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Update on Canadian federal regulatory developments for insurers

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Federally, the Office of the Superintendent of Financial Institutions ("OSFI") is responsible for the prudential regulation of insurers carrying on business in Canada. The federal legislation is the Insurance Companies Act (Canada) (the "ICA") which is overseen by the federal Minister of Finance and administered by OSFI. In addition to the ICA, much of OSFI's regulatory supervision is accomplished through the issuance of guidelines and advisories which federally-regulated insurers ("FRIs") are required to follow.

There are 10 provinces and three territories in Canada which regulate the market conduct activities of insurers. Each province has its own statute and its own regulatory body that oversees the activities of insurers. The Canadian Council of Insurance Regulators ("CCIR") is made up of the provincial superintendents of insurance and a representative of OSFI. The CCIR aims to enhance insurance supervision and regulation to serve the public interest and foster increased cooperative oversight and information sharing among provincial regulatory authorities.

There are also a number of active federal industry groups in Canada. For instance, the Canadian Life and Health Insurance Association ("CLHIA") is a voluntary association whose members account for 99% of Canada's life and health insurance business. On the property and casualty ("P&C") side, the Insurance Bureau of Canada ("IBC") is the national industry association representing Canada's private home, auto and business insurers.

This update will focus on developments at the federal level (namely, OSFI and federal industry groups) as well as the CCIR. OSFI's policy work had been suspended for several months in 2020 due to the COVID-19 pandemic, but has now recommenced.

Climate change

The link between climate change and more frequent and severe natural catastrophes (and the resultant stress on the insurance industry) continues to be a popular topic, and climate change was noted as the top emerging risk amongst actuaries in a recent study.

In November 2020, OSFI and the Bank of Canada announced plans for a pilot project using climate change scenarios to better understand the risks to the financial system relating to a transition to a low-carbon economy. A small group of institutions from the insurance and banking sectors will participate. A report is expected to be published at the end of 2021, sharing details on the specific scenarios, methodology, assumptions and key sensitivities.

In December 2020, the CLHIA announced that it has joined the United Nations' Principles for Sustainable Insurance initiative. The initiative is a collaboration between the United Nations Environmental Programme and the global insurance industry to promote greater environmental and social sustainability. The principles seek to build upon insurers' core business of managing risk by engaging insurers around the world in developing innovative solutions, improving business performance, and contributing to environmental, social and economic sustainability.

In January 2021, OSFI published a discussion paper focusing on risks arising from climate change that can affect the safety and soundness of federally regulated financial institutions ("FRFIs"), including FRIs. Comments and submissions were invited until 12 April 2021. The responses may be used to inform the development of future OSFI guidance.

At present, OSFI recommends that insurers spread out regional exposure and transition investment portfolios towards industries that are climate resilient and well-positioned for a low carbon future.

Fraud risks

In October 2020, the IBC issued an updated report that reviews the insurance fraud landscape six months into the COVID-19 pandemic. The report notes that times of widespread economic hardship and natural disaster can be a breeding ground for insurance fraud, and the pandemic has presented both of these factors. The report analyses the increased risks of cyber-attacks and telemedicine fraud arising out of remote connectedness. The report also highlights the increased risk of real estate development and auto theft fraud.

Technology risks

Technology adoption continues to change the ways in which insurance business is conducted and has resulted in new risks that must be actively monitored and mitigated against.

In September 2020, OSFI published a discussion paper focusing on risks arising from rapid technological advancement and digitalisation. The paper includes a discussion of operation-

al risk and resilience, understanding the role of the prudential regulator with respect to technology and data risk management and the development of core principles in relation to cyber security, advanced analytics and the technology third party ecosystem. Note that OSFI has had an advisory in place requiring cyber security incident reporting since early 2019.

In January 2021, the CCIR published an issues paper to engage stakeholders in supporting the safe and swift deployment of Connected and Autonomous Vehicles ("CAVs") in Canada. The paper reviews the existing regulation and describes the issues to be addressed (including liability and fault determination, claims resolution, pricing, cyber security and data privacy). The CCIR notes that difficulties around attempts to adapt the current law are likely to lead to years of uncertainty for drivers and injured people as the use of CAVs increases.

Reinsurance and large insurance exposures

In June 2019, OSFI published proposed revisions to its guideline on reinsurance practices. The changes are designed to: (i) encourage better identification and management of risks arising from the use of reinsurance, particularly counterparty risks; (ii) clarify OSFI's expectation that reinsurance payments flow directly to a FRI-cedant in Canada; (iii) reaffirm OSFI's expectation that a FRI not cede "substantially all" of its risks; and (iv) clarify other aspects of OSFI's expectations related to reinsurance. OSFI claims that the changes are needed because Canadian insurers have been increasing the amount of commercial risk they cover and ceding a substantial portion offshore to unregistered reinsurers. The draft guideline set off alarm bells for many insurers who would need to substantially increase the amount of capital they hold in Canada. The industry is keenly awaiting the final version of the guideline expected in mid-2021.

In November 2020, OSFI published proposed revisions to its guideline on large insurance exposures and investment concentration. The revisions primarily address single large insurance exposures of P&C insurers. The new proposed rule requires P&C insurers to be able to cover the maximum loss related to a single insurance exposure on any policy it issues, assuming the default of its largest unregistered reinsurer on that exposure. Although the guideline is in draft form and has been met with industry push-back, OSFI is already asking insurers for information on how they intend to address its requirements, including their policy on gross underwriting limits, criteria and approach for determining and measuring the maximum loss on a single exposure and policies with respect to the management of investment concentration.

IFRS 17 implementation

The implementation of the IFRS 17 - Insurance Contracts standard ("IFRS 17") (which will replace the IFRS 4 Insurance Contracts standard for annual periods beginning on or after 1 January 2023) will continue to be a major area of focus for OSFI. To ensure that insurers stay on track, OSFI requires semi-annual progress reports. Questions with respect to IFRS 17 preparedness are also being asked by OSFI as part of the application process for new entrants.

In November 2020, OSFI indicated that it is developing a new approach to determine regulatory capital requirements for segregated fund guarantee ("SFG") to accord with IFRS 17. Under the new approach, capital requirements will be calculated by applying shocks to SFG liabilities. OSFI expects to publish the draft approach for public consultation in September, 2021. The new approach will become effective on 1 January 2023 to coincide with IFRS 17.

Other areas of interest in Canada relate to upcoming changes to record-keeping requirements, the potential expansion of fintech activities for insurers, and how analytics and insurtech are being used to alter insurance products and the ways in which they are administered.

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