



October 27, 2014

File No.: 78000-03-01

Ref. No.: 0836

To: BC Insurers and Non-Federal Extra-Provincial Insurers Operating in BC

Re: Consultation on Adoption of a Prudent Person Approach

The purpose of this letter is to inform British Columbia incorporated insurers and non-federal extra-provincial insurers operating in the province of the Financial Institutions Commission’s (FICOM) intention to adopt prudent investment and lending guidelines issued by the Office of the Superintendent of Financial Institutions (OSFI). It is FICOM’s view that these guidelines are aligned with the requirement that authorized insurers use prudent standards when making investment and lending decisions as mandated under section 136(2)¹ of the *Financial Institutions Act* (FIA).

FICOM is seeking confidential feedback from insurers on the proposed adoption of the guidelines set out in the table below listing each type of insurer to which they are targeted. FICOM will only require companies to adhere to the guidance that is relevant to their activities.

No.	Subject	Life	P&C
B-1	Prudent Person Approach	X	X
B-2	Large Exposure Limits	X	
B-2	Investment Concentration Limit		X
B-4	Securities Lending	X	
B-4	Securities Lending		X
B-5	Asset Securitization	X	X
B-7	Derivatives Best Practices	X	X
B-11	Pledging	X	X
B-20	Residential Mortgage Underwriting Practices and Procedures	X	X
E-2	Commercial Lending Criteria	X	

If adopted, insurers will be expected to adhere to the principles set out in these documents and to implement guidance from OSFI guidelines where appropriate, with modifications according to size, scope, and complexity of the activity in question. Insurers should also note that besides setting prudent person expectations, section 136(1) of the FIA also imposes an additional

¹ Section 136(2) applies to provincial and to non-federal extra-provincial insurers pursuant to section 158(3)(b) of the FIA.

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

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fiduciary duty to “make investments without undue risk of loss and with a reasonable expectation of a fair return on the investments,” which must be incorporated into an insurer’s practices.

For extra-provincial non-federal insurers operating in BC, where the insurer’s home jurisdiction has applied a prudent approach aligned with that of OSFI’s prudent person guidelines, FICOM will rely on that approach. Where the home jurisdiction has not adopted a prudent person approach to investment and lending, or that approach is not substantively aligned with the OSFI expectations, then FICOM expects the insurer to implement guidance from the documents set out below to ensure that it is meeting the required prudent standards.

Enclosed are copies of the following for your review:

- OSFI *Guidelines B-1, B-2 (Life & P&C), B-4 (Life & P&C), B-5, B-7, B-11, B-20 & E-2.*
- Appendix: Clarification of Requirements for the Prudent Person Approach; and
- FICOM Guideline Impact Analysis Statement for the Prudent Person Approach.

Please note that the OSFI guidelines can also be accessed through OSFI’s website at:

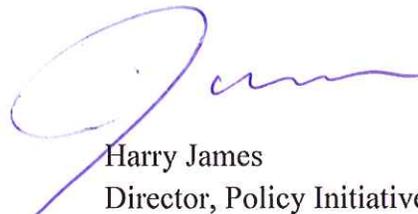
<http://www.osfi-bsif.gc.ca/eng/fi-if/rg-ro/gdn-ort/gl-ld/Pages/default.aspx>.

The consultation period on alignment with the above guidelines will be roughly 45 days. FICOM will review all comments before making a decision on the extent to which the prudent person guidelines will be applied to BC insurers and to non-federal extra-provincial insurers operating in BC and will communicate an appropriate transition period for implementation.

Stakeholder’s input is received on a confidential basis in order to obtain open and forthright opinion to assist us in our policy decision making process, and FICOM will treat submissions as confidential records and will not publish individual submissions or attribute content. However, please note that all submissions received are subject to the *Freedom of Information and Protection of Personal Privacy Act*.

Please direct any comments or questions to Molly Burns, Analyst, Policy Initiatives at insurance@ficombc.ca by December 10, 2014.

Yours truly,



Harry James
Director, Policy Initiatives

Enclosures (3)

KB/ac

Appendix

Clarification of Requirements for the Prudent Person Approach

This appendix clarifies FICOM's requirements for references made in the OSFI guidelines issued under the prudent person approach.

No.	OSFI References	FICOM's Requirements
B-1	<ul style="list-style-type: none"> • <i>Prudent person legislation</i> • <i>Providing Information to OSFI</i> • <i>Appendix – Summary of Statutory Limits</i> 	<p>FICOM's "prudent standards" requirement is set out in s.136(1) & (2) of the <i>Financial Institutions Act</i> (FIA).</p> <p>Insurers should note that s.136(1) of the FIA imposes an additional fiduciary duty to "make investments without undue risk of loss and with a reasonable expectation of a fair return on the investments."</p> <p>Non-federal extra-provincial insurers operating in BC are also required to follow s.136(1) & (2) by way of s.158(3)(b).</p> <p>Under the FIA, BC-incorporated financial institutions are required to file investment and lending policies with FICOM.</p> <p>The statutory limits set out in the Appendix to B-1 do not apply to provincially regulated institutions.</p>
B-2 (Life)	<ul style="list-style-type: none"> • <i>Minimum Capital Test (MCT) and Minimum Continuing Capital and Surplus Requirements (MCCSR)</i> • <i>III(vi) Definition of "entity"</i> 	<p>Sections 8 and 8.1 of the capital requirements regulation require BC insurers adhere to the MCT and MCCSR guidelines.</p> <p>For the definition of "entity", refer to the FIA s.1(1).</p>
B-2 (P&C)	<ul style="list-style-type: none"> • <i>Definition of "entity"</i> 	<p>For the definition of "entity", refer to the FIA s.1(1).</p>
B-4 (Life)	<ul style="list-style-type: none"> • <i>Use of an Agent</i> 	<p>If a company chooses to employ an agent for the administration of its securities lending program, it is governed under s.3(j) of the investment and lending regulation (BC Reg 330/90).</p>
B-4 (P&C)	<ul style="list-style-type: none"> • <i>Use of an Agent</i> 	<p>Companies are not required to employ an agent for the administration of a securities lending program. If a company does choose to employ an agent, it is governed</p>

No.	OSFI References	FICOM's Requirements
		under s.3(j) of the investment and lending regulation (BC Reg 330/90).
B-5	<ul style="list-style-type: none"> • <i>MCT and MCCSR</i> • <i>5.1 Setting up, or causing to be set up, an SPE [Special-Purpose Entity]</i> 	<p>Sections 8 and 8.1 of the capital requirements regulation require BC-incorporated insurers adhere to the MCT and MCCSR guidelines.</p> <p>In order to set up an SPE, a company must have prior approval from FICOM under s.138(1)(d) of the FIA. An SPE is not an exempt entity.</p>
B-7	N/A	N/A
B-11	<ul style="list-style-type: none"> • <i>Legislative requirement</i> • <i>Establishing pledging policies</i> 	<p>BC legislation does not require BC-regulated financial institutions to set out policies regarding the pledging of securities. However, FICOM considers this to form part of sound practices.</p> <p>Policies regarding the use of security for loans and leases must be set out in the Investment and Lending Policy as per s.3(c) of the investment and lending regulation (BC Reg 330/90).</p>
B-20	<ul style="list-style-type: none"> • <i>Maximum 80% loan-to-value (LTV) ratio for uninsured residential mortgages</i> • <i>Maximum 65% LTV ratio for non-conforming residential mortgages</i> • <i>Maximum 65% LTV ratio for non-amortizing component of home equity lines of credit (HELOCs)</i> • <i>Disclosure requirements</i> 	<p>BC legislation does not set out maximum LTV ratios for uninsured residential mortgages, non-conforming residential mortgages, or the non-amortizing component of HELOCs.</p> <p>However, FICOM expects BC insurers to establish appropriate limits for residential mortgage LTV ratios and to look to B-20 for guidance.</p> <p>FICOM is particularly seeking comment on the public disclosure requirements described in section III of this guideline.</p>
E-2	<ul style="list-style-type: none"> • <i>Commercial lending powers</i> • <i>Definition of “commercial loan”</i> 	<p>Commercial lending powers are established in s.65 of the FIA and s.2(g) of the prescribed types of business regulation (BC Reg 575/2004).</p> <p>For the purpose of this guidance, FICOM will follow the same definition of “commercial loan” articulated in E-2.</p>