FINANCIAL REVIEW COMMITTEE
FINANCIAL EXAMINATION COMMITTEE

September 14, 2022

To: Financial Services Regulatory Authority

From: OMIA – Financial Examination Committee

Subject: FSRA – Insurance Prudential Supervisory Framework (IPSF)

Summary

The IPSF document is comprehensive in overview, but limited in detail regarding how the individual Ontario property and casualty insurers will be supervised/ regulated.

Risk Definition

FSRA's sets out how it will assess risk, with emphasis on dynamic, proactive, adaptable and comprehensive. What resources will be used to assess risk? How will this assessment and process be shared with the Ontario insurers? What input would be expected from individual companies themselves, reinsurers, industry associations, etc.?

In terms of the Relationship Manager, how many companies would be under the purview of the RM? Would the same RM be responsible for all the Ontario farm mutuals?

Insurance prudential supervisory framework overview

It is mentioned in the Risk assessment process that "a common approach to risk assessment across insurers and over time" would be used. In this section, FSRA references "inherent risk" which is intrinsic to a business and is evaluated before any mitigation. Does this mean that, for example, all insurers in Ontario who transact Automobile business would have the same "inherent risk"? What would be the business activities – for example, with automobile, would it be subdivided into commercial, personal, etc. for larger insurers but not for the smaller ones?

Financial inherent risks

There are three identified, which are specifically set out in OSFI's Minimum Capital Test. How are each of these elements to be assessed? Is there any relationship to the MCT? Operational risk is identified as non-financial. What are the major classifications of risk within these major categories? Would the proportion of MCT capital required to total capital be part of the risk assessment?

Oversight functions

Some of the oversight functions, e.g., Internal audit, would not be feasible as a separate function for a small sized insurance company. Ontario insurers, not only the FMGF members, tend to be small and thus many of them would not have this resource. Within smaller companies, different managers, etc. would be responsible for more than one function, as would the various Board members. How would the various oversight functions required by FSRA be adapted to smaller companies?

Capital and Earnings, Liquidity and Resilience

FSRA will be assessing the capital adequacy of an insurer on a "forward looking time frame". Will FSRA provide insurers with details on its forward-looking assessment as well as how FSRA expects ESG risks to affect capital? Environmental risks in terms of weather-related risks have been long recognized by the insurance industry. What role can FSRA be expected to play in identifying ESG factors and risk research in their own forward assessment work? It is important that FSRA create transparency and consistency on the work FSRA will be doing in this process.

For Liquidity, insurance companies normally have sufficient cash flows from investments and premiums to cover claims and operational costs. How does FSRA expect exposure to ESG risks to affect liquidity of insurance companies? What are the quantitative and qualitative measures that FSRA is using in the assessment of liquidity adequacy? Would FSRA share these measures with the companies?

In terms of Resilience, FMGF members have established their ORSA levels, with actual capital levels that exceed ORSA by a wide margin. For the Recovery Plan, Business continuity Plan and Disaster Recovery Plan, does FSRA have specific criteria that must be met /included in these plans to meet FSRA' assessment of resilience?

Supervisory Process

Would FSRA at this time share with the FEC the supervisory stage that is being used to assess individual companies? As this is a key document, it would be beneficial if the FEC and member companies could obtain details as soon as possible.

In executing the supervisory work, FSRA indicates that it would consider the performance of a company to "its peers". Has FSRA established criteria for how it would set the peers say for a mid sized FMGF member? Are there different groups of peers for the mutuals? Are they included with stock companies?

The Supervisory work appears to be very intensive and thus it would be beneficial if FSRA could provide an implementation timeline or an annual calendar on supervisory activities for the FMGF members. Does FSRA have a schedule that it could share with the individual companies?

We also believe that it would be very beneficial for FSRA to share its information gathering with the insurers on the emerging issues, both insurer specific and sector -wide. The more information that FSRA provides to the companies supervised, the better prepared the companies will be to address and respond to FSRA's concerns.

All of the foregoing information would be in addition to the Supervisory Letters that are specific to individual companies.

Intervention Level

This subject presents the most concerns to the FEC as it sets out a level of intervention in the operations of companies that are deemed by FSRA to be a level that may not warrant such action.

Risk Rating – ORR Levels

In earlier meetings, FSRA has stated that there must be a group of high-risk companies within the FMGF members. The officials were adamant that within any group, some companies had to be classified as high risk. This appears to take a relative approach rather than an absolute one to risk assessment.

In the categories for ORR rating, to be consider "Low" a company must have consistently performed well, and most key indicators are better than sector averages. In the P&C industry, a company could experience worse than average claims in a particular period and still be low risk. The consistency criteria that FSRA has set is not realistic. Does FSRA plan to categorize a certain precent/ number of companies in each of the categories?

The Intervention steps are very extensive, and it is crucial that we have a full understanding of how the risk levels are first assigned. The steps companies will be required to take are onerous and not necessarily beneficial. FSRA sets out the improvement plan that is to rectify or address FSRA's identified concerns. When a company experiences financial difficulties, it will implement, when necessary, corrective steps that address the reasons for the losses. In many instances, if the losses arose from inadequate rates/ rapid growth, it could take several years for the actions to be effective. During this time, would FSRA maintain the company at level 2 or even higher?

Appeal Process

There is no mention in the document of the appeal process that will be established to allow individual companies, or groups of companies to challenge the assessments completed by FSRA nor the proposed actions being taken / imposed on the companies. Such a process should be set out and detailed.

Fire Mutual Guarantee Fund

As you are aware, the Ontario farm mutuals are members of the FMGF. They are also members of Farm Mutual Re and the Ontario Mutual Insurance Association.

In the document, there is no mention of any of these organizations, nor the Financial Examination Committee. Will there be further work or documentation that captures the specifics structures, processes, and responsibilities that are unique to FMGF solvency regime?

At the outset of the document, mention was made of protecting policyholders from financial loss. In the FMGF, policyholders would be fully covered for any unearned premiums or outstanding losses for any failed member of the FMGF. The stress test analysis provided to FSRA demonstrates the strength of the system. The Supervisory Framework established by FSRA must recognize this unique structure.

Conclusion

We look forward to receiving more details on the approach FSRA will be taking to supervise the member companies of the FMGF.

Regards
Catherine MacLellan, Rick Walters, Bob Nielson. Jeff Wickware