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EXPERT GUIDE

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So you want to insure risks in Canada, eh? A guide to becoming a licensed insurer

By Carol Lyons & Darcy Ammerman

There are two levels of government that regulate insurers in Canada. Federally, the Office of the Superintendent of Financial Institutions (OSFI) is responsible for the prudential regulation of insurers carrying on business in Canada. Federal qualification of insurers is governed by the Insurance Companies Act (Canada) which is overseen by the federal Minister of Finance.

There are also 10 provinces and three territories in Canada (collectively, "provinces") which regulate market conduct activities of insurers carrying on business within a particular province. Each province has its own statute and its own regulatory body that oversees the activities of insurers. Therefore, once federally incorporated or qualified, the insurer must obtain a licence in each provincial jurisdiction in which it intends to carry on business.

Forms of Insurance Entity

There are two main vehicles for establishing a federally regulated insurance business: (i) incorporation of a Canadian insurance company and (ii) qualification of a Canadian branch of a foreign insurance company. Insurers may also carry on business in Canada in other forms, such as a fraternal benefit society or a reciprocal exchange, and may be incorporated under the laws of a province. For simplicity, this article is restricted to insurers carrying on business in Canada as a company or a branch and whose primary regulator is OSFI.

The information requirements and timing for incorporation of a Canadian company and establishment of a Canadian branch are quite similar. Both involve an extensive application to OSFI. Since a branch is not a separate legal entity from the foreign insurer, one of the main differences between the two vehicles from a legal perspective is that a Canadian insurance company requires a board of directors and mandatory board committees. This is because the federal legislation and guidelines issued by OSFI including, among others, the OSFI Corporate Governance guideline, contain comprehensive requirements for board and committee membership and oversight. Although a branch operation does not have a board of directors in Canada, OSFI requires the Chief Agent of a branch to fulfill many of the governance and risk oversight functions required of a board of a Canadian company. Despite the legal distinction between a company and a branch, from an accounting perspective (e.g. financial, tax and regulatory reporting), the branch is treated as a separate entity from the foreign company.

There are a number of insurers that have been incorporated under the laws of a Canadian province. However, most of the largest insurance companies in Canada are federally-incorporated and many insurers that were originally incorporated provincially have migrated into federal jurisdiction where the legislation is comparatively modern and solvency regulation is more robust. At least one provincial insurance regulator has considered imposing a moratorium on the incorporation of insurers under its provincial laws, and requiring existing insurers incorporated in that province (other than reciprocal exchanges and farm mutuals) to transfer to federal jurisdiction or another jurisdiction where the insurer is subject to supervision that meets the solvency standards set by the International Association of Insurance Supervisors (IAIS).

> **In a recent FSMA Communication regarding the consequences of Brexit on the provision of investment services and performance of investment activities, the FSMA invites the companies concerned to proceed very carefully with their analysis.**

Focus of OSFI Review – Business Plan

If an applicant wishes to incorporate a Canadian insurer federally, or establish a Canadian branch, the focus of much of OSFI's review will centre on the proposed business plan that is submitted with the application, including the financial projections and actuarial calculations. The business plan must be comprehensive and include, among other things, descriptions of the proposed activities (by line of business), a complete market analysis, identification of sources of capital as well as pro forma financial statements and solvency ratio calculations, in each case for three years following start up. The business plan is to be stress tested for the three year period. OSFI, including its actuarial staff, will probe and assess the business plan, including the actuarial calculations and stress testing.

Although the federal legislation requires a minimum initial paid-in capital of Cdn $5 million for an incorporation, the amount of initial capital that OSFI ultimately will require in the case of both an incorporation and a branch qualification will be determined based on the business plan's contents, stress testing and OSFI's own assessment. As set out in OSFI's guidance documentation, OSFI generally expects a company and a branch to maintain minimum solvency ratios throughout each of the first three years of operation. The minimum expectations for companies are:

- a Minimum Capital Test (MCT) of 300% for a property and casualty corporation, and
- a Life Insurance Capital Adequacy Test (LICAT) of 150% for a life corporation.

For branches, the minimum expectations are:

- a Branch Adequacy of Assets Test (BAAT) of 300% for a property & casualty branch, and
- a Life Insurance Margin Test (LIMAT) of 150% for a life branch.

It is important to note that it is OSFI's expectation that the initial paid-in capital (for incorporation) or initial assets vested in trust (for a branch) will be sufficient, on "day one", to maintain the minimum solvency ratios throughout the first three years.

Restrictions and Prohibitions

The company or branch will be authorised to conduct life or non-life business only – i.e. one or the other. No new dual-licensed or "composite" companies are permitted in Canada. Any conditions or limitations will be stipulated in the order issued by OSFI (e.g. "restricted to the business of reinsurance"). Generally speaking, governments, political subdivisions of governments, government agencies and government-controlled entities – other than qualifying foreign institutions – are not permitted to incorporate an insurance subsidiary in Canada.

Summary Information for Federal Applications – Incorporation and Branch

The following chart contains a summary of the processes and requirements to incorporate a Canadian insurer federally and qualify a Canadian branch, based on OSFI's guidance and instructions issued to date.

	Incorporation	Branch
Application Timeframes	Approximately 12 to 18 months	Approximately 12 to 18 months
Application Form	Letters Patent; and Order to Commence and Carry on Business	Order approving the Insuring in Canada of Risks by a foreign entity
Minimum OSFI Fees	Cdn. $32,000	Cdn. $32,000
Estimated government fees for provincial licenses[1]	Cdn. $65,000	Cdn. $65,000
Minimum capital	Statutory: Company to have a minimum of Cdn. $5 million paid-in capital (or such greater amount specified by the Minister, e.g. based on the proposed business plan) OSFI Guidance: Company to be initially capitalised such that it can maintain a minimum regulatory solvency ratio (MCT of at least 300% for property and casualty and LICAT of at least 150% for life) for the first three years of operation	Life: Applicant corporate group to have consolidated assets of Cdn. $1 billion; capital and surplus of 5%-10% of liabilities Non-life: Applicant corporate group to have consolidated assets of Cdn. $200 million; capital and surplus of 20% of assets OSFI Guidance: Branch to vest and maintain in trust account under the control of OSFI sufficient initial assets to permit the branch to maintain a minimum regulatory solvency ratio (BAAT of at least 300% for property and casualty and LIMAT of at least 150% for life) for the first three years of operation
Information Requirements	Regulatory information for applicant (details of ownership and financial strength; regulation in applicant's jurisdiction, etc.) Financial information (financial statements for applicant, comprehensive business plan for the company – pro forma financial statements and solvency test calculations – planned reinsurance arrangements Criminal background checks for principals and senior officers Copies of governance, risk management and compliance policies and procedures to be submitted	Regulatory information for applicant (details of ownership and financial strength; regulation in applicant's jurisdiction, etc.) Financial information (financial statements for applicant, comprehensive business plan for the branch – pro forma financial statements and solvency test calculations – planned reinsurance arrangements Criminal background checks for Chief Agent and senior employees Copies of governance, risk management and compliance policies and procedures to be submitted

	Incorporation	Branch
Entity Infrastructure/ Advisors	Board of directors and statutory and regulatory governance committees Management – "Oversight Functions"[2] Appointed Actuary Governance, risk management and compliance policies and procedures Information Technology External Auditor Peer Review Actuary	Chief Agent Management – "Oversight Functions"[2] Appointed Actuary Governance, risk management and compliance policies and procedures Information Technology External Auditor Peer Review Actuary
Other	Pre-notification publication requirements Name clearance "Support principle" acknowledgement by controlling shareholder "Letter of commitment" regarding notification of material changes to business plan Membership in industry compensation association OFSI on-site review of operations Reinsurance arrangements and any related OSFI approval and Reinsurance Security Agreement (for "unregistered reinsurance", if applicable)	Pre-notification publication requirements Name clearance "Letter of commitment" from senior officer of applicant regarding notification of material changes to business plan Membership in industry compensation association OFSI on-site review of operations Establish branch trust account and trust agreement with OSFI, applicant and custodian Reinsurance arrangements and any related OSFI approval and Reinsurance Security Agreement (for "unregistered reinsurance", if applicable)

1. Assumes licenses are obtained in all provinces.

2. Finance, Actuarial, Risk Management, Compliance and Internal Audit.

Provincial Licensing

Once qualified as a federal insurance company or branch, the insurer will be required to obtain a license in each province in which it intends to carry on business. Generally, to attract licensing requirements, the provincial legislation contemplates that the insurer will have some kind of presence and/or carry on some insuring activities in the province. However, at the time of preparation of this paper at least three provinces require licensing if the risk (e.g. person or property) or peril is located in the province. Although the legislation of each of the 13 provincial jurisdictions varies, the Canadian Council of Insurance Regulators (CCIR)[3] has put together a standardised application form which can be used for applying for a license in all 13 jurisdictions. Although the CCIR form is standardised, each jurisdiction will conduct its own evaluation of the application and may require additional information and documentation. The depth of provincial review and analysis can vary widely. Accordingly, timeframes for issuance of provincial licenses also varies (roughly ranging from one month to six or more) and many provinces will not entertain the insurer's application until after the OSFI qualification process has been completed.

Compliance with other Statutes

If there is a foreign bank in the applicant's corporate group, there are restrictions under the Bank Act (Canada) with respect to having a financial establishment in Canada, such that the provisions contained in that statute may have to be reviewed for compliance. Where the applicant is not Canadian, the establishment of a new Canadian insurance business may require a notification filing under the Investment Canada Act.

Note that OSFI has the authority to consider other criteria and to request additional informational requirements, so the requirements provided herein may not be exhaustive.

Carol Lyons is co-chair of McMillan's Financial Services Regulatory Group. She advises clients on a variety of corporate/commercial matters, including mergers and acquisitions, corporate reorganisations, contract procurement, and formation of strategic alliances. Carol specialises in working with clients in the insurance industry and her practice includes assisting insurers and reinsurers with transactions and regulatory matters. Carol is Chair and sits on various Committees of a leading Canadian reinsurance company that is a subsidiary of a multi-national reinsurer, past Corporate Secretary of two Canadian property and casualty companies, Advisory Board Member and Audit Committee Member of an Ontario insurance reciprocal, and participates on various charitable boards.

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