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OSFI Revises Related Party Reinsurance Governance **January 2014**

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By law, when a federally-regulated insurer (an “**Insurer**”) intends to enter into a reinsurance arrangement with a related party that is not also a federally-regulated insurer (the “**Related Reinsurer**”), prior approval of the Superintendent of Financial Institutions (Canada) (the “**Superintendent**”) is required. As part of its continuing effort to modernize its approvals, on January 1, 2014 the Canadian Office of the Superintendent of Financial Institutions (“**OSFI**”) updated its procedures regarding Superintendent approvals of reinsurance with a Related Reinsurer (“**Related Party Reinsurance**”). While Related Party Reinsurance approvals previously were granted in respect of each separate reinsurance arrangement, including modifications of these arrangements, they now generally will be granted for an indefinite term in respect of the reinsurer.

This new approach to Related Party Reinsurance follows up on the 2010 repeal of the previous 25% limit on the use of unlicensed reinsurance, which repeal resulted in many Insurers entering into significant fronting and quota share reinsurance arrangements with foreign Related Insurers. This latest change reflects the commercial reality that multiple reinsurance or retrocession arrangements are often entered into by Insurers with a single Related Reinsurer, with relatively short notice. The nature of the corporate relationship between Insurer and Related Reinsurer results in the Insurer conducting different legal and financial diligence on its counterparty, and requiring different internal approvals. Where an Insurer is a part of an insurance group with global operations, removing the requirement for Superintendent approval of entry into or modification of each reinsurance arrangement will help the group in its efforts to implement the reinsurance arrangement with speed, provided that the Related Reinsurer has already been approved.

What It Means

This change to Related Party Reinsurance should be seen within the broader OSFI effort to update its oversight of Insurers, including the December 2010 revision to OSFI Guideline B-3, *Sound Reinsurance Practices and Procedures* (“**Guideline B-3**”) and the new OSFI Corporate Governance Guideline (the “**Governance Guideline**”). Related Party Reinsurance should be among the issues addressed in an Insurer’s Risk Appetite Framework under the Governance Guideline. Insurers are reminded that OSFI expects full implementation of the Governance Guideline by no later than January 31, 2014. In fact, OSFI has stated its belief that this new approach to Related Party Reinsurance will provide it with additional insight into Insurer risk exposure to Related Reinsurers.

The result of OSFI’s new approach to Related Party Reinsurance is that once an Insurer has received approval to reinsure risks with a Related Insurer, future reinsurance arrangements with that same Related Insurer should not require additional approvals. Accordingly, where a Related Insurer is already approved, this new approach may rightly be seen as offering Insurers additional flexibility (as to eligible counterparties) and certainty (as to timing). The flip side of this streamlined approach is that insurers should expect OSFI to scrutinize Insurer and Related Reinsurer financial, risk management, exposure and governance questions more carefully in considering applications. This will likely include a deeper look at the home jurisdiction of the Related Reinsurer – where this jurisdiction is seen as having standards similar to those of OSFI, this will be looked-upon more favourably than jurisdictions that do not follow similar regulatory standards. Accordingly, Insurers and their Related Reinsurers should expect that initial applications for Related Party Reinsurance will take longer, and will require more information, than did previous such applications.

Transition of Legacy Reinsurance Arrangements

In respect of any new reinsurance arrangements with Related Reinsurers, or material changes to existing approved reinsurance arrangements with Related Reinsurers, to be executed after January 1, 2014, Insurers should seek Superintendent approval under the new regime. To assist in the transition from the previous agreement-centred approvals to the new Related Reinsurer-centred approvals, OSFI has advised as follows:

- Where an Insurer has obtained approval under the prior regime of a reinsurance arrangement with a Related Reinsurer and this approval has no expiry date, the Insurer is expected to apply prior to January 1, 2015 for approval of existing Related Reinsurer(s) under the new regime; and
- Where an Insurer has obtained approval under the prior regime of a reinsurance arrangement with a Related Reinsurer for a defined period, that approval will be extended until June 30, 2015 and the Insurer is expected to apply prior to January 1, 2015 for approval of existing Related Reinsurer(s) under the new regime.

Next Steps

While this revised, “risk-based”, approach will result in approvals over Related Reinsurers being granted for an indefinite term, such approvals will be conditional on the Insurer providing certain information to OSFI on an annual basis. This information will typically include:

- a) Evidence that the reinsurer continues to be a related party of the Insurer, including a current organizational chart of the group;
- b) Confirmation from a senior officer or chief agent of the Insurer that the reinsurance agreements between the insurer and the Related Reinsurer:
 - i. Conform with Guideline B-3 and the Insurer’s reinsurance risk management policy;
 - ii. Are on terms and conditions at least as favourable to the Insurer as market terms and conditions, including the basis on which this assessment is made;
 - iii. Effect a true transfer of risks and were accounted for in the appropriate manner; and
 - iv. Did not result in the Related Reinsurer insuring in Canada a risk, which would otherwise require that the Related Reinsurer apply for and receive from the Superintendent an order to insure in Canada risks;
- c) A copy of the annual reinsurance declaration made by the senior officer or chief agent of the Insurer, as required by Guideline B-3;
- d) Details regarding:
 - i. Any relevant changes made to the Insurer’s reinsurance risk management policy;
 - ii. Any changes made to the Related Reinsurer’s legal name;

- iii. The due diligence performed by the Insurer in respect of the continuing suitability of the Related Reinsurer, including reference to the requirements and principles of Guideline B-3 and the Insurer's reinsurance risk management policy;
 - iv. The type and duration of the reinsurance contracts with the Related Reinsurer that were entered into, renewed, or modified; and
 - v. Any reinsurance contracts with the Related Reinsurer that were commuted or otherwise terminated; and
- e) Confirmation that, where the Insurer is a branch in Canada of a foreign company, all claims payments by the Related Reinsurer were made in Canada to the chief agent of the branch.

Insurers should continue to track all of their reinsurance arrangements with Related Reinsurers, should monitor that these arrangements are appropriate transfers of risk and on market terms and conditions, and should verify that reinsurance arrangements and modifications to such arrangements continue to comply with their reinsurance risk management policy.

Although this new regime is expected to impose more short-term work for an Insurer until such Insurer's Related Reinsurers are Superintendent-approved, in the medium and long terms we expect that these recent changes will make it easier for Insurers to enter into new reinsurance arrangements and modifications to existing reinsurance arrangements with Related Reinsurers.