Market access and trade barriers faced by European insurers and reinsurers in foreign jurisdictions

CANADA

The review of the Canadian regulatory framework includes several potential threats to foreign/European reinsurers that conduct business on a cross-border basis. Insurance Europe is also concerned that the review will increase Canada's protection gap, as reinsurance capacity will significantly reduce and insurance prices will have to rise.

Existing legislation and recent developments

Currently, reinsurance is permitted on a cross-border basis. However, there was a collateral requirement, which used to be 115% (of ceded policy liabilities plus receivables from the assuming insurer minus the amount of payables to the assuming insurer, and was increased to 120% for policies as of 1 January 2020.

In June 2018, the Canadian regulator — the Office of the Superintendent of Financial Institutions (OSFI) — launched the review of the reinsurance framework, with the publication of a discussion paper. It suggested proposals that could threaten the operations of foreign reinsurers. One of the proposals would create an unlevel playing field between non-registered reinsurance (ie, business written on a cross-border basis) and registered reinsurance (ie, business written by a branch), in favour of registered reinsurance. Furthermore, the proposed framework would lead to additional restrictions and/or increased capital charges on policy limits, significant quota shares, fronting arrangements and a prohibition on ceding reinsurance from branch to parent via an unregistered affiliate. It would also tighten requirements for reinsurance security arrangements and transactions with affiliates. These reforms focus mainly on property and casualty (P&C) business — some additional life and health capital requirements are already in place.

The proposed policy changes are to be implemented in phases. Phase 1 was effective at the beginning of 2019, Phase 2 is expected to come into force in 2021 and no timing is yet available for Phase 3. According to an OSFI newsletter of August 2020, OSFI expects to complete the reinsurance review in mid-2021.

After significant industry feedback, OSFI opened a public consultation on reinsurance risk management, with a draft revised guideline, "B-3, Sound Reinsurance Practices and Procedures". This draft still included a prohibition on ceding reinsurance from a branch to the parent via an unregistered affiliate.

In March 2021, OSFI also opened for consultation a draft revised guideline, "B-2, Property and Casualty Large Insurance Exposures and Investment Concentration", requiring registered P&C insurers to be able to cover the maximum loss related to a single insurance exposure (as opposed to three of its largest policy limit losses) on any policy it issues, assuming the default of its largest unregistered reinsurer on that exposure. Insurance Europe's Reinsurance Advisory Board contributed to this public consultation and raised concerns on a number of issues (see the contribution here).

Impact on foreign reinsurers

The proposed reform creates barriers to foreign/European reinsurers doing business on a cross-border basis and would impact the business models of major international insurance and reinsurance players. Registered (re)insurers would need to obtain additional capital or secure collateral in Canada from unregistered reinsurance counterparties. It is also likely that limits on certain business lines would need to be reduced.

Insurance Europe considers that the proposals would constitute market access barriers, including the introduction of a reinsurance concentration limit for retrocession contracts, as well as limitations on high-risk exposure policies to be ceded to a reinsurer. The target of overseeing the default counterparty risk should not result in regulations that eliminate vital reinsurance diversification and free access to cross-border reinsurance.

The impact of the proposed B-2 Guideline would be to concentrate reinsurance purchasing in the hands of a relatively small number of registered reinsurers in Canada (effectively eliminating access to unregistered reinsurance capacity) thereby driving the cost of reinsurance significantly higher.

Cedants will have no option but to pass on the burden of higher reinsurance costs to Canadian policyholders. Some Canadian businesses will not be able to purchase the coverage they need, and this will increase the insurance gap. If the Canadian (re)insurance market shrinks, this will have negative implications for premium taxes and HST (a local form of value-added tax).

If implemented, these proposals are likely to created inintended consequences that may adversely impact the Canadian insurance market and effectively reduce its reinsurance capacity. The functioning of insurance markets relies on the global nature of reinsurance and the ability of writers of large coverages to pool these risks effectively with other risks diversified by geography, line of business, etc. While OSFI may view the acquisition by Canadian cedants of registered reinsurance to be preferable, it ignores the benefits of reinsurer counterparty diversification. The impact of Guideline B-2, if implemented, will be the concentration of reinsurance counterparty credit risk.

Recommendations and preferred outcomes

Insurance Europe believes that the proposed reform does not adequately take into account how the global reinsurance market operates.

This development is clearly not in line with the spirit of the Canada-EU free trade agreement, although the agreement does stipulate that a local regulator can apply separate rules, which is what OSFI is doing. It is unclear whether the proposal is in line with the WTO's General Agreement on Trade in Services (GATS).