

July 5, 2013
File No.: 13-0505
Ref. No.: 78000-00

To: British Columbia Incorporated Property and Casualty (P&C) Insurers

Re: Adoption of a Revised Minimum Capital Test (MCT) and Capital Regime

On May 24, 2013, the federal Office of the Superintendent of Financial Institutions (OSFI) issued a discussion paper setting out proposed changes to the capital tests used by P&C insurers: the Minimum Capital Test (MCT) for Canadian insurers and the Branch Adequacy of Assets Test (BAAT) for Canadian branches of foreign insurers¹. Since the MCT is established by the *Financial Institutions Act*² as the test British Columbia P&C insurers must use to determine capital adequacy, the changes proposed by OSFI will have a direct impact.

Attached is the OSFI discussion paper outlining these changes: *Discussion Paper on OSFI's Proposed Changes to the Regulatory Capital Framework for Federally Regulated Property and Casualty Insurers*.

FICOM wishes to understand the impact of the proposed changes on British Columbia P&C insurers. Each BC P&C insurer is asked to complete the attached quantitative impact study (QIS) (instructions are also attached) and return it to this office by no later than **August 9, 2013**. Comments on the proposed changes are also encouraged. The QIS results and all comments on the discussion paper will be kept confidential but will inform any feedback provided to OSFI with regards to the potential ramifications, impact, and/or issues of the proposed changes.

This paper and the QIS study are only a part of the discussion regarding the MCT. FICOM continues to work with OSFI, the Autorité des marchés financiers (AMF) and industry stakeholders to consider how earthquake risk should be incorporated into the MCT capital formula. That work, as well as feedback from the proposed changes outlined in the discussion paper, will inform a draft revised MCT guideline and a QIS which will be released for consultation before year end. A final MCT Guideline is expected to be published in Summer 2014, to take effect on January 1, 2015.

¹ As the BAAT only applies to foreign insurers, any references to it in the OSFI discussion paper can be ignored.

² Under section 67(1) of the FIA a FI must have at all times an adequate capital base in accordance with the regulations. Under section 8 of the Capital Requirements Regulation the capital base amount is determined in accordance with the MCT guidelines established and published by OSFI.

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- Superintendent of Financial Institutions
 - Superintendent of Pensions
 - Superintendent of Real Estate
 - Registrar of Mortgage Brokers

Suite 2800, Box 12116
555 West Hastings
Vancouver, BC V6B 4N6
Telephone: 604 660-3555
Facsimile: 604 660-3365
www.fic.gov.bc.ca

Insurers may find that they are not currently capturing some of the data required for the QIS. Where insurers identify a data issue, steps should be taken to actively address the matter in preparation for the implementation of the new guideline in 2014. They should also complete the QIS as best as possible using existing data and report any data gaps to FICOM with the filing.

Some highlights of the proposed changes to the MCT are:

- the test is being modified to calculate capital requirements at a set target level (intended to be set using a Conditional Tail Expectation at a 99.0% confidence level). The target level will then be divided by 1.5 to determine the minimum amount of capital held. This is the reverse of the current approach which is to calculate the minimum level first and then multiply it by 1.5 (or 150%);
- the composition of capital components, risk factor weightings and what qualifies as eligible capital are changed;
- more granularity is being added to certain risk weightings;
- more risk factors are being assessed including enhancements to credit risk, premium and policy liability risk and off-balance sheet exposures;
- a new explicit risk charge for Operational Risk is added;
- recognition that an aggregate benefit can arise from diversification of risk insurance risk and credit and market risk; and
- the calculation for the margin required for reinsurance ceded to unregistered reinsurers is changed.

While the calculation will change, insurers will still be expected to have at all times capital that is at least at a margin of 150 per cent of the MCT and should be striving to maintain capital at their internal target level which is determined based on the insurers assessment of risks to capital.

For more information on MCT, please visit the [OSFI website](#).

The time and support you provide in this matter is appreciated. Completed studies and any comments are to be submitted to Insurance@ficombc.ca

If you have any questions, please do not hesitate to contact either your FICOM Relationship Manager directly or email me at Frank.Chong@ficombc.ca.

Yours truly,



Frank Chong
Executive Director, Supervisory Support
and Policy