Insurance & Reinsurance - Canada

OSFI Announces New Assessments Required of Corporate Leaders

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On February 11 2008 the Office of the Superintendent of Financial Institutions (OSFI) - the primary Canadian regulator of financial institutions - released a new guideline to be followed by financial institutions (including insurance companies and branches of insurance companies) operating in Canada. Guideline E-17, Background Checks on Directors and Senior Management of Federally Regulated Entities (FREs) is a result of the OSFI emphasis on risk management. Specifically, Guideline E-17 is aimed at mitigating risk that may be posed by the leadership of an organization, as the suitability and integrity of these individuals - and their actions while in office - are expected to have an impact on the stability, financial soundness and reputation of the organization. Guideline E-17 will become effective on January 31 2009.

Purpose

Over the past several years regulators and industry groups have developed policies to ensure that the directors and senior management of the companies they regulate possess the required skills, experience and ethics to direct companies properly, and maintain these skills and ethics. Guideline E-17 is targeted at bringing Canadian financial regulations into line with the Basel Committee on Banking Supervision, the International Association of Insurance Supervisors, the Canadian government's Financial Action Task Force and Canada's provincial securities commissions, such as the Ontario Securities Commission. Guideline E-17 achieves the same goals as those of these organizations by implementing and requiring from financial institutions a process of continual assessment of company leaders to ensure that these leaders maintain the appropriate qualifications to permit them to continue to serve in their capacities as leaders. As a result, upon the implementation of Guideline E-17, the Canadian requirements will meet the common international benchmark with respect to the backgrounds of the directors and senior managers of financial institutions.

Upon the implementation of Guideline E-17, federally regulated entities, such as insurance companies and branches of foreign insurance companies, will be required to establish written policies and procedures to conduct assessments of the suitability and integrity of the corporate leaders referred to in Guideline E-17 as 'responsible persons'. This class of person includes directors, principal officers, chief agents and the senior management of the organization, which may include the chief executive officer, the chief financial officer and any other officer who has a functional reporting line directly to the board of directors or chief executive officer.

OSFI's approach to ensuring the suitability and integrity of responsible persons is part principles-based and part risk-based. Guideline E-17 sets out various principles in the establishment of policies and procedures in the conduct of assessments of responsible persons. However, OSFI has also indicated that it will, where warranted, assess an entity's processes based on risk factors. For example, OSFI will use a risk-based approach when reviewing how companies address situations where assessments of responsible persons reveal an enhanced risk to the company.

Requirements

The mandates of Guideline E-17 include:

- designing a policy;
- assessing the suitability of responsible persons;
- implementing the policy; and
- following up on the results of the assessment.

Upon the enactment of Guideline E-17, insurance companies and branches will be required to:

- determine which individuals and job categories should be considered responsible persons;
- design a policy for assessing these responsible persons;
- abide by this policy; and
- at regular intervals, assess each responsible person (as well as potential new responsible persons) to determine whether they are suitable or have the correct integrity, and to ensure that unsuitable people do not have positions of responsibility.

Insurance companies and branches will need to be aware of the importance of their assessment policies and their proper implementation. In particular, they should:

- ensure that an appropriate schedule and timeline of assessments is designed, including assessment frequency;
- select appropriate jurisdictions and determine how far back verifications should be conducted, based on the responsible person, the position held and the circumstances;
- assess when attestations from responsible persons (or individuals being considered for a position that would make them a responsible person) will be sufficient and when independent verification will be necessary; and
- determine effective key practices to follow with respect to, for example, disclosing the organization's assessment policy to responsible persons or potential new responsible persons, or deciding what to do if the assessment of a responsible person or a potential new responsible person reveals concerns with the person's background.

With respect to the assessment process itself, insurance companies and branches will need to address certain questions, such as the following:

- Who will conduct the assessment? Will the assessment be done internally or outsourced? How will the assessors be selected?
- What information will be sought by the assessors?
- What type or quantity of adverse information is material and sufficient to disqualify a person from a position as a responsible person? What additional information (if any) should be sought to follow up on this adverse information? Examples of additional information may include mitigating factors or circumstances that influenced or led to the adverse circumstances and information.
- How will decisions be reached? Will the company appoint a committee or will there be an ultimate decider? Who will assess the assessor(s)?
- How will the process be documented? Documentation will be essential in cases where responsible persons, or potential responsible persons, charge that they were treated unfairly during or after the process and seek damages from the company, its board of directors or the assessors.
- Where a responsible person is not removed, what risk minimization and mitigation techniques will the company use? These could include more frequent assessments, more thorough assessments, the purchase of additional insurance, requiring additional approval for certain transactions and the shifting of certain sensitive responsibilities to a different responsible person.

Finally, the insurance company or branch should address employment and privacy legal concerns and issues that may arise to ensure that the process and assessment policy protect the company, the board of directors and other assessors as much as possible. These concerns include:

- referring to OSFI or Guideline E-17 in employment policies and contracts;
- ensuring that the personal information of responsible persons or potential responsible persons is kept confidential; and
- ensuring that confidentiality is emphasized in any outsourcing agreement whereby the assessment of responsible persons is undertaken by a third party.

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