IMF Financial Sector Stability Assessment May Give Rise to Changes in Insurance Regulation in Canada

The International Monetary Fund (the "IMF") recently released its Financial System Stability Assessment (the "Assessment") for Canada. The Assessment has been released in accordance with the IMF's Financial Sector Assessment Program.

In 2010, the IMF mandated that stability assessments be conducted regularly for nations deemed to have "systemically important financial sectors", as part of bilateral surveillance under Article IV of the Articles of Agreement of the IMF.[1] An assessment must be conducted every five years in which the stability of a country's financial system is evaluated and suggestions for improvement are provided.[2] Canada is deemed to have a systemically important financial sector by the IMF that ranked ninth in the World in 2010.[3] This ranking is based on the weighted average of a country's financial sector size and interconnectedness to other countries' economies.[4]

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[1] IMF, *Financial Sector Assessment Program: Frequently Asked Questions*, (18 March 2014).

[2] *Ibid*.

[3] IMF, *Integrating Stability Assessments Under the Financial Sector Assessment Program into Article IV Surveillance*, at p. 14 (27 August 2010).

[4] *Ibid*.

The Assessment noted that Canada's insurance sector performed well in stress tests undertaken by the IMF.[5] However, the IMF offered suggestions to further safeguard the stability of Canada's insurance sector. Canada's federal insurance regulator is the Office of the Superintendant of Financial Institutions ("OSFI"). OSFI publishes a list of its priorities on a cyclical basis. One of OSFI's priorities for 2014 to 2017 is "Anticipating and Responding to Risks Emanating from the Economy and Financial System". Addressing the Assessment's recommendations is included as one of OSFI's strategies for meeting this priority.[6],[7] When reached for comment about which recommendations might be implemented (as of the date of this article), OSFI stated that they are still in the process of reviewing the recommendations and have yet to determine what actions will be taken. It is therefore possible that some of the IMF's recommendations may be implemented in some form by OSFI in the near future.

There were a number of issued raised by the IMF and this article concentrates on notable recommendations.

IMF Key Insurance Recommendations:

Improvement of Group-Wide Insurance Regulation:

The Assessment recommended that Canada's insurance regulators work together as well as work with the Department of Finance to improve the regulation of group-wide insurance by enacting a clear and consistent regulatory regime for the supervision of group-wide insurance throughout Canada.[8] The Assessment further suggested that supervision for group-wide insurance should include material

[5] IMF, *Financial Sector Stability Assessment – Canada*, at p. 15 IMF Country Report No. 14/29 (Washington, DC: International Monetary Fund, 2014).

[6] Canada, OSFI, *Plans and Priorities for 2014-2017* (Report), (Ottawa: 2014).

[7] Note: Addressing the recommendations from the Assessment is listed in both "Plans and Priorities for 2013-2016" and "Plans and Priorities for 2014-2017".

[8] *Financial Stability Assessment – Canada*, *supra* note 5 at 22.

non-regulated entities as well as prudential and market conduct requirements at the group level.[9]

Moreover, the Assessment recommended that insurance regulators in Canada be given powers to take necessary remedial and enforcement measures at the holding company level in line with emerging international best practices.[10] While the Assessment did not articulate the specific emerging international best practices, the IMF's approach is similar to that outlined in the International Association of Insurance Supervisors' publication *Insurance Core Principles, Standards, Guidance and Assessment Methodology* which states in reference to supervision of group-wide insurers that "[r]emedial or enforcement actions should be taken in coordination with other involved supervisors, where required and appropriate".[11] The Assessment suggested that the recommendations regarding the improvement of group-wide insurance regulation should be implemented within one to three years.[12]

Regulator's Powers:

The Assessment noted that Canada's *Insurance Companies Act* (the "Act") allows the Minister of Finance to overrule OSFI in certain circumstances.[13] While the IMF acknowledged that this is not currently considered to be a controversial issue, it stated that Canada's regulatory structure could be improved if the Act was amended to permit the Minister to override OSFI's prudential

[9] *Ibid*.

[10] *Ibid* at 22.

[11] International Association of Insurance Supervisors ("IAIS"), *Insurance Core Principles, Standards, Guidance and Assessment Methodology*, at para 23.8.1. (np: IAIS, 2013).

[12] *Financial Stability Assessment – Canada*, *supra* note 5 at 8.

[13] *Ibid* at 20.

decisions only in "extraordinary circumstances and with full public disclosure".[14]

Similarly, the IMF recommended that Canada's laws be revised so that insurance regulators such as OSFI retain sole authority over prudential decisions.[15] The IMF identified change of control as an example of a prudential issue over which the regulators should have decision-making control. The IMF further recommended that OSFI should be empowered to make and enact its own legally enforceable rules. Currently, OSFI can issue guidelines that are essentially best or prudent practices that it expects financial institutions to follow.[16] As a practical matter, the strong powers generally given to OSFI under the Act tend to raise OSFI guidelines to a higher level than best practices, as OSFI has means by which it can persuade regulated entities to comply. In any event, the Assessment suggested that OSFI should be granted such rule making powers within one to three years.[17]

Macro-Prudential Tools to Manage Risk in the Insurance Sector:

The Assessment recommended that Canadian insurance regulators use macro-prudential tools to help manage risk in the insurance sector. It suggested that market-wide stress tests be conducted to determine which tools to use to manage risk. It furthers stated that an example of a macro-prudential tool that could be used by Canadian regulators is instituting a limit on the amount of higher risk business that insurers are allowed to conduct.[18] While not mentioned in the Assessment, other examples of macro-prudential tools include requiring reserves and instituting debt-to-equity

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[14] *Ibid*.

[15] *Ibid* at 22.

[16] Canada, OSFI, *Table of Guidelines*, (Ottawa: 2014).

[17] *Financial Stability Assessment – Canada*, *supra* note 5 at 8.

[18] *Financial Stability Assessment – Canada*, *supra* note 5 at 13.

standards.[19] The IMF did not provide an implementation timeframe for this recommendation.

Conclusion:

It is not possible to predict which of the IMF recommendations, if any, will be implemented in Canada. Indeed, insurance supervision was only one aspect of the Canadian financial system that IMF reviewed. Other sectors included banking supervision and securities regulation. Therefore, it will remain to be seen whether and to what extent Canada makes any changes to (a) group-wide insurance regulation, (b) the relative powers of the insurance regulator and governmental departments, and (c) rule making authority of insurance regulators. With respect to risk management tools in the insurance sector, OSFI has, over the past year or so, implemented a number of requirements relating to risk management that are commensurate with international best practices. Examples include the requirement for insurers to design and implement a risk appetite framework and an own regulatory solvency assessment (ORSA).

It is evident that Canada has attempted to be and desires to stay on the forefront of international supervisory standards. In speaking to the 58th Annual Canadian Reinsurance Conference on April 2, 2014, OSFI's Superintendent Julie Dickson commented on the

[19] *Jacek Osiński, Katharine Seal & Lex Hoogduin, Macroprudential and Microprudential Policies: Towards Cohabitation, Monetary and Capital Markets Department Staff Discussion* at p. 9. Note 13/05 (np: IMF, 2013).

Assessment, noting that "The assessors ... have concluded that we continue to be effective with a high level of compliance with international standards."[20] She further stated that "...it is very important, however, not to rest on laurels because the bar is constantly rising".[21]

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a cautionary note

The foregoing provides only an overview and does not constitute legal advice. Readers are cautioned against making any decisions based on this material alone. Rather, specific legal advice should be obtained.

[20] Julie Dickson, "*Remarks by Superintendent Julie Dickson Office of the Superintendent of Financial Institutions Canada (OSFI) to the 58th Annual Canadian Reinsurance Conference*" (Remarks, delivered at the 58th Annual Canadian Reinsurance Conference, Toronto, 2 April 2014).

[21] *Ibid*.