Office of the Superintendent of Financial Institutions Canada
Bureau du surintendant des institutions financières Canada

Questions and Answers

Guidance for Reinsurance Security Agreements

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The following table of questions and answers is intended to provide supplementary guidance to insurance companies that are affected by the implementation of OSFI's Guidance for Reinsurance Security Agreements ("the RSA Guidance"). Many of the questions contained herein were derived from enquiries OSFI has received through its interaction with industry stakeholders during the process to clarify certain aspects of the regime. This document will be updated on a periodic basis.

Question	Answer
A) Termination of Reinsurance Trust Agreements (RTAs) and Transition Period	
Why has OSFI chosen to replace its standard Reinsurance Trust Agreements with the RSA Guidance?	In the past, OSFI developed a standard form Reinsurance Trust Agreement (RTA) that federally regulated companies (ceding companies) were required to use in order to be eligible for a capital/asset credit in respect of unregistered reinsurance. While OSFI was of the view that its standard form RTA generally provided adequate protection to ceding companies, the decision to adopt a new approach came as a result of discussion within the legal community as to whether the enforceability of RTAs could be challenged and whether other arrangements would be beneficial to ceding companies, while providing a similar or greater level of protection. **Rationale** OSFI's decision to move away from standard form agreements was supported by a number of factors. These factors include: • requiring ceding companies to manage risks related to unregistered reinsurance; • giving companies flexibility to create their own forms of security agreements; • harmonizing with the practice for other security and collateral arrangements by deposit taking institutions; • recognizing that the use of an appropriate standard form agreement is a fact-specific determination and the creation of a first-ranking perfected security interest depends on more than just the form of agreement (e.g., registration); • maintaining access to Canadian courts; and • minimizing the costs to, and responsibility of, OSFI associated with the review of all personal property legislation as well as securities transfer legislation in the thirteen provincial/territorial jurisdictions that would have been required if OSFI had decided to develop a standard Reinsurance Security Agreement.

Question	Answer
What are the main features of the new RSA Guidance?	Under its new approach, OSFI will require ceding companies to negotiate and enter into suitable arrangements and to take all necessary practical and operational measures to create and maintain a valid first-ranking security interest in assets of an unregistered reinsurer that are held in Canada in order to be eligible for a capital/asset credit in respect of unregistered reinsurance. Ceding companies will also have to provide a legal opinion addressed to the ceding company, and on which OSFI will be entitled to rely, asserting that such an interest has been created in their favour. Further, ceding companies will be expected to approve assets pledged or withdrawn. In that regard, OSFI has outlined minimum standards for both the security agreement and the accompanying legal opinion. Issues related to supervisory matters are also addressed.
Is OSFI providing a standard-form RSA?	No. Although OSFI had initially considered developing a standard RSA to replace the current RTA, OSFI has decided not to pursue that approach. OSFI's decision to move away from standard form agreements was supported by a number of factors, including requiring ceding companies to manage risks related to unregistered reinsurance and giving companies the flexibility to create their own forms of security agreements.
Must an application be made to the Superintendent to collapse a Reinsurance Trust and replace it with an RSA?	Yes. Prior OSFI approval is required to release assets from an RTA. Please refer to the termination provisions contained in the standard reinsurance trust agreement. Companies must apply to OSFI's Securities Administration Unit (SAU). For instructions on completing and filing the application for approval, see Procedures for Completing OSFI 298 Form. The "Reason for Release" should indicate "transfer of assets from RTA to RSA". It is expected that all assets will flow to an account pursuant to the RSA. If any assets are to be released to the reinsurer at this time, a separate Form 298 should be provided. Before approval of transfer is granted, the ceding company must have filed a scanned copy of the executed RSA and corollary agreements with OSFI's Securities Administration Unit (the collateral agent may do so if the company has delegated this authority). The SAU will provide an identification number (S+4 digits) to the Collateral Agent for reporting purposes.
Are there consequences and/or penalties for companies who fail to transition to the RSA structure by the deadline?	Pursuant to RSA Guidance, OSFI expects companies to take all commercially reasonable efforts to replace existing RTAs. The institution's designated OSFI Relationship Manager (RM) will follow each ceding company's efforts and progress. Thus the RM may evaluate whether "commercially reasonable efforts" have been taken. Likewise, where certain arrangements render conversion impractical, the RM will review and determine whether, and under what conditions, capital/asset credit should be permitted. Institutions need to advise their RM if they will not be able to meet the January 1, 2012 deadline.

Question	Answer
New Reinsurance Security Agreements	Reinsurers should discuss requirements with the ceding company and refer to the relevant guidance outlined above. Cedants should contact their OSFI RM if they have any questions. As described above, OSFI does not provide a standard form RSA; however, some of the major law firms in Canada and/or your proposed collateral agent may have sample templates of an RSA available.
B) Alternatives to RSAs	
a) Are Letters of Credit (LOCs) deemed to be acceptable collateral?	Yes. RSAs are but one form of collateral enabling a capital credit for unregistered reinsurance and LOCs are deemed to be acceptable as well. However, LOCs are subject to specific limits and conditions. For guidance, ceding companies should refer to the Minimum Capital Test (MCT) Guideline or to the Minimum Continuing Capital and Surplus Requirements (MCCSR) for Life Insurance Companies Guideline, as applicable, and to the General Guidelines for the Use of Letters of Credit. Companies may also wish to refer to OSFI Guideline B-3 *Sound Reinsurance Practices and Procedures*.
b) If so, may they be kept by a collateral agent under an RSA?	No. LOCs are instruments with distinct attributes and mechanisms for drawing-down of funds. These are held by the ceding company (if a Canadian insurance company) or by the ceding company's trustee (if a foreign insurance branch) and, as such, would not be included as part of an RSA, which relates to a reinsurer's pledged assets.
Are funds-withheld arrangements deemed to be acceptable collateral?	Yes. As outlined above, RSAs are but one form of collateral enabling a capital credit for unregistered reinsurance. OSFI relies on the ceding company and its legal counsel to ensure that a funds withheld arrangement creates a first ranking security interest and otherwise satisfies the requirements. For guidance, refer to OSFI Guideline B-3 *Sound Reinsurance Practices and Procedures*. Please note that if a reinsurance contract provides for a funds withheld arrangement, the contract must clearly provide that, in the event of the ceding company's or reinsurer's insolvency, the funds withheld, less any surplus due back to the reinsurer, must form part of the property of the ceding company's general estate, or part of the assets in Canada of a foreign insurance company as defined under the *Winding-up and Restructuring Act* and the *Insurance Companies Act*.

Question	Answer
C) RSA minimum standards	
a) What amount of collateral is required from the Reinsurer?	Ceding companies should refer to the MCT Guideline or to the MCCSR for Life Insurance Companies Guideline, as applicable, for guidance on how to calculate the capital/margin requirement for unregistered reinsurance. In some cases, the margin requirement for each unregistered reinsurer may be reduced to a minimum of 0: Where the credit for unregistered reinsurance available for an unregistered reinsurer exceeds the credit that has been applied towards the requirements for reserves ceded to the reinsurer, the amount of the excess, divided by 1.5 (or another factor if specifically required by the Superintendent), may be used to reduce certain components of required capital for the reinsured policies. For example, in recognition of OSFI's minimum 150% supervisory capital target for P&C companies, any portion of collateral remaining to cover the margin of 10% is divided by 1.5. In other words, in order to offset a 10% margin completely, the ceding company would need to hold 115% of collateral to avoid holding capital on the unlicensed reinsurance.
b) Is an additional margin required on collateral?	Yes. Counterparty credit risk capital requirements are applied to the collateral.
a) What types of assets will be permitted as collateral**?**	OSFI has not prescribed a list of permitted assets. Ceding companies are expected to define in their policies the types of prudentially acceptable pledged assets and limits as well as practices and procedures in place for managing and controlling risks related to any pledged assets. Of note, ceding companies should consult the MCT or MCCSR Guidelines for information on capital charges for investments related to unregistered reinsurance. In addition, in respect of a particular RSA, the ceding company is required to obtain a legal opinion asserting that a valid and enforceable security interest, that has priority over any other security interest in the pledged assets, has been or will be created in its favour for the type of assets covered by the legal opinion.
b) Is cash a permitted asset?	It is OSFI's understanding that there may currently be legal issues regarding priority and perfection of certain types of assets, such as cash, under some provincial laws. Given the number of jurisdictions involved and the ongoing potential for jurisprudential or statutory developments, OSFI has taken the view that the ceding company should obtain a legal opinion to confirm that it has a valid and enforceable first ranking security interest in the particular type of assets. In all cases, assets must be held in Canada (either by Collateral Agent or by CDS Clearing and Depository Services) and otherwise comply with requirements as set forth in the RSA Guidance.

Question	Answer
Can assets be held by foreign sub-custodians and in foreign depositories?	No. In all cases, pledged assets must be held in Canada and otherwise comply with requirements as set forth in the RSA Guidance. Assets held by foreign custodians or in foreign depositories are not considered by OSFI to be held in Canada.
Is it acceptable to combine both the RSA and a control agreement into a single legal document by and between the ceding company, reinsurer and collateral agent/custodian, or does OSFI expect that the companies will enter into separate RSA agreements and control agreements?	OSFI has no objections to companies either entering into two separate agreements or a single combined RSA/control agreement, as long as all RSA Guidance requirements are satisfied. A copy of all relevant agreements forming the RSA should be filed with OSFI (we do not require the reinsurance treaties but it is expected that any relevant legal documents (see below) will be kept on file with the legal opinion by the ceding company to be produced upon request). Ceding companies should be mindful when negotiating such agreements that factors such as relying on a standard-form template could in practice have an impact on the terms that are ultimately agreed upon.
Does RSA Guidance require that the collateral agent/custodian monitor assets to ensure compliance?	Under RSA Guidance, it is generally the ceding company's responsibility to ensure that pledged assets at all times comply with the requirements. In addition, it is the ceding company's responsibility to monitor the assets held pursuant to an RSA to ensure they comply with the parties' own schedule of authorized asset classes. In other words, it is the responsibility of the reinsurer to provide adequate and appropriate security and that of the ceding company to monitor the collateral appropriately. OSFI understands that in certain cases, collateral agents may not automatically monitor the assets held pursuant to the RSA to assist in ensuring compliance with RSA Guidance and/or the ceding companies' policies. It is the parties' prerogative to make contractual arrangements to facilitate this process for the ceding company. For example, the ceding company may choose to insist upon a clause to ensure that the reinsurer will only remit to the collateral agent permitted assets that are part of a particular schedule of assets, and/or that non-permitted assets may only be pledged together with a note from the ceding company indicating consent. The collateral agent is required to file a monthly report to OSFI on assets held pursuant to the RSA (see RSA Guidance). OSFI Supervision may request the ceding company to have an asset replaced should they determine an existing asset is not appropriate or in keeping with the cedant's investment policy.
Will OSFI accept a priority in favour of the collateral agent for the agent's customary fees?	RSA Guidance requires that the reinsured company have a first priority security interest in the collateral. Despite this restriction, upon review, OSFI has determined that it will not object to the parties including a right of set-off or allow a priority interest in favour of the custodian in either of

Question	Answer
	two cases: (i) to secure the payment of the custodian's customary fees and expenses (arising in the ordinary course of business) payable under the custodian or control agreement and (ii) with respect to an overdraft arising from an account transaction (*e.g.*, to settle a transaction that could otherwise fail). However, OSFI will not accept a broad right of set-off or priority created in favour of the custodian for other types of obligations, liabilities, indebtedness, or indemnification (as may be the case in certain other standard form control agreements).
D) Accompanying Legal Opinion	
Must the legal opinion be issued by the ceding company's legal counsel or may it be obtained from the reinsurer's inside or outside counsel?	Pursuant to RSA Guidance, OSFI expects that ceding companies entering into an RSA will obtain a legal opinion, *on which OSFI and the ceding company will be entitled to rely*, asserting that they have obtained and maintain a valid and enforceable security interest in the reinsurer's pledged assets that have priority over any other security interest in these assets. Where the ceding company intends to obtain the legal opinion, or portion thereof, from the reinsurer's counsel or another third party, the company should satisfy itself by consulting its own counsel as appropriate that it is an opinion on which both OSFI and the company will be *entitled to rely*, having regard to the relevant jurisdiction's laws and/or ethical rules. In all cases, the opinion must be provided by a lawyer who either has expertise in the area of personal property security legislation in the Canadian province where the assets are held or who is reasonably relying on the legal opinions of those who have such expertise. In addition, Canadian counsel may elect to request a legal opinion from a lawyer who has expertise in this area in the jurisdiction of the unregistered reinsurer to ensure the security interest is recognized in the foreign jurisdiction. Finally, where a legal opinion is provided by in-house counsel, OSFI expects that the opinion will state that it is provided by counsel in his or her professional capacity as a lawyer and not in any other capacity. In relation to a particular RSA, where the ceding company approves a new type of asset not already covered by the accompanying legal opinion, OSFI expects that the company will obtain an additional legal opinion asserting that a valid and enforceable security interest has been or will be created in its favour in respect of this new type of asset.

Question	Answer
Must the legal opinion be provided to OSFI?	A copy of the legal opinion should not be filed with OSFI. It is a requirement of RSA Guidance that the ceding company obtain a legal opinion, but this legal opinion should be kept on file with the company to be produced upon request. OSFI expects that the legal opinion will be in place before the executed copy of the RSA is provided to OSFI and before capital relief may be claimed for assets held.
Which documents does OSFI expect to be attached to the legal opinion? Must all reinsurance agreements entered into by the companies be attached?	RSA Guidance requires that an accompanying legal opinion be obtained in respect of any RSA entered into by the ceding company and that a copy of all legal documents and/or agreements to which the opinion applies be duly included as an attachment to the opinion. These are to be kept on file by the ceding company to be produced upon request. OSFI expects that in all instances, this would necessarily include the RSA. In addition, lawyers are expected to include any other legal documents, as applicable, to which the opinion relates or which are otherwise relevant for understanding and/or interpreting the opinion.
E) Other	
Does OSFI provide advice on specific wordings for reinsurance contracts?	Certain industry associations and organizations, such as the Reinsurance Research Council (RRC), and Property and Casualty Insurance Compensation Corporation (PACICC) issue various technical reference tools, providing wordings for reinsurance contracts and/or insolvency clauses for the Canadian industry. While there are several such sources, it must be noted and stressed that OSFI does not provide or endorse particular language or wordings for reinsurance contracts. Companies are encouraged to consult with their legal counsel. In any event, the wordings used in any reinsurance arrangements are expected to be consistent with Guideline B-3 *Sound Reinsurance Practices and Procedures*. Companies may also wish to refer to OSFI's RSA Guidance and other background on OSFI's Reinsurance Policy Review.