 January 2022.[304] IFRS 17, issued by the Insurance Accounting Standards Board,[305] is aimed at bringing transparency,

304 International Financial Reporting Standards Foundation, "About IFRS 17 Insurance Contracts" (2017), online: IFRS <https://www.ifrs.org/issued-standards/list-of-standards/ifrs-17-insurance-contracts/> ["IFRS, 'About IFRS 17 Insurance Contracts'"]. Deferred by the International Accounting Standards Board to one year later than originally announced, online: IASB Press Release (14 November 2018) <ifrs.org>.

305 Insurance Accounting Standards Board, "*IFRS 17* Insurance Contracts" (approved 18 May 2017, effective as of 1 January

consistency and comparability to insurance companies reporting financial results.[306]

Since insurance contracts combine features of financial instruments and service contracts and many generate cash flows with substantial variability over a long period, IFRS 17 is aimed at creating more reliable accounting of these products.[307] IFRS 17 will combine current measurement of future cash flows with the recognition of profit over the period that services are provided under the contract; it will present insurance service results such as insurance revenue separately from insurance finance income or expenses;[308] and it will require an entity to make an accounting policy choice of whether to recognize all insurance finance income or expenses in profit or loss or to recognize some of that income or expenses in other comprehensive income.[309] A multinational insurer will have to account for its insurance contracts consistently within the corporate group, making it easier to compare results by product and geographical area.[310]

OSFI is working with the life and P&C insurance industries through a consultative process to change 2021 LICAT and MCT guidelines to meet the standards set out in IFRS 17, and it has reported that it may adjust certain aspects of the capital tests or introduce transitional measures to alleviate the capital impact.[311]

2022), online: IFRS <https://www.ifrs.org/supporting-implementation/supporting-materials-by-ifrs-standard/ifrs-17/>.

306 International Financial Reporting Standards Foundation, "IFRS 17 Fact Sheet" (2017), online (pdf): IFRS <https://www.ifrs.org/-/media/project/insurance-contracts/ifrs-standard/ifrs-17-fact-sheet.pdf> ["IFRS, 'IFRS 17 Fact Sheet'"].

307 IFRS, "About IFRS 17 Insurance Contracts", *supra* note 304.

308 *Ibid*.

309 *Ibid*.

310 IFRS, "IRFS 17 Fact Sheet", *supra* note 306.

311 OSFI, "Letter to Federally Regulated Life and Property and Casualty Insurers regarding LICAT and MCT 2021 Review for IFRS 17" (27 June 2018), online (pdf): OSFI <http://www.osfi-bsif.gc.ca/Eng/Docs/licatmct_let.pdf>, replacing its predecessor IFRS 4. OSFI reports that: "For life insurers with segregated fund guarantee (SFG)

The risks to implementation of IFRS 17 for Canadian insurers include the cost in time and resources to shift accounting practices, given that all the functions reporting in to financial reporting will be affected, including operational processes, product pricing, data feeds, actuarial systems, general and subledgers, and reporting systems.[312]

The greater transparency in financial statements that will be required by IFRS 17 includes breakdown of insurance liabilities between expected cash flows, risk adjustments and profitability to be released, referred to as the "contractual service margin", and "how each of these components is being released into net income".[313] For example, insurance companies will no longer be able to front-end projected and expected profits at the time of contract issuances.[314] Interest credited to insurance cash flows of insurance liabilities can no longer be tied to return on the assets supporting those liabilities, which could increase volatility in both earnings and liabilities accounting.[315] The risk premium on future asset returns will not be recognized in the discount rate, which may result in an increase of an insurer's policyholder liabilities. PwC has observed that "the de-linking of asset returns from insurance liabilities discount rates and the different discount rates applied to different components of the insurance contract liability will mean implementing different asset-liability management and hedging strategies".[316]

---

business, the current methodology for determining associated capital requirements will be maintained in 2021. Development work will continue on a new standard approach for determining capital requirements for SFG business, for implementation after 2021."

312 PwC, "IFRS 17: Insurance accounting changes redefining the industry" (11 October 2017) at 7, online): PwC <https://www.pwc.com/ca/en/industries/insurance/ifrs17.html>.

313 *Ibid* at 6.

314 *Ibid* at 5, PwC reporting that these profits will be held back in a new insurance liability component, "the contractual service margin" and will be amortized into income over each group of insurance contacts' coverage period.

315 *Ibid.*

316 *Ibid* at 7.

The change to IFRS 17 standards could lead to quite different reporting of capital and liquidity, which could result in insolvency risk for insurance companies. The risk is that insurers will no longer meet capital adequacy requirements, particularly when accounting for legacy businesses such as long-term care and variable annuities. The upside is that it may force companies to address these legacy liabilities by selling these liabilities or taking other remedial action before IFRS 17 comes into effect.

2. IFRS 9 Financial Instruments and Disclosures

There are also issues associated with the move to International Financial Reporting Standard 9 *Financial Instruments and Disclosures* ("IFRS 9") and OSFI's guideline regarding the application of IFRS 9 to federally-regulated financial institutions.[317] IFRS 9 was to be in place beginning in fiscal 2018, but the deadline has been deferred for life insurers until 1 January 2021 to allow for implementation of the 2018 introduction of OSFI's new LICAT,[318] as discussed

317 OSFI, "IFRS 9 Financial Instruments and Disclosures: Guideline" (June 2016), online: OSFI <http://www.osfi-bsif.gc.ca/Eng/fi-if/rg-ro/gdn-ort/gl-ld/Pages/ifrs9.aspx>. OSFI's guideline is divided into chapters addressing the Fair Value Option, Impairment and Disclosure expectations and replaces the following seven guidelines that were in effect under IAS 39: C-1 Impairment — Sound Credit Risk Assessment and Valuation of Financial Instruments at Amortized Cost; C-5 Collective Allowance — Sound Credit Risk Assessment and Valuation Practices for Financial Instruments at Amortized Cost; D-1, D-1A, D-1B Annual Disclosures; D-6 Derivatives Disclosures; and D-10 Accounting for Financial Instruments Designated as Fair Value Option.

318 OSFI, "Advisory: Deferral of IFRS 9 Application for Federally Regulated Life Insurers" (March 2017), online (pdf): OSFI <http://www.osfi-bsif.gc.ca/Eng/Docs/ifrs9def.pdf>, reporting that: "With the publication in September 2016 of the IASB approved amendment, *Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts*, companies were given an option of exercising a temporary exemption from applying IFRS 9 *Financial Instruments* if their activities are predominately connected with insurance. The IASB amendment is subject to The Canadian Accounting Standards

previously. OSFI's guideline provides application guidance to insurers applying IFRS 9.[319]

OSFI's concern is that use of the fair value option ("FVO"), which permits companies to fair value any financial asset or financial liability at initial recognition to profit and loss for accounting purposes, may not be sufficiently reliable for prudential capital purposes.[320] More of an issue for deposit-taking banks, OSFI has expressed concern about the reliability

---

Board's (Canadian AcSB) defined due process to incorporate into the Chartered Professional Accountants (CPA) Canada Handbook-Accounting any new standards or amendments when issued by the IASB. As such, the amendment to IFRS 4 requires approval by the Canadian AcSB for incorporation into the CPA Canada Handbook — Accounting. OSFI considered the costs and benefits of the temporary exemption and found a strong prudential need for additional accounting guidance for life insurers... While OSFI supports the improved standard over the existing IAS 39 *Financial Instruments* Standard, OSFI also finds that a deferral of IFRS 9 for life insurers is needed given the 2018 introduction of OSFI's new Life Insurance Capital Adequacy Test (LICAT). Thus, OSFI expects life insurers to defer the application of IFRS 9 until the expected effective date of the IASB new Insurance Contracts Standard of January 1, 2021."

319 The OSFI "IFRS 9" guideline applied to "an [insurer] or a fraternal benefit society incorporated, formed or continued under the [*ICA*]; an insurance holding company incorporated or formed under Part XVII of the [*ICA*]; and the Canadian branch of a foreign company in respect of which an order under [s 574 of the *ICA*] has been made". OSFI, "IFRS 9 Financial Instruments and Disclosures: Guideline Impact Analysis Statement" (June 2016), online: OSFI <http://www.osfi-bsif.gc.ca/Eng/fi-if/rg-ro/gdn-ort/gl-ld/Pages/ifrs9_gias.aspx> ["OSFI, 'IFRS 9 Financial Instruments and Disclosures: Guideline Impact Analysis Statement'"].

320 OSFI, "IFRS 9 Financial Instruments and Disclosures: Letter" (21 June 2016), online: OSFI <http://www.osfi-bsif.gc.ca/eng/fi-if/rg-ro/gdn-ort/gl-ld/Pages/ifrs9_let.aspx> ["OSFI, 'IFRS 9 Financial Instruments and Disclosures: Letter'"]. See also OSFI, "IFRS 9 Financial Instruments and Disclosures: Guideline Impact Analysis Statement", *ibid*: "OSFI's Guideline D-1A and Guideline D-1B expects federally regulated life and property & casualty insurers to provide financial disclosures with their annual financial statements or annual reports in addition to, or in conjunction with, all the disclosures required by IFRS".

of fair values used by life insurers from a prudential perspective, but it has said that it recognizes the need to balance this concern against the fact that mortgages and loans are less material in the case of life insurers and that the asset-liability matching business model of life insurers will likely require them to use "fair value through other comprehensive income" ("FVOCI") for their assets supporting policyholder liabilities.[321] OSFI's guideline is aimed at addressing the reliability of fair values of assets with unobservable market inputs under IFRS 9 and ensuring the changes in fair values are not included as part of regulatory capital.[322] OSFI seeks to promote greater confidence in the fair valuation practices of life insurers by reviewing their fair value practices and developing a capital solution to address any quality of capital issues for loans measured at fair value.

The implementation of IFRS 9 will provide greater transparency and may require some insurers to take corrective action to meet capital adequacy requirements.

3. Climate Change Insurance Financial Risk

Globally, many insurers in the 2017 PwC survey reported that anthropogenic climate change is the biggest long-term risk for insurers, with the rise in frequency of natural catastrophes posing a "very large, even existential, threat to the insurance industry".[323]

321 OSFI, "IFRS 9 Financial Instruments and Disclosures: Letter", *ibid*. "If the business model results in life insurers classifying mortgages and loans at FVOCI, OSFI is willing to allow them to use the FVO to reclassify these mortgages and loans from FVOCI to Fair Valued through Profit and Loss. Therefore OSFI has made an exception for the mortgages and loans on life insurers' financial statements that would otherwise have been classified as FVOCI."

322 *Ibid*.

323 PwC, "Insurance Banana Skins", *supra* note 20 at 32. See also Janis Sarra, "Fiduciary Obligations in Business and Investment: Implications of Climate Change", CCLI Working Paper Series — April 2018.

Climate change presents risk management challenges to the insurance industry, both in terms of liability under P&C policies and issues in respect of potentially stranded assets regarding investments by insurers in the fossil fuel sector. In the P&C insurance sector, excluding mortgage insurance, catastrophes and weather-related losses are now a key risk and have been a significant driver of earnings volatility in the past two years. The Canadian P&C industry suffered a 67 per cent decline of net income in 2016, mainly as a result of catastrophe-related losses.[324] However, OSFI notes that, while these events had a significant negative impact on industry profitability, most insurers had geographically diversified portfolios and adequate reinsurance.[325]

In 2018, the IAIS and the Sustainable Insurance Forum ("SIF"), a network of insurance supervisors and regulators collaborating to strengthen sustainability for the insurance sector, published a paper on climate change risks to the insurance sector.[326] It reports strong scientific evidence that climate change is having an influence on the frequency, severity, and distribution of natural catastrophes and extreme weather events.[327] The IAIS/SIF reports that, while insurers may be equipped to adjust exposures from extreme events through annual contract re-pricing, the potential for physical climate risks may change in non-linear ways, resulting in unexpectedly high claims burdens.[328] Insured losses from climate-related

324 OSFI, *Annual Report 2016-2017*, *supra* note 16 at 11.

325 *Ibid*. OSFI has reported: "OSFI is conducting an expanded review of industry reinsurance practices. The objective is to ensure that institutions appropriately balance their financial resources in Canada when compared to their insurance exposures, and have comprehensive risk management practices to avoid over-reliance on reinsurance and concentrated counterparty credit risks": *ibid* at 11.

326 IAIS and Sustainable Insurance Forum, "Issues Paper on Climate Change Risks to the Insurance Sector" (July 2018), online (pdf): Wixstatic <https://docs.wixstatic.com/ugd/eb1f0b_0e5afc146e44459b907f0431b9e3bf21.pdf> ["IAIS/SIF 'Issues Paper on Climate Change Risks'"].

327 *Ibid* at 11-12.

328 *Ibid* at 14.

natural catastrophes reached record levels in 2017, $138 billion USD.[329]

The report observes:

> Climate risks present significant material challenges for the insurance sector, which are likely to grow over time. Insurers play a critical role in the resilience of households, firms, and corporate sectors to physical climate risks, which will become even more important in the future as impacts begin to manifest with greater intensity. Through their underwriting and investment activities, insurers are also exposed to the broad range of physical and transition risks that may arise from climate change. This may affect their capacity to write insurance business and pay claims. The availability of insurance will hold important implications for the evolution, speed, and smoothness of the low-carbon transition — posing important strategic challenges for business models.[330]

i. Physical risks of climate change

The IAIS/SIF study reports that the insurance sector is affected by physical risks arising from increased damage and losses from physical phenomena associated with climate trends, such as changing weather patterns and sea level rise, and events such as natural disasters and extreme weather.[331] Uninsured losses from physical risks may affect resource availability, the profitability of firms and individual assets, pose supply chain disruptions, and ultimately impact insurance market demand, with cascading impacts across the financial system.[332] The

329 *Ibid.* It reports: "Beyond insured losses from physical climate damages, climate trends and shocks can pose economic disruptions affecting insurers, the economy, and the wider financial system. The insurance 'protection gap' for weather related losses remains significant, with roughly 70% of losses uninsured (Figure 3) — resulting in significant burden on households, businesses, and governments."

330 *Ibid*

331 *Ibid* at 14.

332 *Ibid,* citing Sandra Batten, Rhiannon Sowerbutts and Misa Tanaka, "Let's talk about the weather: the impact of climate change on central banks", Bank of England Working Papers No 603 — May 2016, online: Bank of England <https://www.bankofengland.co.uk/working-paper/2016/lets-talk-about-the-weather-the-impact-of-climate-change-on-central-banks>.

study observes that the risk of uninsurability due to high physical risk profiles may have significant impacts on the performance of credit and investment across the economy. It reports that pricing risks arise from changing risk profiles to insured assets and property, changing mortality profiles and demographic trends (life and health); claims risk arising from unexpected confluence of extreme events such as concurrent hurricanes; and strategic and market risks arising from changing market dynamics.[333]

The IAIS/SIF report observes that climate change is already affecting the frequency and concentration of high impact natural catastrophes, leading to increases in weather-related insurance claims.[334] It further observes that, from a pricing risk perspective, insurers' capacity to write insurance business may be constrained by increasing physical risks to insured property and assets. If risk-based pricing rises beyond demand elasticity and customer willingness to pay, and property in high risk areas is being rendered uninsurable due to high exposure to physical risks, such as wildfires, storms and sea level rise, it may affect revenue sources.[335]

ii. Transition risks of climate change

The second major risk identified by the IAIS/SIF study is transition risk, arising from shifts associated with the transition to a low-carbon economy. Such risks may include policy changes, market dynamics, technological innovation, or reputational factors.[336] Transition factors may impact the types of insurance products and services demanded from firms. The IAIS/SIF study observes that while solar and other types of renewable energy technologies are already cheaper than fossil fuel generational technologies in certain markets, they

333 *Ibid* at 16.
334 *Ibid,* reporting, for example, that Lloyds reports to have paid out $5.8 billion USD in major claims, most of which were climate-related.
335 *Ibid* at 17.
336 *Ibid* at 15.

create both risks and opportunities for insurers.[337] The study observes that liability risks include the risk of climate-related claims under liability policies, as well as direct claims against insurers for failing to manage climate risks, and there may be exposure under D&O, personal injury and third-party environmental liability policies.[338]

IAIS/SIF reports that life and health insurers are beginning to understand the impacts of climate factors on their underwriting portfolios, for example heat-related health issues associated with extremes in weather events, especially for vulnerable policyholders. It observes that impacts of climate change on mortality are becoming a priority focus for actuaries regarding relationship to insurance, annuity and pension programs.[339]

It further notes that while reinsurers may be more resilient to climate factors due to geographic diversification, as the severity and frequency of significant natural disasters increases, the availability and cost of reinsurance cover for weather-related risks may become prohibitive for smaller insurers.[340] It uses the example of Canada, where total payout for weather-related claims had been about $1 billion CAD per year over the past decade, until 2017 when the Fort McMurray wildfire brought the total liabilities to $4.5 billion CAD.[341] The Canadian general insurance market is comprised of many small insurers and is heavily dependent on the international reinsurance market to provide coverage for major natural catastrophes. Although the 2017 liabilities did not present an issue to large reinsurers, claims in other regions at the same time means that there is potential for a reinsurance gap to emerge for weather-

337 *Ibid,* such as risk associated with sudden policy changes that affect risk profiles of insured assets.

338 *Ibid* at 15.

339 *Ibid* at 18.

340 *Ibid* at 19.

341 *Ibid*. See also Jeremy Rudin, OSFI Superintendent, "A Climate of Change" (remarks delivered at the 2016 National Insurance Conference of Canada, Vancouver, BC, 29 September 2016), online: OSFI <http://www.osfi-bsif.gc.ca/Eng/osfi-bsif/med/sp-ds/Pages/jr20160929.aspx> ["Rudin, 'A Climate of Change"].

related losses if costs rise significantly or reinsurers stop reinsuring or restrict reinsurance for these natural catastrophes.[342] OSFI has advised insurers to consider whether their reinsurers' business is concentrated in these areas, and if so, whether there is potential for loss of reinsurance coverage.[343]

Moody's, a major credit-rating agency, recently concluded that climate change has a net negative credit impact on P&C and reinsurance sector, reporting that although catastrophic events have always been a key risk to P&C insurers and reinsurers, the increase of insured property values along coastlines and increased frequency of weather-related catastrophic events will magnify the volatility over time and "result in a number of risk management challenges associated with the assessment, measurement and mitigation of catastrophic risks".[344]

In response to climate risk, some insurers are updating their product offerings, risk management processes and

342 *Ibid.*

343 *Ibid* at 19-20. To the extent such a risk exists, OSFI expects direct insurers to identify alternatives to ensure they can meet their liabilities to policyholders. See also Neville Henderson, OSFI Assistant Superintendent, "Summary of remarks delivered at the 2018 Risk Canada Conference", Toronto, ON, 13 June 2018), online: OSFI <http://www.osfi-bsif.gc.ca/Eng/osfi-bsif/med/sp-ds/Pages/nh20180613.aspx>, identifying and elaborating on the three key prudential risks associated with climate change: physical risks — direct losses arising from weather-related events, such as storms, floods, droughts, fires, etc, increased vulnerabilities to future events, as well as increased costs of supply chain disruptions or resource scarcity; investment risks — financial risks that could arise from downward pressure on the value of carbon-linked assets during the transition to a lower-carbon economy, and the speed with which the transition takes place; and liability risks — claims that could arise from parties that have experienced damage and loss from climate change and seek to recover the loss from other parties whom they deem responsible.

344 Moody's Investor Service, "Climate change heightens key risks for P&C insurance, reinsurance sectors" (15 March 2018), online: Moody's <https://www.moodys.com/research/Moodys-Climate-change-heightens-key-risks-for-PC-insurancereinsurance-PR_380898>.

governance processes relating to climate change risks, including using predictive methods and enhanced risk modelling.[345] The UN Principles for Sustainable Insurance ("UNPSI"), the Geneva Association, and the Insurance Development Forum have worked together to develop frameworks that insurers can adopt to tackle different aspects of the climate risk challenge.[346]

Insurance supervisors need to understand climate change from a core prudential perspective, exploring how physical, transition and liability factors may pose new solvency risks to the safety and soundness of individual firms, and affect stability of insurance markets.[347] The IAIS/SIF report also examines which of the insurance core principles are engaged with climate change risk.

In 2015, the Bank of England Prudential Regulation Authority assessed climate risk in the UK insurance sector, conducted a high-level analysis of sector vulnerabilities, and set out a framework for understanding the impacts of climate change on insurers. In France, the Autorité de contrôle prudentiel et de résolution ("ACPR") is actively including climate-related risks in its day-to-day supervisory framework for insurers.[348] The ACPR in 2018 published an analysis of exposure of French insurers to climate change risks, estimating that between 240 billion and 450 billion of assets could be issued by entities from sectors exposed or potentially exposed to transition risks.[349]

Insurers are also addressing climate change in terms of their own investment policies. Paris-based Axa SA has pledged to

---

345 IAIS/SIF "Issues Paper on Climate Change Risks", *supra* note 325 at 22.

346 Principles for Sustainable Insurance and UNEP Finance Initiative, "Home" (2018), online: UNEP/PSI <http://www.unepfi.org/psi/>.

347 IAIS/SIF "Issues Paper on Climate Change Risks", *supra* note 326 at 25.

348 *Ibid* at 48-49.

349 *Ibid* at 50, finding that issues include data consistency, better understanding the relationship between physical and transition risks.

phase out insurance coverage for new coal construction projects and oil sands businesses,[350] and Munich Reinsurance Co, the world's biggest reinsurer, announced in 2018 that it is stopping investment in bonds and shares of companies that generate more than 30 per cent of their sales with coal-related business.[351] These strategies are at a nascent stage, insurers lagging behind many large institutional investors.

4. Cybersecurity Risk

Cybersecurity risks include theft and ransom of customer medical and financial data, corruption of insurers' databases,

350 Gloria Gonzalez, "Coalition calls on US insurers to make investments in clean energy", *Business Insurance* (31 January 2018), online: <https://www.businessinsurance.com/article/20180131/NEWS06/912318855/Coalition-calls-on-US-insurers-to-make-investments-in-clean-energy>. "As investors, the insurance industry, under its liability-driven approach, is constrained by fiduciary duties and regulations, according to a report called Climate Change and the Insurance Industry: Taking Action as Risk Managers and Investors published by the Zurich-based Geneva Association and based on interviews with 62 C-level executives at 21 globally active insurers and reinsurers. Insurers are addressing climate change through their risk modeling and pricing, knowledge of preventive measures and innovation in risk transfer solutions, as well as from an operational perspective by reducing their carbon footprints, according to the report....in December, AXA Group committed to quadruple its green investment targets to reach 12 billion by 2020, as the company reached its initial 3 billion investment target in 2015.... In addition, AXA pledged to phase out insurance coverage for new coal construction projects and oil sands businesses, which required some difficult conversations with the company's underwriters about why insuring such projects was not 'good for the planet,' he said. He likens it to a health insurer declining to invest in tobacco companies because of the health problems associated with smoking."

351 Thomson Reuters, "Munich Re to back away from coal-related business: CEO", *Business Insurance* (6 August 2018), online: <https://www.businessinsurance.com/article/20180806/NEWS06/912323159/Munich-Re-to-back-away-from-coal-related-business-CEO-Joachim-Wenning>. "Swiss Re Ltd., world No. 2 by share value, said in July it would not reinsure any company for which thermal coal represents more than 30% of its business, following French peer Scor SE."

and the theft of intellectual property.[352] A recent example was in May 2018 when fraudsters pierced the security at two of Canada's biggest banks and threatened to release the private account information of 90,000 Canadians.[353]

New insurance products are trying to respond to these issues; one example is cloud-based on-demand insurance, aimed at protecting digital assets from cybersecurity threats using innovative technology, insurance, and claims processes.[354]

OSFI has observed that whether or not an insurer is offering insurance for cybersecurity risks, insurers themselves are exposed to cyber risk as they offer new Internet-based products and expand their share of customers' insurance portfolios.[355] The personal information held by insurers makes their data attractive to fraudsters. OSFI observes that cyber-attacks on insurance firms can result in significant, tangible damage as well as the loss of policyholders' trust. Insurers need both defences and controls in place to prevent cyber-attacks and they need response plans to act quickly if their systems are compromised. OSFI expects insurers to review cyber risk management policies and practices to ensure that they remain appropriate and effective in light of changing risks.[356] OSFI issued a "Cyber-Security Self-Assessment Guide" to assist

352 *Ibid* at 15.

353 Don Pittis, "Hacking attacks at BMO and CIBC's Simplii highlight why cybersecurity cannot be a patchwork job", *CBC News* (30 May 2018), online: <https://www.cbc.ca/news/business/bank-hacks-cibc-simplii-bmo-1.4682162>.

354 For example, "XL Catlin is creating the world's first on-demand cyber insurance solution for U.S. small and medium-sized business and built on the Slice Insurance Cloud Services (ICS) platform. XL Catlin is the third large insurer to use ICS since Slice launched the platform in January of 2018": "XL Catlin to Build World's First On-Demand Cyber Insurance Solution with Slice ICS", *Insurance Canada* (25 July 2018), online: <https://www.insurance-canada.ca/2018/07/25/xl-catlin-slice-cyber-solution/>.

355 Rudin, "A Climate of Change", *supra* note 341.

356 OSFI, "Cyber-Security Self-Assessment Guide" (28 October 2013), online: OSFI <http://www.osfi-bsif.gc.ca/Eng/fi-if/in-ai/Pages/cbrsk.aspx>.

insurers in assessing cybersecurity readiness.[357] In 2017, OSFI announced that a new objective was to reexamine its role and approach to enhancing cybersecurity at federally-regulated financial institutions, including insurers.[358]

5. Other Fintech Issues

Innovations in financial technologies ("fintech") pose both opportunities and risks for insurers. The IAIS has observed that fintech may disrupt the insurance sector by reducing insurance market competitiveness over the long-term; cause traditional insurers to exit the market; result in more individualized insurance products that may affect price comparability and consumer choice; increase insurance sector interconnectedness due to the use of a limited number of technology platforms; and lead to changes in insurer business models if profit margins come under pressure.[359] It notes that while fintech may increase a focus on improving the customer experience, it could give rise to issues of affordability of insurance products, security issues regarding data, as previously discussed, and increased financial exclusion.[360] The challenge is really one of using available and rapidly developing new technologies to respond to customer and market changes; and ensuring that current monitoring of prudential governance, capital and policyholder protection are responsive to these changes.

6. Reinsurance and Counterparty Credit Risk

Risk transfer and mitigation activities such as reinsurance assist direct insurers to reduce insurance risks and the volatility of

357 *Ibid*.
358 *Ibid* at 4.
359 IAIS, "FinTech Developments in the Insurance Industry" (21 February 2017), online: IAIS <https://www.iaisweb.org/page/news/other-papers-and-reports>.
360 *Ibid*. The IAIS report takes stock of financial innovations such as the telematics, use of big data, robo-advisors, distributed ledger technology, blockchain and smart contracts.

financial results, stabilize solvency, and better withstand catastrophic events.[361] Reinsurance can also indirectly benefit policyholders because it allows direct insurers to offer coverage over a wider range of risks, and with higher coverage levels.[362]

OSFI's "Own Risk Solvency Assessment" ("ORSA") guideline emphasizes the importance of both emerging risks and risks arising from risk transfer and mitigation, and counterparty credit risk. OSFI reports that the majority of insurers, both life and P&C, are managing their reinsurance risk prudently, in accordance with OSFI's "Sound Reinsurance Practices and Procedures Guideline".[363] However, it has found a small but significant group of insurers have concentrated counterparty credit risk issues, in part because of their leveraged business model, whereby insurers insure commercial risks in Canada, while reinsuring a very significant portion of that risk offshore with only small amounts of capital being maintained in Canada.[364] Highly concentrated exposure to a counterparty poses the risk of impairing the insurer's ability to compensate policyholders in a severe but plausible event.[365] OSFI is engaged in a prudential review of these issues in 2018.[366]

VIII. CONCLUSION

Canada is, for the most part, "resolution ready" for insurance company insolvency. There are strong policyholder protections in place and mechanisms for early intervention to remedy governance, capital and liquidity issues identified with

361 Rudin, who observes that insurers also benefit from reinsurers' knowledge and expertise when expanding into new lines of business: Rudin, "A Climate of Change", *supra* note 341.

362 *Ibid.*

363 OSFI, "Guideline B-3: Sound Reinsurance Practices and Procedures" (December 2010), online: OSFI <http://www.osfi-bsif.gc.ca/Eng/fi-if/rg-ro/gdn-ort/gl-ld/Pages/b3_Sound.aspx>.

364 Rudin, "A Climate of Change", *supra* note 341.

365 *Ibid.*

366 *Ibid.*

insurers. Canada's supervisory and resolution system measures up relatively well compared with international standards, although this article suggests some legislative reforms that would fill identified gaps, offer greater protection to stakeholders, and further enhance the resolution regime. One priority should be solvent recovery and resolution, as it offers the most effective way of protecting policyholders and the safety and soundness of the insurance system. There are significant challenges ahead, with changes to insurance products, accounting and capitalization requirements, and emerging insurance risks such as climate change, all of which deserve careful attention moving forward.