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

255 Albert Street
Ottawa, Canada
K1A 0H2

255, rue Albert
Ottawa, Canada
K1A 0H2

www.osfi-bsif.gc.ca

Ruling

Category: **Business and Powers** **NOTICE***

Subject: **Experience Refund Programs**

No: **2004 – 01**

Issue: The issue was whether a foreign insurance company's experience refund program operating in Canada would be considered to be a reinsurance arrangement, thereby requiring the foreign insurance company to obtain an order to insure in Canada risks under the *Insurance Companies Act* (ICA).

Background: A foreign insurance company (FIC) proposed to offer insurance to its multinational clients using a network of insurers located in those jurisdictions where the clients have subsidiaries or establishments. In Canada, for example, the FIC would arrange for an insurer authorized to insure in Canada risks ("Canadian insurer") to provide employee insurance coverage to its multinational client's subsidiary or establishment in Canada ("Canadian operation").

To offer the insurance, the FIC developed a program that built upon the concept of an experience refund. An experience refund typically involves an insurer remitting to a client part of the profits that are in excess of those projected in the original premium base or generated as a result of a better than expected experience on claims pertaining to that client ("surplus").

Under the FIC's program, where a Canadian insurer's coverage of the Canadian operation resulted in a surplus, the Canadian insurer would remit the surplus to the FIC rather than to the Canadian operation. The FIC would hold in a fund for the account of its multinational client the Canadian insurer's surplus along with the surpluses collected from the other participating insurers. The FIC would first use these funds to pay, on a pro rata basis, all participating insurers that had suffered a loss and then remit to its multinational client the balance remaining in the fund, if any.

Under the arrangement with the FIC, the Canadian insurer would:

(a) determine the needs of the Canadian operation;
(b) make offers for the employee insurance coverage based on its own tariffs and conditions;
(c) underwrite and administer the insurance covers, in Canada, for the Canadian operation; and
(d) have the discretion to reinsure up to 100% of the insurance risks with any reinsurer approved by the FIC.

Given that the FIC did not have an order to insure in Canada risks, it requested a ruling to determine whether OSFI would consider the program, as it would operate in Canada, to be a reinsurance arrangement.

Considerations: In determining whether the program in Canada would be a reinsurance arrangement, OSFI considered whether the risk that would be insured by the Canadian insurer would be transferred to the FIC. In this regard, OSFI considered whether the FIC would (a) have an obligation to indemnify the Canadian insurer for any particular risks insured by the Canadian insurer, (b) assume directly any of the risks insured by the Canadian insurer or (c) be responsible for any claims under a policy underwritten by the Canadian insurer.

In evaluating the program against those considerations, OSFI determined that a significant characteristic of the program was that the Canadian insurer's right to compensation for its losses would be contingent upon other participating insurers having a surplus.

If there were no surpluses for a particular program year, the Canadian insurer would be responsible for all claims and would have to assume all losses on its policies; the FIC would have no obligation to remit funds to the Canadian insurer to offset all or part of its losses on its coverage of the Canadian operation. In addition, the FIC would not assume any of the risks insured under the policies underwritten by the Canadian insurer nor be responsible for any of the claims. Conversely, if there were surpluses and the Canadian insurer were to incur losses on its coverage of the Canadian operation, the Canadian insurer would have access to a fund that would offer the possibility of offsetting all or part of its losses. However, the FIC would not guarantee that the Canadian insurer's losses would be fully offset.

Conclusion: Based on its consideration of the facts set out above, OSFI did not regard the program, as it would operate in Canada, to be a reinsurance arrangement under the ICA. The FIC would have no obligation to indemnify the Canadian insurer in respect of particular risks insured by the Canadian insurer. Neither would it assume any of the risks insured by the Canadian insurer under the policies or be responsible for any of the claims. Consequently, to offer its program in Canada, the FIC would not require an order to insure in Canada risks under the ICA.

Legislative References: Subsection 573(2) of the ICA states that a foreign company shall not in Canada insure a risk unless the risk falls within a class of insurance that is specified in the order of the Superintendent approving the insuring in Canada of risks by the foreign company.

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