OSFI'S REVAMPED, RISK-BASED MCT GUIDELINE IN PLACE FOR 2015

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On September 24, 2014 the Office of the Superintendent of Financial Institutions Canada (OSFI) announced that recent revisions to the Minimum Capital Test (MCT) Guideline will come into effect on January 1, 2015 (subject to a 3-year phase in period). This is not breaking news for Canadian federally regulated property and casualty insurers. The changes have been brewing for some time. In May of 2013, OSFI published for public consultation a discussion paper on proposed changes to the regulatory capital framework for federally regulated property and casualty insurers. Then on December 20, 2013, OSFI published the draft 2015 MCT Guideline for industry consultation. After receiving a good number of submissions, the 2015 MCT Guideline has now been finalized.

The noteworthy aspect of this development for outside observers is that it is part of a continuing OSFI initiative to stay in step with developments in risk-based regulation of financial institutions. The 2015 MCT Guideline has been updated to become a more vigorous risk-oriented test that aligns capital requirements to the level of risk encountered by the property and casualty insurance industry. Under the revised capital framework, the supervisory target level of capital required for Canadian property and casualty insurers and margin required for foreign property and casualty branches (capital required) will be derived explicitly, based on a pre-determined confidence level. According to OSFI, this approach is more consistent with the risk-based regulation concept and is in line with international regulatory developments.

The 2015 MCT Guideline provides for new and updated risk factors and margins plus a revised definition of "available capital". According to OSFI, these revisions were finalized based on the public consultation, industry input, and comprehensive testing and analysis.

The new risk-based capital framework results in a 2.8 percentage point net decrease in the capital ratio (MCT and Branch Adequacy of Assets Test (BAAT) combined) on average across the entire property and casualty industry. Interestingly, on an individual basis, the new framework resulted in a total impact of +3.6 percentage points in the MCT and a -27.4% percentage point impact in the BAAT. Although the decline in the overall capital ratio (combined) is not material, OSFI notes that the impact may vary by individual company as the new framework better aligns each insurer's capital requirements with its risk profile.

OSFI has stated that it will continue to monitor emerging issues and developments in the property and casualty insurance industry and will revise the MCT Guideline accordingly to ensure that the MCT continues to accurately reflect risks.

by Carol Lyons

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.