Regulatory Update - CAFII Executive Operations Committee, February 14, 2014

Prepared By Brendan Wycks, CAFII Executive Director

Executive Summary of this Issue

Alberta

Follow-up Alberta Insurance Council Presentation On Canadian Insurance Participant Registry (CIPR)

On January 8, Tom Hampton, Chief Operating Officer, and Robin Thompson, Director of Information & Business Services, with the Alberta Insurance Council gave a demo presentation of the beta test version of the new *Canadian Insurance Participant Registry* (CIPR) to a group of CAFII members at TD Insurance in Toronto.

Given interest in CIPR from a number of CAFII members who were unable to attend the January 8 session, Robin Thompson agreed to Brendan Wycks' request that he repeat his presentation in an electronic, online format, in the near future. **CAFII is now in the process of organizing that follow-up presentation, which will be for both CAFII and CADRI members.**

The CIPR is designed to deal with all participants in the insurance industry; all will be issued a unique business identifier that will be their lone, lifetime identification number. Alberta already has a commitment from its LLQP education providers to use the unique CIPR identification number when communicating with licensees.

The CIPR is designed to be run "in the cloud"; it uses open source technology and modern development tools. AIC is currently the "host" of the system, but it has been designed to be handed off to an external host in due course.

CIPR is a back-end registration system which can facilitate a licensing system; but it is not a national licensing system in and of itself. The licensing process is still the responsibility of the individual provincial jurisdictions.

The CIPR addresses a need that CAFII has been advocating for years. If set up properly and adopted by other Canadian provinces, it can become a first step toward a national registration system. Tom and Robin advised that three or four other provinces, including New Brunswick, are working diligently to be able to join in on CIPR in the near future. They indicated that letters of encouragement from CAFII and other industry stakeholders have already been influential in prompting other jurisdictions to expedite their efforts to come on board.

Code of Conduct Review

The Alberta Insurance Council has announced that it is currently updating its Codes of Conduct for Life and Accident and Sickness agents, General agents, and Insurance Adjusters. The Council's web site invites feedback on the Draft Codes that have been developed to date, but no deadline has been stated for submissions. Executive Director Brendan Wycks has followed-up with a query to CEO Joanne Abram's Executive Assistant to find out the timelines for this consultation.

Meeting With CAFII On March 17, 2014

Alberta Insurance Council CEO Joanne Abram and Board Chair Ron Gilbertson have requested a meeting with CAFII Executive Director Brendan Wycks in Toronto on Monday, March 17. CAFII EOC members Moira Gill and John Lewsen will also attend the meeting.

While the topics or agenda for the meeting are not known at this time, the Council's 2013-15 Strategic Plan states an objective of ensuring that "Board decisions are shared with industry trade Associations and intermediaries and that industry issues and views are shared with the Board." And as well, "Senior Management will seek stakeholder comments and feedback on regulatory activities on an ongoing basis and report to the Board annually."

Saskatchewan

Commission Lists Requested To Ensure All Parties Transacting In Insurance Are Licensed

On January 14, the Insurance Councils of Saskatchewan issued a bulletin to insurers, agencies and adjusting firms related to its practice of requesting commission lists. It anticipates that this practice will increase in 2014 as it endeavours to ensure that business entities and/or individuals operating in the province are appropriately licensed.

Saskatchewan has identified numerous websites where businesses are soliciting insurance on behalf of an insurer, and receiving compensation for that solicitation, without holding an insurance licence. Websites that solicit insurance or which may have a mechanism for the consumer to obtain an insurance quote, or which may be linked to an insurer for the purpose, must be licensed. It is also not permissible for individuals who are not licensed to speak with Saskatchewan consumers about insurance and then refer them to a licensed individual to finalize a sale.

It is the insurer's responsibility to ensure that business entities and/or individuals are licensed in accordance with the Insurance Act before they accept insurance business from them.

Quebec

Update On Two-Page Distribution Guide

On January 14, in response to an e-mail from Brendan Wycks requesting a status update, Louise Gauthier, the AMF's Director, Distribution Practices and Self-Regulatory Organizations, advised that "due to other priorities, we have not had the chance to finalize the next iteration of the Guide. We should be able to do it during the next coming months. Please rest assured that you will be kept in the loop."

Federal/National

Canadian Council of Insurance Regulators

Discussion Paper On Options And Issues Re Compliance With International Supervision Standards

Now that the International Monetary Fund has released its assessment report on Canada's financial sector, CCIR has asked its Insurance Core Principles Implementation Committee to draft a discussion paper to outline the continuum of options available and issues to consider, to assist jurisdictions in deciding on their position regarding building and maintaining compliance with the international standards for insurance supervision expressed in the IAIS Insurance Core Principles.

CCIR Strategic Plan, 2014-17

As the term of CCIR's current strategic plan is coming to an end, the Council has begun work on its next three-year plan. CCIR has therefore issued a formal call for stakeholder input, and CAFII will be making a submission by the deadline of February 21, 2014 indicated by Carol Shevlin, Policy Manager.

Canadian Insurance Services Regulatory Organizations (CISRO)

One-on-One Stakeholder Group Meetings Re LLQP Modernization

On February 10, three CAFII representatives met with CISRO's LLQP Committee, chaired by Ron Fullan, for a one-on-one stakeholder group meeting about the LLQP modernization effort thus far. A separate Regulatory Visit Report on that meeting has been prepared by Brendan Wycks.

Office of the Superintendent of Financial Institutions (OSFI)

Superintendent Julie Dickson Addresses KPMG's Annual Insurance Issues Conference

On December 2, 2013, OSFI Superintendent Julie Dickson was interviewed by KPMG's National Insurance Leader Neil Parkinson in a 'fireside chat' format. Here is an excerpt from their conversation:

Neil Parkinson: Julie, last year I asked you if we would be able to sustain a made-in-Canada approach to financial services regulation. Over the past year, in particular with the Insurance Core Principles issued by the International Association of Insurance Supervisors (IAIS), there just seems to be an ever-increasing impact on what we do here in Canada, both federally and provincially. We still have a strong reputation for the quality of regulation and supervision internationally. But how do you think we're doing, and where do you think we need to go as an industry?

Julie Dickson: I think we are doing well. We were subject this year to an IMF Financial Sector Assessment Program (FSAP). The assessors were on site in June and again in September. Based on my discussions with the assessors, we will do well. And if there are opportunities for improvement noted, then we will address those. I think one reason why everyone is paying attention to the Core Principles is that they are new, and also because countries are being assessed against them. That's a part of Financial Stability Board (FSB) membership. You have to agree to be assessed on a regular basis by the IMF.

In terms of where the industry needs to go, you are the experts in terms of where you want to go as a business. From OSFI's perspective, understanding the speed of change is important. And the fact that the Financial Stability Board is looking over the shoulder of the insurance industry, I think things are going to happen a bit more quickly going forward than what the industry is used to. So, I would definitely focus on the speed of change.

Neil Parkinson: One issue about the Insurance Core Principles is very much related to market conduct, and I recognize of course that falls in the provincial sphere. But we've had some really massive compliance events in other countries. In the last year, the estimate I saw for the one in the UK in September was a total of 17 billion pounds for restitution and remediation costs, related to what we call the 'treating customer fairly' standard.

And that is very closely aligned with what is in the Insurance Core Principles. Do you see those global regulatory standards really shifting the emphasis more towards consumer protection issues going forward?

Julie Dickson: Well, it could be a combination of things. I think the Insurance Core Principles could be playing a role. But I also think that, as issues have been identified and made public, more people start to zero in on that area. And it's not only in the insurance area, of course. Market conduct in particular in the banking industry is a big issue. We can look at LIBOR manipulation, the 'Whale' (and most recently JP Morgan) and the issues with mortgage-backed securities and the mortgages that were feeding into those instruments, as well as that big settlement. I think this is an issue for regulators as well because these are eye-popping judgments. It really goes to the core of risk governance and what institutions are doing in that regard. Product approval processes, how you're selling your products, are critical. And we think that our focus on corporate governance and risk management certainly helps in that regard. We also think the risk culture work helps. And I know your next panel will cover that.

Neil Parkinson: Another thing, harkening back to last year, I was bemoaning how hard it was to make a buck on investments. And of course so are the insurers to this day. We still seem to be in a long period of low growth, uncertainty, and low investment returns and low interest rates generally. Do you think that the insurers have been able to adjust to protracted low investment returns?

Julie Dickson: We think Canada was pretty well situated. While there were a lot of complaints about the way our accounting standards worked, in effect they did force companies to recognize early the impact that low interest rates could have. We've seen a lot of re-pricing and a lot of strategic thinking by companies about where they want to go. So I think that they are well situated. We know that the Actuarial Standards Board (ASB) has also kicked into gear looking at some of the standards that were applicable. Some of those standards imposed a lot of costs on institutions due to the low interest rates. And the ASB will be coming out with some changes in that regard. But all-in-all, I think Canadian companies are very well situated now compared to others, in particular compared to the US insurance sector.

Neil Parkinson: I suppose they could react further, and here I'm thinking mostly of the life insurers, for example by increasingly shifting the risk of the investments back to the policy holder, with less implicit or explicit guarantees of investment returns. We sold a lot of participating product in this country and that's become less popular. There are places like France and Germany that have an awful lot of par type offerings for ordinary products. Do you think that is just good risk management, or does it give rise to another set of regulatory concerns about possible mis-selling, or over-selling the idea of what investment returns might be going forward?

Julie Dickson: Well, I think that a number of companies who had abandoned par policies are thinking about going back into par. But many companies had continued to sell par all along and are very familiar with the product. So for us, I think the bigger risk would be if companies start to get into completely different lines of business, where they don't have the controls and risk management that they need. Alternative investments could be one example. But par policies have been around for 200 years. A lot of experience still exists in that area. People have learned how important it is to get the risk transfer right, as well as the need to ensure that consumers know what they're buying. That risk has always been there, and always will be. But it is a risk that most companies have a pretty good feel for. So I think that, like anything, you have to be thinking about what you're doing. But for OSFI, it is more getting into other lines of business that would be a bigger deal.

Neil Parkinson: OSFI has also commented on the importance of internal audit, and you know, really supporting a whole range of control and oversight practices. And of course there are lots of smaller and mid-size entities who don't have internal audit, or they might be Canadian operations of foreign insurers that occasionally have a visit from the head office internal audit function. Do you think that the size of organizations which should have internal audit capabilities is dropping?

Julie Dickson: Well, our focus on internal audit now is really with respect to the large, complex financial institutions. That is where we need to be out there doing more cross-sector reviews and taking into account the fact that the bar has risen. If you look at guidance issued by the Basel Committee, as well as the risk governance review done by the FSB across the world last year, it's obvious that the bar has been rising in terms of what is expected of these internal audit functions. But that is focused mainly on the large, complex financial institutions. So in Canada, that would include the six domestic systemically important banks as well as the large life insurance companies, and we may add a few of the large P&C companies. But small institutions are not our current focus. We do recognize that, as you said, we've got a lot of very small institutions, and they will rely on the home office or on the parent for internal audit assistance. And we do look for effectiveness, but a small institution is clearly a very different animal than one of these large, complex institutions.

Neil Parkinson: One of my client CEOs is fond of observing that some of the more spectacular corporate failures on record have all had the apparent trappings of good risk management — Chief Risk Officers, risk committees and so on — and still manage to override them or ignore them anyway. Is risk culture sort of the secret sauce that makes risk management work?

Julie Dickson: Yes. We think it is. The person who talks about all these firms who had the right structure, those are characteristics, and we look at those, but it's all about effectiveness. So I would agree with whoever said that to you. Risk culture is extremely important, and the institutions we've been talking to are of the same view. We've begun discussions with major institutions about risk culture in their organizations. It is something that the boards in particular really want to talk about because directors come from a variety of different industries. They have different experiences, from different cultures, and I think they have a lot of really good observations on this front. And it's an area where they feel they can add a lot of value. They may not be experts in the industry, although we are seeing many more people on boards who understand the financial services industry. We're interested in culture because we have supervisory findings wherever we go that often go back to the culture within the organization. So this is becoming a big issue. An industry roundtable will be held in Amsterdam next week to discuss the FSB paper on this topic. We're looking for any comments that people have. So hopefully the next panel will come up with some feedback. You can give me a call on what you find.

Neil Parkinson: I sense they're hoping that you would help them answer questions they're going to deal with, but I suppose that's a bit like art. 'I don't know art, but I know what I like' sort of thing. Maybe the same thing would apply to risk, whether it's good or bad. Is there something that you recognize as being particularly effective, or examples of areas where you've got a dysfunctional risk culture?

Julie Dickson: It can be a challenge to tackle this issue. We focused on four general areas as being important, and we have some indicators under each. Things like tone from the top, and whether firms are actually taking any steps to try to figure out what the culture is, as opposed to assuming they know what it is. Because often it comes as a surprise, the kind of cultures that are evident in financial institutions. We're also focused on incentives. We're focused on effective challenge, and the kinds of challenge within an institution.

This is all about escalating problems and about challenging the CEO, for example. We're talking about accountability as well. Everybody has accountabilities within an institution, and if you see something and are not raising it, you are accountable for that.

We've tried to put a structure around it. Most of all, we've been very clear that this is something that supervisors have to pay a lot of attention to going forward, and that institutions need to pay attention to.

Neil Parkinson: A last question from me. I think I asked this last year. Since we're getting into the Christmas season, do you have a wish list for the industry?

Julie Dickson: Well, I usually don't ask for a lot for Christmas. But this year I'm going big. For the insurance industry, and the banking industry as well, we need to see the US economy pick up significantly because that will allow the Canadian economy to rotate more to export-driven growth as opposed to what we've seen —growth in household imbalances. That would also enable an increase in interest rates and an environment where you're seeing growth, which is a good thing. I'm going to also ask Santa for the US to fix its medium and long-term fiscal problems, and to do that with certainty and speed. That's a big one.

And on top of that, for the US to be able to exit the quantitative easing that they have employed without any major shocks or volatility. We saw what happened in May and June when they simply started talking about tapering. We saw the volatility and what that did to emerging markets. That emerging markets got through the episode may have actually comforted people, but it shouldn't. So that's on my list as well.

Turning to Europe, I'm going to ask Santa Claus for the European Central Bank to do a fantastic job on the asset quality review that they're about to embark on, and on the stress testing they are supposed to do before they take control of bank supervision a year from now. At this point, they haven't released their stress test. They haven't really released much detail. But I'm going to ask Santa to ensure that all works really well and nicely, so that things will be looking up for whoever is sitting here next year.

The full transcript of the fireside chat with Julie Dickson can be found here: http://www.osfi-bsif.gc.ca/Eng/osfi-bsif/med/sp-ds/Pages/jd20131202.aspx.

Financial Consumer Agency of Canada

FCAC Partners With Collaborators Around Consumer Financial Literacy

FCAC has posted information on its website about how it will work with businesses in the financial services industry and with other organizations on Consumer Financial Literacy initiatives. FCAC calls such partner organizations "collaborators." Becoming an FCAC Collaborator is an opportunity worthy of exploration by CAFII.

How FCAC Works With its Collaborators

Cooperating with business and community groups on initiatives that help Canadians make sense of the financial world is vital for FCAC to achieve its mandate. Collaboration has allowed us to bring innovative programs to more Canadians than we could alone.

If you know of an organization or program that would benefit from FCAC's materials, please contact us at 866-461-FCAC (3222) or email outreach@fcac.gc.ca.

Become an FCAC Collaborator

The Financial Consumer Agency of Canada has a wide range of collaborators, including government departments and agencies, community-based organizations and consumer groups, that help us provide information to Canadians.

Our goal is to continue to strengthen and expand relationships with a broad range of collaborators in the public, private and not-for-profit sectors.

We evaluate all potential collaborators according to their fit with FCAC's mandate. The criteria include:

- access and/or influence with large numbers of FCAC's target audiences
- established relationships with FCAC's target audiences
- active involvement with target audiences (i.e., one of your primary business audiences is one of FCAC's target audiences)
- established and timely communications vehicles to reach FCAC's target audiences. If you know of an organization or program that would benefit from FCAC's materials, please contact us at 866-461-FCAC(3222) or email outreach@fcac.gc.ca

International/Global

International Monetary Fund (IMF)

IMF Releases Financial System Stability Assessment Report On Canada

On January 29, the IMF released its Country Report titled Canada: Financial System Stability Assessment (FSSA) Update. This is a comprehensive assessment report on Canada's financial sector, the research for which included IMF assessor visits to the AMF in Quebec and FSCO in Ontario. Very little in the report is commentary directly on the business of insurance; in fact, less than three pages of the 70 page report address insurance.

The FSSA Update found that Canada's financial system successfully navigated the global financial crisis, and stress tests suggest that major Canadian financial institutions (banks and insurance companies) are resilient to credit, liquidity, and contagion risks arising from a severe stress scenario. Elevated house prices and high household debt remain an area of concern (despite the substantial level of government-guaranteed mortgage insurance), though targeted prudential and macro-prudential measures are proving to be effective. The regulatory and supervisory framework demonstrates strong compliance with international standards.

Nevertheless, the Update called for more clarity around the legal independence of OSFI and for assigning stronger prudential responsibilities to this regulator.

In the securities markets, provincial regulators and the federal government have made significant progress in implementing a robust and harmonized framework, but challenges remain in enforcement, risk identification, and timely policy making.

The FSSA Update argues that the federal system of safety nets is credible, although there is no single body with an explicit mandate to take a comprehensive view of systemic risks or to undertake crisis preparedness. Improving cooperation between federal and provincial authorities would further reinforce system-wide oversight arrangements.

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities.

The full Country Report on Canada, in which the main insurance industry-related content is on pages 23-24, can be found here: http://www.imf.org/external/pubs/ft/scr/2014/cr1427.pdf.