



Office of the Superintendent of
Financial Institutions Canada

Bureau du surintendant des
institutions financières Canada

Risk Management in Canadian Life Insurance Companies

Allan Brender
Senior Director, Actuarial Division

September 14, 2005



OSFI
BSIF

Canada 

Risk Management in Canadian Life Insurance Companies

- **A new phenomenon with a lengthy history**
- **Similar to RM for banks, but also quite different**
- **Regulatory influence on development**
- **Rapidly developing**

Regulatory Interest in RM

OSFI Act

4 (2) The objects of the Office, in respect of financial institutions, are

(c) to promote the adoption by management and boards of directors of financial institutions of policies and procedures designed to control and manage risk

Regulatory Interest in RM

Capital requirements are a primary regulatory tool

- CAR for banks
- MCCSR for life insurance companies
- MCT for P&C insurance companies

They are risk-based

- CAR primarily concerns asset risk, relatively little risk discrimination
- Basel II increases discrimination, extends to op risk
- MCCSR, MCT deal with a wider diversity of risks

Interaction of Capital and RM

- **Risk management is the first line of defence for a financial institution**
 - Prevent trouble from happening
- **Capital requirements are a second line of defence**
 - The ability to pay for trouble if it happens
- **Use of advanced or company-specific requirements is only acceptable in the presence of solid risk management practices**

Regulatory Interest in RM

- **Supervisors have limited resources**
 - Focus them where they are most needed
- **Risk-based supervision**
 - Assess the net risk in a financial institution
- **Concentrate supervision on companies and areas of greatest net risk**
- **This approach is described in OSFI's *Supervisory Framework***

Everything old is new again!

The actuarial function in insurance companies included risk management activities before RM emerged

- Valuation of liabilities
- Risk-based capital requirements
- Dynamic Capital Adequacy Testing (DCAT)
- Whistle blowing

Valuation of Liabilities

- **Each assumption is the combination of a “best estimate” and a margin for adverse deviations**
- **Professional guidance links the size of the margin to the uncertainty or risk in the underlying estimate**
- **Under the Canadian Asset Liability Method (CALM) the valuation is linked to the degree of asset/liability matching in the company**

Risk-based Capital

- **MCCSR covers a variety of risks**
 - Credit
 - Mortality, morbidity
 - Interest rates, reinvestment
 - Policyholder behaviour
 - ALM
 - Operational risk
- **Actuarial responsibility for MCCSR**
 - Appointed actuary must sign the return
 - Formal actuarial opinion to be required

Dynamic Capital Adequacy Testing

- **Project company operations over at least five future years and assess the resulting financial position**
- **Multiple projections based upon a variety of (adverse) scenarios**
- **May build in effects of remedial actions**

Dynamic Capital Adequacy Testing

- **Financial Condition Report based upon DCAT must be presented to the company's board by the actuary**
- **Copies to OSFI or l'AMF, CompCorp, auditors**
- **Reports are confidential**
 - Few are in a position to assess the quality and effectiveness of reports

Whistle Blowing

Insurance Companies Act

369 (1) *The actuary of a company shall report in writing to the chief executive officer and chief financial officer of the company any matters that have come to the actuary's attention in the course of carrying out the actuary's duties and that in the actuary's opinion have material adverse effects on the financial condition of the company and require rectification.*

Whistle Blowing

Insurance Companies Act

369 (2) An actuary of a company who makes a report under subsection (1) shall forthwith provide a copy of it to the directors of the company.

(3) Where, in the opinion of the actuary of the company, suitable action is not being taken to rectify the matters referred to in subsection (1), the actuary shall forthwith send a copy of the report to the Superintendent and advise the directors that the actuary has done so.

Protection

Insurance Companies Act

370 (2) The actuary or former actuary of a company who in good faith makes an oral or written statement or report under section 363 or 369 shall not be liable in any civil action seeking indemnification for damages attributable to the actuary or former actuary having made the statement or report.

Risk Management Today

- **Insurers are introducing a risk management function**
- **There is a wide divergence in implementation**
- **The CRO is usually an actuary but not the company or appointed actuary**

The CRO and the AA

- **Reporting relationship**
 - To executive
 - To the Board
- **Who has the wider horizon?**
- **Who does DCAT?**
- **Whistle blowing responsibility**

Risks

- **Credit**
 - Important but not to the same degree as in banks
 - Past good experience
- **Market**
 - Little trading, relatively little equities
 - Much passed through to policyholders (UL)
 - Maturity guarantees
- **Insurance**
- **Market conduct**
 - Mis-selling
- **ALM**

Risks

- **Liquidity**
 - Not well understood
- **Reputation**
 - e.g. selling finite reinsurance
- **IT**
 - Prevalence of legacy systems
- **Operational**
 - But high frequency & low impact events are not as important as for banks
- **Product design**
 - Probably the most important non-financial risk

Long Term or Short Term?

- **Most insurance products and many investments are long term in nature**
- **Tendency in the industry to play down short term risks and volatility**
 - Financial hedging is in its infancy in the life insurance industry
- **But there is also weak long term memory and little imagination**

Implementation of RM

- **Financial RM or ERM?**
- **Importance of corporate culture**
- **Company-specific capital requirements as an impetus to RM**
- **Future developments**
 - Cross-sector influences



Office of the Superintendent of
Financial Institutions Canada

Bureau du surintendant des
institutions financières Canada

Thank you for your attention
Questions?

www.osfi-bsif.gc.ca



OSFI
BSIF

Canada 