



**Remarks by Superintendent Julie Dickson  
Office of the Superintendent of Financial Institutions Canada (OSFI)  
to the  
Insurance Bureau of Canada, Regulatory Affairs Symposium**

**Toronto, Ontario  
Friday, October 26, 2007**

**CHECK AGAINST DELIVERY**

For additional information contact:

Jason LaMontagne  
Communications and Public Affairs  
[jason.lamontagne@osfi-bsif.gc.ca](mailto:jason.lamontagne@osfi-bsif.gc.ca)  
[www.osfi-bsif.gc.ca](http://www.osfi-bsif.gc.ca)



Remarks by Superintendent Julie Dickson,  
Office of the Superintendent of Financial Institutions Canada (OSFI)  
to the Insurance Bureau of Canada Regulatory Affairs Symposium

Toronto, Ontario  
October 26, 2007

---

## **Managing Risks in the P&C Industry**

### **Introduction**

Thank you for inviting me here today to address the IBC symposium. We at the Office of the Superintendent of Financial Institutions (OSFI) welcome the opportunity to get out to these types of events. We like to speak to people in the business, and hear your perspectives on the industry. The feedback we receive at events like this is an important part of our assessment of the state of the industry.

### **State of the Industry**

I spoke to a property and casualty (P&C) audience in the spring, shortly after the data for fiscal 2006 had been collected and processed. My opening comments at that time pointed to the fact that 2006 was the third year in a run of very good years for the P&C industry. I said then, and it remains true now, that any sector with returns of around 20 per cent will be looked upon with envy by other players in the financial sphere.

But can industry returns of around 20 per cent be sustained? Well since that time the second quarter results have been released, and, I think to no one's surprise, we are seeing an ordered pullback from the previous years' exceptional results, and a return to what can be seen as more realistic profit levels -- profit levels that are typical of a very competitive industry.

Results to the end of the second quarter have indeed shown some deterioration from recent historic highs. ROE (depending on how you wish to measure it) is down - about 16 ½ per cent on a rolling four quarters basis, or, if we annualize six months worth of results, it is down about 13 ½ per cent.

An orderly pullback suggests that industry players are taking to heart the lessons of the past. While the continued environment of positive returns speaks to the general health of the industry, we cannot forget history. I think we all remember that not so many years ago circumstances were very different.

Indeed, in 2003 everyone was up in arms. OSFI was asked by the Secretary of State Finance for a report so that the Minister could better understand the increases in P&C insurance premiums in certain regions of the country. At the time, the financial position of the P&C industry had been deteriorating for several years. Claims had been growing, and competition and controls over premium rates, had created a situation where premium revenue had not kept pace.

Revenues from investment portfolios were declining so income was not being generated to offset mounting underwriting losses. Many companies started to approach OSFI's minimum capital target – not a pleasant state of affairs. A low capital base leaves companies exposed to unexpected events and reduces confidence that they can meet claims.

That was not that long ago. I trust that the industry does not want to see a return to such conditions. I hope that there is a conscious and disciplined effort by the industry to avoid severe rate cutting to gain market share, because that represents short term gain for long term pain. While it appears that sanity is prevailing, the industry needs to remain vigilant.

### **Cooperation between Prudential and Market Conduct Regulators**

In the 2003 report that OSFI prepared on the industry at the request of the Minister, we noted the following: “Sustainable profitability at reasonable rates of return is important for the safety and soundness of the industry. Going forward, actions related to premiums and costs can have a material impact on the industry. It is important that they be balanced if the prudential position of the industry is not to be adversely affected.”

That statement was true then and it is true today. As a prudential regulator, we have an interest in promoting safe and sound companies that can meet claims of Canadians when called upon. Sustainable returns are key to that safety. Because actions related to premiums and costs can have a material impact on the industry, they are important to both prudential regulators and market conduct regulators.

This means that communication between solvency supervisors and market conduct supervisors is very important in the P&C industry. We experienced this directly in the last downturn. Some companies were in delicate positions, and we were able to work with our provincial regulators to communicate our general concerns about solvency in the industry, which factored into the decision making at the provincial level.

This communication was valuable to regulators on both sides. It underscores the need to have a very strong link between prudential supervisors and market

conduct supervisors.

Going forward we would like to strengthen that link significantly. OSFI will begin to send a specialized P&C representative from our supervision sector to future CCIR meetings so as to encourage more dialogue on safety and soundness issues, and so that our supervisors can get a better sense of important market conduct issues.

At this point I want to move to three areas of risk management -- managing reinsurance risk, accounting risk, and earthquake risk.

## **Reinsurance**

Recent events have clearly demonstrated that whatever business you are in, you need to know what risks you have transferred, and whether they can come back to bite you. The analogy to this in the P&C world could be reinsurance.

Notwithstanding the economic reasons behind any reinsurance contract – it is essential that all parties be fully aware of the intent, and the terms and conditions of the contract. Common sense would dictate that the expectations are known to the parties prior to contract inception, and that the defining terms and conditions have been mutually agreed upon – in writing. This is not always the case. We have seen situations where differing interpretations have led to significant disputes, and ultimately to the liquidation of the ceding company involved.

For many years, OSFI has relied on suasion in an attempt to compel companies to improve their documentation practices, in order to mitigate the uncertainties related to coverage terms and intent. Usually, these efforts have met with good results, but not always. This is why OSFI has proposed new guidance (B-13), which sets out our minimum expectations regarding what cedants/reinsurers should expect from each other in terms of contract execution.

Along with a call for clarity on the timing of document execution, this new guidance will require that contracts contain unambiguous wording, that the contract represents the entire agreement, and that no side bars or side letters exist. The feedback we have received from our consultative process is remarkably favourable, and will likely assist Canadian cedants in their dealings with international reinsurers.

## **Accounting**

We know from our review of first and second quarter filings, that the new accounting instrument classifications have created challenges for some companies, especially in organizations where there may be less in-house

accounting expertise. The same challenges were seen implementation of OSFI's Accounting Guideline (D-10).

If you are in this category, it would be advisable for you to seek out the help required now, as the complexity of recent accounting changes is only the beginning. As we move to International Financial Reporting Standards (IFRS) in Canada, more time and effort will be required to ensure that accounting changes and their impacts are determined long before implementation.

IFRS might require additional dialogue with your auditors given the amount of change, the complexity, and the knowledge gaps that must be addressed. My message to all P&C companies (big and small) is that you need to start work on the move to IFRS now. This will help bring your people into the loop by the time IFRS goes live, and help to ensure a smooth transition.

Additionally I would like to add that we are aware of the challenges arising from the new accounting regime's impact on operating metrics and certain exhibits that accompany regulatory returns. For example, the combined ratio may no longer be the indicator of health it used to be. We recognize this and will continue to work with the IBC to ensure reasonable and meaningful operating results are made available.

## **Management of Earthquake Risk**

Before I conclude my remarks, let me touch briefly on earthquake provisioning.

It has been over 10 years since OSFI implemented earthquake reporting. At that time the goal was to ensure that with a combination of surplus, reinsurance and special earthquake provisions, each company would have the capacity to handle a one in 250 year earthquake. Over the next 25 years this capacity would be increased to a one in 500 year event.

We eagerly await the results of an earthquake survey commissioned by the IBC. Once we complete our review of the results, we plan to engage in discussions with our colleagues at the IBC to see what, if any, issues may have come to light, and how the results might affect earthquake reporting requirements.

Today many companies are already at the one in 500 year level, and in most cases the earthquake risk is managed well, as part of the company's risk management process. So most companies have realized that it is not enough to fill in your earthquake form and call yourself compliant. Managing your earthquake exposure is important for risk management. We are encouraged to see that most companies do take this very seriously, as we will continue to look for industry readiness on this issue.

The ultimate goal, however, remains unchanged. In the event of a major earthquake we expect Canadian companies to have adequate resources to pay all legitimate claims.

## **Closing**

Let me conclude my remarks by saying that as leaders in the P&C community, your job is not always easy. Businesses change, industries evolve, and that can present some challenges. But it can also open a world of opportunities.

Together, the P&C industry and its regulators can work towards meeting those challenges, so we are all better able to seize the opportunities.

While we are on opposite sides of the regulatory fence, we all have a common desire -- to build a strong and prosperous Canadian financial system, a system in which Canadian can put their reliance and their trust.

I think we are on the right track.

Thank you.