Guideline

Subject: **Annual Disclosures (Life Insurance Companies)**

Category: **Accounting**

No: **D-1A** **Date:** **December 1997**
Revised: **October 2006**

Introduction

This guideline outlines disclosures OSFI expects federally regulated life insurance enterprises to provide to supplement the disclosures required by the *CICA Handbook* and other OSFI guidelines. These disclosures are to be made in the notes to the annual financial statements or in a supplementary management report appended to the annual financial statements. Fraternal benefit societies and branches of foreign life insurance companies that do not prepare annual financial statements should make these disclosures in the portion of their OSFI annual return that is covered by the auditor's opinion and in a supplementary management report filed with the annual return.

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Part 1 - Quantitative Disclosure

Part 1 of the guideline sets out minimum levels of quantitative disclosure for certain financial statement items. Disclosures by category or type need not be met where the amounts are not material. The quantitative disclosure should be made in the notes to the annual financial statements or in the audited portion of the annual return in cases where annual financial statements are not prepared.

Portfolio Investments

In disclosing the information required by Section 3861 of the *CICA Handbook*, a life insurance enterprise should disclose the aggregate balance sheet value and the fair value of its portfolio investments showing separately any amounts relating to:

(a) bonds and debentures,
(b) residential mortgage loans,
(c) non-residential mortgage loans,
(d) common and preferred shares,
(e) real estate, and
(f) other investments,

by category of classification of the financial instrument, as presented in the financial statement:

(i) held to maturity,
(ii) available-for-sale,
(iii) held for trading[1],
(iv) designated as held-for-trading (Fair Value Option)[2], and
(v) loans and receivables.

Separate disclosure is recommended, within the above categories, for any type of portfolio investment that constitutes 10% or more of the carrying value of the total portfolio investments.

Part 2 - Risk Management and Control Practices

Part 2 outlines the disclosures OSFI expects regarding the risk management and control practices adopted by a federally regulated life insurance enterprise. The enterprise should provide this qualitative disclosure in a supplementary management report appended to the annual financial statements or in a supplementary management report appended to the audited portion of the annual return in cases where annual financial statements are not prepared.

Each life insurance enterprise should identify and describe the risks that are significant to its business. These include, but are not limited to, interest rate risk, credit risk, reinsurance risk, foreign exchange rate risk, liquidity risk, and the other major risks that are inherent in measuring and managing policy liabilities. The enterprise should describe the way in which it monitors and

[1] As per CICA handbook section 3855.19 (f)(i)
[2] As per CICA handbook section 3855.19 (f)(ii)

controls such risks. It should also set out the responsibilities of the board of directors and senior management for risk management, including policy setting, implementation, monitoring and review.

The enterprise should discuss the extent of any significant exposures to areas where there recently has been, or there is the potential for, significant loss due to industry specific factors or general industry recession and outline the steps it has taken to contain risks in these areas.

The enterprise should also discuss methods of measuring and controlling other market-related risks where they are significant.

Risks Associated with Policy Liabilities

Since policy liabilities generally constitute the largest single balance of a life insurance enterprise's balance sheet, OSFI expects specific disclosure relating to the management of the risks that significantly impact it in addition to the risks referred to in the following paragraphs. These risks include mortality/morbidity risk, business retention risk, investment yield risk and expense risk.

The enterprise should discuss its risk management policies for each of these risks, including the role of the board and management in their development, review, approval and implementation, and the procedures in place to effectively monitor and control them.

The enterprise should identify and describe the techniques used to analyze and review mortality experience risk, the claims management processes to mitigate morbidity risks, the underwriting practices to ensure appropriate risk classification and premium levels for each customer, pricing and dividend policies, the controls placed on the growth of expenses and the management of investment yields.

Interest Rate Risk

Interest rate risk is the risk that the value of a financial instrument will fluctuate due to changes in market interest rates and that such movements will have an adverse effect on the financial condition of the enterprise. An enterprise should set out its objectives and associated business strategy in interest rate risk management.

The enterprise should discuss its interest rate risk management policies, including the role of the board and management in the development, review, approval and implementation of interest rate risk policies, and the procedures in place to effectively monitor and control the interest rate risk. The discussion should include information on the policies that exist for measuring the enterprise's interest rate risk exposure, including the frequency of measurement.

Consistent with Guideline D-6, *Derivatives Disclosure*, the enterprise should explain how it uses derivative instruments to manage interest rate risk and provide quantitative information on the extent to which these instruments are used.

Credit Risk

Credit risk is the risk that one party to a financial instrument will fail to discharge an obligation and cause the other party to incur a financial loss. This risk can relate to recognized and unrecognized financial assets.

The enterprise should discuss its credit risk management policies, including the role of the board and management in the development, review, approval and implementation of credit risk management policies, and the procedures in place to effectively monitor and control the credit function. The discussion of the credit risk management policies should include information on the methods used by the enterprise to identify existing and potential risks inherent in the portfolio and the policies that exist for monitoring and controlling these risks. The enterprise should include a description of its risk measurement and rating classification systems.

Reinsurance Risk

Reinsurance risk is the risk that a ceding enterprise could suffer a loss or liability in the event a reinsurer is unable to meet its obligations to pay claims reinsured under the terms of a reinsurance contract with the ceding enterprise.

The enterprise should discuss its reinsurance risk management policies, including the role of the board and management in the development, review, approval and implementation of reinsurance risk policies, and the procedures in place to effectively monitor and control the reinsurance risk. The discussion should include information on the policies that exist for measuring the enterprise's reinsurance risk exposure.

Foreign Exchange Rate Risk

Foreign exchange rate risk is the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates.

The enterprise should discuss its foreign exchange risk management policies, including the role of the board and management in the development, review, approval and implementation of foreign exchange risk management policies, and the procedures in place to effectively monitor and control the foreign exchange risk function.

The enterprise should identify and describe the analytical techniques used to measure foreign exchange rate risk, the limits it imposes and the frequency of measurement. The enterprise should also set out the key sources of foreign exchange rate risk within its portfolio. It should also provide information on how it measures foreign exchange gains and losses.

Consistent with Guideline D-6, *Derivatives Disclosure*, the enterprise should explain how it uses derivative instruments to manage foreign exchange rate risk and provide quantitative information on the extent to which these instruments are used.

Liquidity Risk

Liquidity risk is the risk that an entity will encounter difficulty in raising funds to meet commitments associated with financial instruments.

The enterprise should discuss its liquidity risk management policies, including the role of the board and management in the development, review, approval and implementation of liquidity risk management policies, and the procedures in place to effectively monitor and control the function. It should describe the methods used for measuring the enterprise's current and projected future liquidity.

The enterprise should include a description of its policies and performance with respect to:

- controlling the mismatch between recognized and unrecognized financial assets and liabilities; and
- ensuring it has sufficient liquid assets on hand in relation to its daily cash inflows and outflows.

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