reinsurance advisory board

Market access challenges: Canada

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

Existing legislation and recent developments

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

The review of the reinsurance framework in Canada was started in June 2018, when the Canadian regulator — the Office of the Superintendent of Financial Institutions (OSFI) — published a discussion paper. It included several proposals that potentially threaten the operations of foreign (including European) reinsurers. One of the proposals would create an unlevel playing field between non-registered reinsurance (ie, business written on a cross-border basis) and registered reinsurance (ie, business written by a branch), in favour of registered reinsurance. In addition, the proposals would lead to new restrictions and/or increased capital charges on policy limits, significant quota shares, fronting arrangements and a prohibition on ceding reinsurance from branch to parent via an unregistered affiliate. They would also tighten requirements for reinsurance security arrangements and transactions with affiliates. These reforms focus mainly on property and casualty (P&C) business — some additional life and health capital requirements are already in place.

The proposed policy changes are to be implemented in phases. Phase 1 was effective at the beginning of 2019, Phase 2 is expected to come into force in 2021 and no timing is yet available for Phase 3. According to an OSFI newsletter of August 2020, OSFI expects to complete the reinsurance review in mid-2021.

After significant industry feedback, in mid-2019 OSFI opened a public consultation on reinsurance risk management, with a draft revised guideline, "B-3, Sound Reinsurance Practices and Procedures". This draft still included a prohibition on ceding reinsurance from a branch to the parent via an unregistered affiliate.

OSFI then released for consultation in March 2021 a draft revised guideline "B-2, Property and Casualty Large Insurance Exposures and Investment Concentration", requiring registered P&C insurers to cover the maximum loss related to a single insurance exposure (as opposed to three of its largest policy limit losses) on any policy it issues, assuming the default of its largest unregistered reinsurer on that exposure. The RAB engaged in the consultation, raising concerns on a number of proposals (see the RAB contribution here).

Impact on foreign reinsurers

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

The RAB therefore opposes a number of proposals, including the introduction of a reinsurance concentration limit for retrocession contracts, as well as limitations on high-risk exposure policies to be ceded to a reinsurer. The target of overseeing the default counterparty risk should not result in regulations that eliminate vital reinsurance diversification and free access to cross-border reinsurance.

Impact on the Canadian (re)insurance market

The impact of the proposed B-2 Guideline would be to concentrate reinsurance purchasing in the hands of a relatively small number of registered reinsurers in Canada (effectively eliminating access to unregistered reinsurance capacity) thereby driving the cost of reinsurance significantly higher.

Cedants will have no option but to pass on the burden of higher reinsurance costs to Canadian policyholders. Some Canadian businesses will not be able to purchase the coverage they need, and this will increase the insurance gap. If the Canadian (re)insurance market shrinks, this would have negative implications for premium taxes and HST (a local form of value-added tax).

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

Recommendations and preferred outcomes

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

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

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