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Guideline

Subject: Standards of Sound Business and Financial Practices - Introduction

No: F-1 **Date: February 1998**

One of the objectives of the Office of the Superintendent of Financial Institutions (OSFI) is to encourage financial institutions to adopt sound business and financial practices. To that end, OSFI is issuing the following guidelines that set out standards of business and financial practices grouped under five broad categories, that federally regulated life and health insurers are expected to abide by:

CATEGORY	STANDARD
Capital	Capital Management
Asset Quality	Credit Risk Management Foreign Exchange Risk Management Securities Portfolio Management Real Estate Appraisals
Liability Quality	Product Design and Pricing Management Underwriting and Liability Management
Relationship of Assets and Liabilities	Interest Rate Risk Management Liquidity Management
Controls	Internal Control

In all cases, **the standards are minimum standards**: each life and health insurer may choose, or OSFI may require, a higher standard.

GUIDE TO THE STANDARDS

To lessen redundancy, the common provisions applicable to each of the 10 subject areas (i.e., Application, Role of Board of Directors, Role of Management, Role of Appointed/Valuation Actuary) have been set out in Guideline F-1. The minimum policies and procedures relevant to one of the 10 separate subject areas are set out in Guideline F-2 to Guideline F-11. Finally, the Glossary in Guideline F-12 contains definitions of terms used throughout the guidelines.

The result is that the comprehensive requirements for each of the 10 subject areas is made up of (i) all of Guideline F-1 and (ii) one of Guideline F-2 to Guideline F-11. Each guideline is to be read using the relevant definitions in the Glossary.

APPLICATION

The standards of sound business and financial practices apply to all life and health insurers carrying on business in Canada that are regulated by OSFI. For greater certainty, the standards apply to all federally incorporated or regulated life and health insurers, including reinsurance companies and fraternal benefit societies.

The term "company" or "companies" in each guideline refers to a life and health insurer to which these standards apply.

The standards apply to the company's overall operations. For a foreign company (i.e., a branch), the standards apply to its Canadian operations. A company must be able to demonstrate compliance in relation to risks that are material to its operations. Unless otherwise specified in a particular guideline, a risk is material to the company if (i) it has the potential to result in financial consequences that would exceed the materiality limit used in the prior year's consolidated financial statement or (ii) it has subsequently been identified as a material risk by the Appointed/Valuation Actuary in his/her assessment of the company's overall financial condition.

For greater certainty, the standards apply to segregated funds of a company only to the extent that potential liabilities arising from the segregated funds could have a material effect on the company's general account.

Where a company is a foreign company, the standards apply only to the vested in trust assets in Canada of the foreign company.

Where a company is federally incorporated, the standards apply to its branches abroad and to its subsidiaries, subject to the points below:

i. in the case of branches abroad and life and health insurance subsidiaries abroad, documented compliance with standards of a foreign jurisdiction will be deemed to constitute compliance by the company with these standards, provided such foreign standards have been approved by OSFI;

ii. in the case of subsidiaries that are property and casualty insurance companies, deposit-taking institutions, mutual fund companies, or companies engaged in investment counselling or portfolio management which are regulated by Canadian or equivalent non-Canadian regulators, documented compliance with standards of the regulator will be deemed to constitute compliance by the company with these standards, provided such standards have been approved by OSFI;

iii. in the case of material subsidiaries, other than life and health insurance subsidiaries, that have not been deemed to comply with these standards pursuant to (ii) above, the company will cause such subsidiaries to develop sound and prudent policies and appropriate procedures and controls in order to ensure that the significant business activities in which the subsidiaries are engaged are prudently managed and controlled. For these subsidiaries, reference should be made to these standards to the extent that a particular guideline deals with a significant risk to which the subsidiaries are exposed; and

iv. notwithstanding the possibility of deemed compliance pursuant to (i) or (ii) above, it is anticipated that the Internal Control and Capital Management guidelines will apply to all material branch operations abroad and material subsidiaries of Canadian companies.

ROLE OF THE BOARD OF DIRECTORS

The board of directors of each company is ultimately responsible for the company's risk management policies and practices. In delegating its responsibility, a board of directors usually charges management with developing and implementing risk management programs and ensuring that these programs remain adequate, comprehensive and prudent. At a minimum, a risk management program should be in place for the risks covered by each guideline.

A board of directors needs to have a means of ensuring that material risks are being appropriately managed. This is normally done through periodic reporting by management and an audit function. The reports should provide sufficient information to satisfy the board of directors that the company is complying with its management policies, including the risks covered by the standards. In relation to each area covered by a guideline, a board of directors, or a committee thereof, should, where appropriate:

- review and approve management's risk philosophy and the risk management policies recommended by the company's management;

- review periodically, but at least annually, management reports demonstrating compliance with the risk management policies;

- review the content and frequency of management's reports to the board or to its committee;

- review with management the quality and competency of management appointed to administer the risk management policies; and

- ensure that the audit function regularly reviews operations to assess whether or not the company's risk management policies and procedures are being adhered to and confirms that sufficient risk management processes are in place.

Where the company is a foreign company, the role of the board of directors (as described in this guideline) shall be discharged, mutatis mutandis (i.e., with appropriate changes where necessary), by a senior executive officer of the foreign company, located in the foreign country, who has the authority to approve the policies developed to comply with this standard.

ROLE OF MANAGEMENT

The management of each company is responsible for developing and implementing the company's management program in relation to each guideline and for managing and controlling the relevant risks and the quality of relevant portfolios in accordance with this program.

Although specific management responsibilities will vary from one company to another, where appropriate, management at each company is responsible for:

- developing and recommending management's risk philosophy and policies for approval by the board of directors;

- establishing procedures adequate to the operation and monitoring of the management program;

- implementing the management program;

- ensuring that risk is managed and controlled within the relevant management program;

- ensuring the development and implementation of appropriate reporting systems to permit the effective analysis and the sound and prudent management and control of existing and potential risk exposure;

- ensuring that an audit function will review regularly the operation of the management program;

- developing lines of communication to ensure the timely dissemination of management policies and procedures and other management information to all individuals involved in the process; and

- reporting to the board, or to a committee thereof, on the management program as comprehensively and frequently as required by the board of directors.

Where the company is a foreign company, the role of management (as described in this guideline) shall be discharged, mutatis mutandis (i.e., with appropriate changes where necessary), by the foreign company's chief agent in Canada.

ROLE OF APPOINTED/VALUATION ACTUARY

The actuary of the company has statutory responsibilities under the *Insurance Companies Act* and professional responsibilities in accordance with the Canadian Institute of Actuaries' Standards of Practice. A primary responsibility is expressing an opinion on the results of the valuation of the policy liabilities. Other responsibilities include reporting on the financial condition and, if directed by OSFI, the expected future condition of the company.

When reporting on the company's financial condition, the actuary identifies and quantifies the risks to which a company's financial condition is sensitive. As amplified in the standards, this provides valuable information for management and the board of directors to determine and establish policies to address such risks, and to manage and control them.

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