Cassels

OSFI Capital and Regulatory Reporting Update

April 14, 2020

In light of the operational and financial impact of COVID-19 on federally regulated financial institutions (FRFIs), the Office of the Superintendent of Financial Institutions (OSFI) announced new measures on April 9, 2020 relating to capital adequacy requirements and reporting requirements. The measures are largely intended to support the operational and financial resilience of FRFIs impacted by the economic disruption caused by the outbreak. Many of the most important new measures are applicable only to banks and other deposit-taking institutions. This article will focus on the measures that are applicable to federally regulated property and casualty insurers and life insurers (collectively, "insurers").

Changes Applicable to All FRFIs

OSFI expects FRFIs to be proactive in addressing any operational or liquidity issues arising from the COVID-19 pandemic with its lead supervisor. OSFI has reiterated that it is prepared to be flexible with FRFIs that require additional time to meet upcoming deadlines for filing regulatory returns due to operational challenges. However, OSFI has been clear that any extensions must be discussed with the FRFI's lead supervisor as soon as the FRFI becomes aware that it may encounter difficulty with meeting any deadlines. Generally, any late filings will attract a Notice of Violation for a Late & Erroneous Filing Penalty, subject to the circumstances and any representations provided by the FRFI for OSFI's consideration. Requests for extensions to deadlines will be assessed on a case-by-case basis. If an extension is granted, a Notice of Violation will not be applicable so long as the return is filed on or before the revised due date. Returns with statutory due dates will not be granted extensions. For example, the auditor's report on the Branch Adequacy of Assets Test for foreign P&C insurers is required to be filed no later than May 31 pursuant to the *Insurance Companies Act* (Canada).

OSFI also provided clarity on the timing for implementation of changes to regulatory returns. No changes are planned for the financial returns of insurers until the implementation of IFRS-17.

Changes Applicable to Insurers

Capital Treatment of Deferred Payments

OSFI has announced changes to improve the capital treatment of payment deferrals granted by insurers due to the COVID-19 outbreak for insurance premiums and mortgages, leases and other loans. Overall, the measures encourage insurers to accept requests for payment deferrals by without higher capital charges being levied against them.

Where an insurer grants a payment deferral for loans and leases due to the impact of COVID-19, such loans and leases will continue to be treated as performing assets under the Life Insurance Capital Adequacy Test (LICAT) guideline and will not be subject to a higher credit risk factor that would be attributable to impaired and restructured assets. Where a P&C insurer approves deferred insurance premium payments for similar reasons, the related assets will not be subject to higher credit risk factors under the MCT. The MCT provides that receivables outstanding for less than 60 days from agents, brokers and other parties, including premiums, are subject to a credit risk factor of 5%. The credit risk factor increases to 10% for receivables that are outstanding for more than 60 days. Based on OSFI's announcement, the risk factor attributable to a deferred premium payment may be calculated based on the deferred payment date.

The capital treatment described above will remain in place for the duration of the payment deferral, to a maximum of six months. Any additional reporting requirements triggered by this change in capital treatment will be communicated by OSFI in the coming weeks. OSFI expects insurers to continue assessing borrower credit quality or the ability of the parties to make contractual payments, as the case may be, and to follow sound risk management practices.

OSFI has confirmed that it does not intend to lower the LICAT, Minimum Capital Test (MCT) or the Mortgage Insurer Capital Adequacy Test ratios, nor does OSFI plan to adjust any of the capital tests at this time. For example, the MCT minimum ratio will remain at 150%.

LICAT – Interest Rate Risk Requirements for Par Products

As the public consultation of the LICAT is on hold, OSFI advised that life insurers may determine interest rate risk requirements for participating products at Q1 2020 using either the current LICAT requirements or rolling averages. The "rolling average" refers to the average of the current requirement for the block and the requirements over the five previous quarters. The rolling average approach will become mandatory for participating products in Q2 2020.

Market Conduct Issues

A number of significant market conduct issues have occurred for insurers as a result of COVID-19. These issues include whether business interruption coverage will be applicable, grace periods for policy cancellation and non-renewal, premium deferrals and mandated rate reductions. OSFI has declined to comment on these issues and has reiterated that it is a prudential and solvency regulator. OSFI has confirmed that these types of issues are clearly under the jurisdiction of provincial insurance regulators.
Communication With the Insurance Industry

Prior to announcing the new measures outlined above, OSFI hosted an unprecedented call on April 8, 2020 which was attended by at least one representative of every insurer regulated by OSFI. OSFI wanted to provide advance notice about the new measures, solicit questions about them and obtain real-time feedback from the insurance industry. During the call, OSFI conducted live-polling online to obtain instant feedback from the representatives participating in the call on several issues. Two of the most important issues OSFI raised were how long the delay should be until OSFI started to require IFRS-17 implementation updates and when OSFI should resume the consultation process for the proposals in the Reinsurance Discussion Paper. According to the polling, the consensus of the insurance industry participants on the call was that the process for all regulatory change filings and the reinsurance consultation should be deferred until April 1, 2021. OSFI indicated that this date appeared to be reasonable but did not formally commit to it.

OSFI has just established an important new way of communicating with the insurance industry in real-time. It appears that OSFI has realized the deficiencies of relying on a process of issuing a discussion paper for consultation and then waiting a number of months for feedback from the industry. OSFI's new approach appears to work well and may be equally effective when things normalize as it is during the current period of crisis. OSFI stated that it intended to have similar update calls on a regular basis with the insurance industry going forward and took a poll during the call on the desired frequency of future update calls. The consensus of participants on the call was that a subsequent call in a month would be appropriate. OSFI agreed with this timing. Similar calls will likely occur at least monthly for the duration of the COVID-19 crisis.

Conclusion

Insurers can expect to continue receiving more frequent than normal requests for information from OSFI regarding their operational resilience and approach to capital management during the COVID-19 pandemic. As new developments arise, we expect that OSFI will continue to quickly refine and evolve its expectations for how insurers operate during a period of crisis.

Governments at both the federal and provincial level have recognized that banking and insurance are essential services. OSFI has indicated that it believes that banks and insurers operating in Canada are well-capitalized and resilient. It appears that OSFI's current view is that the best approach is to encourage banks and insurers to be as conservative as possible while still being able to serve their customers as effectively as possible. OSFI's announcements to date signal that OSFI does not wish to burden FRFIs with new waves of capital requirements or regulations. Hopefully OSFI will continue to maintain this approach for the duration of the COVID-19 crisis.
