Ruling

Category: **Foreign Insurance Company** **NOTICE***

Subject: **Insurance in Canada of Risks – Financial Guarantee Insurance and Residual Value Insurance**

No: **2007 – 03**

Issue: The issue was whether the manner in which foreign insurers that proposed to provide financial guarantee insurance (FGI) or residual value insurance (RVI) to Canadian entities would cause these insurers to insure in Canada risks and therefore to be subject to Part XIII of the *Insurance Companies Act*.

Background: Foreign insurers were proposing to provide FGI to Canadian or foreign entities (the Issuers) that are raising funds to finance infrastructure projects in Canada. The Issuers are seeking FGI to enhance their credit rating. Under a FGI policy, the foreign insurer issuing the policy (FGI Insurer) would indemnify holders of debt instruments for any financial loss suffered as a result of the failure of the Issuer to meet the principal and interest payments when due.

A foreign insurer that issues RVI outside Canada (RVI Insurer) was approached by Canadian financial institutions participating in asset-based financing transactions (banks, finance companies, independent lessors) as well as equipment manufacturers, either directly or through insurance brokers, to insure their loss should, at the end of the lease, the market value of the leased asset be less than the residual value of the asset that they had established at the beginning of the lease, (i.e., to provide RVI to these Canadian Lessors).

The foreign insurers represented that they did not and will not have an office or employees in Canada. They will not solicit business in Canada but will only respond to unsolicited requests. They will receive outside Canada applications for a policy. Their policies will be negotiated, issued, executed and delivered outside Canada. No payments of the insurance premiums will be received by the foreign insurers in Canada or by an agent of the foreign insurers in Canada. The foreign insurers will not maintain a bank account in Canada. All claims under the FGI or RVI policies will be received, processed and paid by the foreign insurers outside Canada.

Prior to the issuance of a FGI policy, the FGI Insurer will perform, primarily in Canada, due diligence on both the infrastructure project and the related debt instruments of the Issuer. In order to assess its insurance risk, the RVI Insurer may visit Canada to inspect the proposed

insured asset (i.e., the leased asset) and/or to determine if the leasing operations of the Canadian Lessor (i.e., the potential policyholder) are consistent with industry standards.

To assist in performing these due diligences, the foreign insurer may retain the services of a third party in Canada, such as engineers, appraisers and lawyers. However, none of the third parties will have the ability to bind the foreign insurer, and they will not act as the agent of the foreign insurer. The foreign insurer will, primarily outside of Canada, evaluate the reports of these Canadian advisors. Furthermore, officers of the foreign insurer may, from time to time, receive, review and discuss these reports with the Canadian advisors while visiting Canada.

In the event of default of the Issuer, the FGI Insurer, as subrogee, will take actions to recover from the Issuer any amount payable to the debt holders. Typically, the Canadian Lessor will not provide security for the RVI policy, except possibly where the RVI is in respect of commercial real estate. Under such policy, if the Canadian Lessor still owns the commercial real estate by the time a claim is paid by the RVI Insurer, the Canadian Lessor may be required to transfer title to the property to the RVI Insurer. Where the assets pledged to the FGI Insurer are located in Canada, or in the case of a RVI policy, the commercial real estate is located in Canada; the foreign insurer may enforce or realize on its security by appointing receivers, managers or other representatives in Canada.

Considerations: Based on the criteria set out in Advisory 2007-01 on Insurance in Canada of Risks, it appears that:

(a) the only interaction leading to the formation of the FGI or RVI policies that will take place in Canada will be the receipt of the policy by policyholders;

(b) the policyholders will be aware that the foreign insurer will perform most, if not all, insurance functions pertaining to its insurance policies from its offices located outside of Canada, namely, the underwriting of the policies, the issuance and signing of the policy, the assessment and adjudication of claims, if any, and the processing and payment of claims;

(c) the foreign insurer, or a third party appointed by the foreign insurer, will in Canada only perform activities that are incidental to the foreign insurers' insurance operations outside Canada (e.g., due diligence on both the infrastructure project and the related debt instruments, inspection of the leased assets and/or evaluation of the Canadian Lessor's leasing operations, realization on security interests);

(d) where a third party is performing, in Canada, activities on behalf of the foreign insurers, it will not act as agent of the foreign insurer and will have no authority to bind the foreign insurer to provide insurance coverage;

(e) the foreign insurer will not solicit business in Canada but will only respond to unsolicited requests, and

(f) the foreign insurer will have no offices, place of business or establishment in Canada.

Conclusion: In these circumstances, OSFI concluded that, for the purpose of the ICA, the foreign insurers will not insure in Canada risks and will not require an order under Part XIII of the ICA to provide coverage to Canadians.

Legislative References: Subsections 573(1) and (2) of the *Insurance Companies Act* provide that a foreign entity shall not insure in Canada a risk unless it is authorized by order made under subsection 574(1) and the risks fall within a class of insurance that is specified in the order.

Table of Concordance: The legislation of other federal financial institutions does not contain similar provisions.