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Evaluating Federal and Provincial Solvency Standards in Canada

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Evaluating Federal and Provincial Solvency Standards in Canada

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ABSTRACT

This article benchmarks solvency supervisory system for the federal and provincially-licensed companies who write insurance in Canada against/The IAIS Common Structure for the Assessment of Insurer Solvency/. The federal regulator (OSFI) is the only one with statutory authority that provides both sufficient power and flexibility to be considered as meeting the core principles of IAIS. At the provincial level, the insurance supervisory system in some provinces falls short of the international standards to varying degrees and, by extension, the practices of the federal insurance regulator. Alberta, British Columbia, and Québec are not far behind. All other Canadian provinces exhibit extensive deficiencies when compared against international standards.

RÉSUMÉ

Cet article compare les systèmes de contrôle de la solvabilité pour les compagnies canadiennes d'assurance fédérales et provinciales en utilisant le IAIS (Structure commune pour la garantie de la solvabilité des assureurs). Le régulateur fédéral (BSIF) est le seul organisme avec l'autorité statutaire qui fournit à la fois le pouvoir suffisant et la flexibilité nécessaire en vue de rencontrer les principes de

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The author:

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base d'IAIS. Au niveau provincial, le système de supervision de l'assurance dans quelques provinces est au-dessous des normes internationales à des degrés variables et, par extension, les pratiques du régulateur fédéral d'assurance. L'Alberta, la Colombie-Britannique et le Québec ne sont pas loin derrière. Toutes les autres provinces canadiennes exposent de vastes lacunes par voie de comparaison avec les normes internationales.

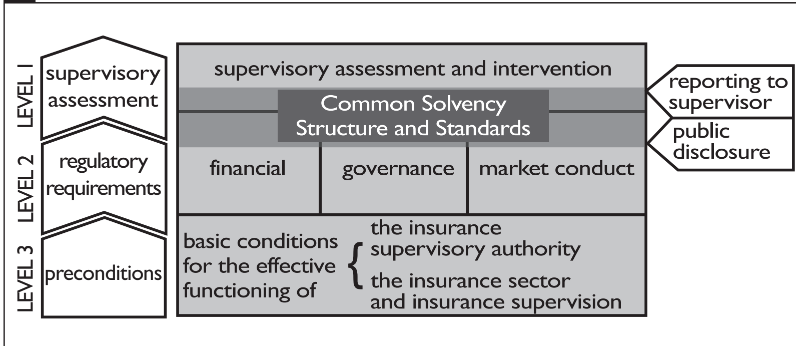
1. INTRODUCTION

Financial solvency supervision in Canada is the responsibility of the Office of the Superintendent of Financial Institutions (OSFI) for federally licensed insurers; provincially licensed insurance companies are subject to provincial solvency supervision. This paper benchmarks solvency supervisory system for the federal and provincially-licensed companies who write insurance in Canada against emerging international standards.

2. COMPARING CANADA'S INSURANCE SUPERVISORY SYSTEM TO BEST PRACTICES

A great deal of work has occurred at the international level to improve and standardize insurance solvency regulations and systems since the International Association of Insurance Supervisors (IAIS) was established in 1994. In 2005 a policy note was issued emphasizing the interdependence among three main "blocks" of insurance supervision: financial, governance and market conduct. C*ommon solvency structure and standards* are found to be a "cornerstone" tying the three blocks together and led to the production of a subsequent paper (IAIS, 2005b) that focuses exclusively on issues of solvency. The companion piece later that year, *A New Framework for Insurance Supervision: Towards a Common Structure and Common Standards for Assessment of Insurer Solvency* (IAIS, 2005a), integrated that work into a broader construct. Figure 1 reproduces the diagrammatic version of the structure that has been designed to bring together the design and implementation of a 'best practices' supervisory system. This document, *The IAIS Common Structure for the Assessment of Insurer Solvency,* received final approval of IAIS membership in February 2007.

FIGURE 1
CATEGORY AND STRUCTURE ELEMENTS DEVELOPPED BY IAIS



Source: The IAIS Common Structure for the Assessment of Insurer Solvency. (Basel: February, 2007).

In essence, Canadian supervisory authorities are being gifted a blueprint that represents the work of insurance regulators and supervisors of some 180 jurisdictions in more than 130 countries with which their existing system of solvency oversight can be compared. The major findings from the three key IAIS standard-setting papers are presented as an Appendix to this report.

Given the extensive work already completed, it is a straightforward – if not simple – task to determine the steps needed to bring one's own jurisdiction up to these basic international standards. The Office of the Superintendent of Financial Institutions (OSFI), Canada's federal insurance regulator, has announced the adoption of the IAIS guidelines, and the resulting regime is reviewed in this paper both in the interest of completeness and as an example for other Canadian jurisdictions to consider. With that as background, this paper continues with its primary purpose, i.e., a review of the extent to which supervisory authorities in the various provinces that have insurers incorporated within their jurisdictions[1] compare with the IAIS solvency infrastructure.

3. STATUTORY PROVISIONS

The basis for any system of solvency regulation is the set of statutes that establishes the supervisory function and gives them the authority to act. A careful review of provincial statutes has been conducted. A summary follows of how these statutes compare with the international standards for the categories and "Structure Elements" developed by IAIS (Figure 1). Statutory provisions that deal with assigned risk pools and other legislated risk-sharing for specific lines of business or subsets of the insurance industry (e.g., factory mutuals) are excluded from this analysis in the interest of conciseness.

This article is organized around the categories of preconditions for effective supervision, requirements for insurer finances, requirements for insurer governance, requirements for insurer market conduct, supervisory actions permitted/required, and disclosure. Several simple tables are presented to show how consistent the various provinces' legislation is with IAIS standards.

Preconditions for Effective Insurance Supervision

This review begins by identifying a few items that can be categorized as preconditions and are unquestionably desirable characteristics, though perhaps some fall short of being essential. First, only a handful of jurisdictions across Canada include explicitly in legislation the objectives intended for the supervision of insurance. Among the best of these is the statement by Nova Scotia that "the Superintendent has general supervision over the business of insurance in the Province, and is to secure the enforcement of the Act." In many other provinces the statutory requirement is simply "an annual report" by the supervisor while remaining silent as to exactly what the supervisor is intended to do or what information the report is intended to convey.

The second advisable statute is one called "supervisory suitability" in some IAIS documents. Seven Canadian jurisdictions have some provision explicitly stating that the "superintendent cannot be a shareholder in an insurance company" with some of those statutes more expansive, e.g., precluding indirect ownership and/or including additional persons in the Superintendent's office. The other six jurisdictions[2] either presume that the ethical standards of the individual appointee will have the same effect or incorporate these requirements in broader law than that which deals with financial institutions.

The third of these preconditions is a statute providing protection against legal action for a supervisor performing the duties of his or

her office. In several provinces, that protection is nearly absolute; a few provide for a process, such as "written permission of the minister" whereby that exemption can be removed. Still others (Ontario, Saskatchewan, and Quebec in the Act respecting the l'autorite) provide that protection elsewhere in their legislation. No such statutory protection is found within the statutes dealing with supervision of financial institutions in New Brunswick, Nova Scotia, Newfoundland & Labrador, and the Yukon Territories. While such protection may exist in case law or elsewhere[3], it is worthwhile to note that the best candidates for the supervisory role may be less willing to assume the responsibility without such explicit protection.

The most fundamental precondition for effective supervision of insurance, identified by IAIS as Structure Element 1, says

"The supervisor must have adequate powers to:

- require an insurer to assess and manage the risks to which it is exposed;
- set regulatory financial requirements for individual insurers to protect policyholders' interests; and
- require that, if necessary, an insurer holds additional capital or takes action to reduce its risks so that the assets it holds are sufficient and appropriate."

In general it is quite difficult to find statutory authority anywhere in Canada that "require[s] an insurer to assess and manage its risks." Rather, what is found is the authority to require disclosure of the results of that assessment and management process. This combinations of facts led the current review to examine the respective statutes to determine if they are sufficiently broad to enable the supervisor to assess (using its own methods) the risks presented by a particular insurer. In general a phrase that goes beyond the requirement to receive financial statements and that gives the Superintendent the authority to "ascertain the ability to pay for its contracts" was considered sufficient to permit the introduction of risk-based capital assessments and other newer risk management tools as they develop. Similarly, a requirement in the financial section of the law that a company must "maintain an adequate capital base consistent with sound and prudent management" was deemed to provide essentially that same level of authority and flexibility. Table 1 reports the results of that statutory review.

TABLE 1 PRECONDITIONS FOR EFFECTIVE INSURANCE SUPERVISION		
Consistent or Largely Consistent with IAIS Standards	*Consistent with IAIS Standards in Some Ways but with Important Deficiencies*	*Missing Most Major Elements of IAIS Standards*
Federal, AB, BC, MB, ON, NB, NL, PEI, QC	Nova Scotia, NWT, SK, Yukon	

Regulatory Requirements: Financial

The most extensive regulation of Canada's insurance companies can be classified broadly as financial. Given the focus and extent of regulation that deals with insurance company finances, it is somewhat ironic that the financial framework found in the IAIS structure has proven the most difficult area of all to apply to Canadian jurisdictions. While insurance regulation has seen a trend globally toward risk-based supervision, that trend has not yet seen widespread adoption across Canada. Therefore, its adoption by the IAIS creates an environment where their *Common Structure* document has "leap-frogged" the more formulaic (rules-based) approach used for many years in many jurisdictions and still widely evident across Canada. Moreover, several elements of the specific characteristics for optimal regulation, such as "incentives for optimal alignment of risk," are largely a matter of day-to-day implementation and, as such, probably should not be found in statute. It is, therefore, not surprising to this researcher that they are not found in statute anywhere in Canada.[4]

As stated previously, giving the Superintendent the authority to "ascertain the ability to pay for its contracts" or having a statutory requirement that a company "maintain an adequate capital base consistent with sound and prudent management" would seem to give the supervisory authority sufficient powers to be able to use the approaches and methods contained in several of the IAIS Structure elements. Within such a legal framework, the policies and procedures established by an honourable supervisor likely will be able to meet the objectives of the law without actually having a risk-based approach delineated in the jurisdiction's legislation. This view is perfectly aligned with Structure Element 8 which states:

"From a regulatory perspective, the purpose of capital is to ensure that, despite adverse conditions, policy claims and obligations

will still be met as they fall due and the required technical provisions remain covered."

All provinces require licensed insurers to meet minimum capital standards and to regularly report their financial condition. That is about the extent to which the law in Canadian jurisdictions is consistent with the specific interpretations by province of what "adequate capital base" means from one jurisdiction to another showing tremendous variation. As shown in Table 2, three provinces have tailored their capital requirements on the basis of OSFI's Minimum Capital Test (MCT) while the others provide rules that are more absolute.

TABLE 2
MINIMUM CAPITAL REQUIREMENTS

Federal	MCT (100% minimum +50% target+ company target)
AB	$5 million for life company; $3 million for property-casualty
BC	MCT (100% minimum + 50% target + company target)
MB	$4 million, with $1 million unimpaired
NB	$3 million with $250,000 unimpaired
NF	$3 million
NS	$5 million for life company; $3 million for other-than-life
ON	MCT (100% minimum +50% target+ company target)
PEI	$3 million with $750,000 unimpaired
QC	MCT (100% minimum + company target)
SK	Assets > liabilities

Beyond the dollar amounts of capital required, another dimension of financial oversight relates to the requirement within each province/territory for the insurance company to go beyond reporting its risk by implementing a requirement that the insurer *manage* the insurance risks it assumes. In Canadian law this generally is found in one of two different forms:

(1) Inclusion of two separate specific requirements, viz. that premiums be adequate and that the insurer conduct an actuarial assessment of its liabilities

or

(2) Inclusion of a single broader requirement that insurers recognize the range of risks that they face and put appropriate measures in place to assess and manage these risks effectively.

TABLE 3
FINANCIAL RISK MANAGEMENT

Require risk management (or both key elements)	*Requires one key element for risk management (but not both)*	*Missing Both Elements of Risk Management*
Federal, BC, ON, QC	AB[1], SK	MB[1], NB[1], NWT, NS, NL, PEI, Yukon

Notes:
[1] Life insurance only is required to be self-supporting.

With respect to financial risk management, this section of the IAIS guidelines provides guidance to a supervisor on how to provide oversight in this rapidly evolving area. The ultimate goal should be to manage the interactions with insurers in a manner that focuses attention on "all relevant potentially material risks, including underwriting risk, credit risk, market risk, operational risk and liquidity risk." In Canada, OSFI's so-called "ladder of intervention" approach is a prime example of the risk-based framework that has developed.

Regulatory Requirements: Governance

IAIS Structure Element 12 states that "Sound governance is a pre-requisite for a solvency regime to operate effectively." Generally, statutory provisions that relate to governance might include provisions that relate to board composition and a requirement for internal controls. Specifically, some jurisdictions limit who can serve as a corporate director, mandate that a certain number or proportion of directors be independent of management, or require representation of policyholders on the board. With respect to statutory oversight of board composition, Table 4a compares the Canadian jurisdictions on the first two of these:

TABLE 4A
GOVERNANCE – DIRECTORS

Prohibit inappropriate persons from serving AND require independent directors	*Prohibit inappropriate persons from serving OR require independent directors*	*NEITHER Prohibit inappropriate persons from serving NOR require independent directors*
Federal, AB, BC, MB	ON, QC	NB, NWT, NS, NL, PEI, SK, Yukon

As to provisions that relate to internal controls, several jurisdictions require the board to have audit committees in place and some explicitly make internal control the responsibility of that Audit Committee.

TABLE 4B
GOVERNANCE – AUDIT AND INTERNAL CONTROL

Mandate audit committee	*Mention governance (but are less prescriptive)*	*No mention of audit committee or internal controls*
Federal, AB, BC, MB, ON	QC	NB, NWT, NS, NL, PEI, SK, Yukon

Regulatory Requirements: Market Conduct

Based on a rationale that relates to reputational risk and indirect losses, the IAIS included market conduct in its document designed chiefly to address solvency concerns. Structure Element 13 begins with a recommendation that the supervisory regime "should require insurers to have sound market conduct policies and procedures…" All jurisdictions in Canada have taken significant steps to control undesirable market conduct in conjunction with their goals of consumer protection. Examples include statutes that address terms of contract not set out in policy, effect of delivery of policy or premium receipt, how premiums may be paid or refunded, and time for payment of claims. A few, e.g., Newfoundland and Labrador, incorporate such prohibitions directly in statute: refusal to provide insurance and the use of certain variables in an insurer's risk classification system. More commonly, many provinces have regulations, e.g., Ontario's similar restriction on the use of certain risk classification variables, which limit certain types of market conduct under their statutory authority but not in statute.

The partial statement of Structure Element 13 (above) continues with the statement that the supervisory regime also "should be transparent as to how policyholder expectations should be expressed and reflected in solvency assessment." In most instances the transparency requirement as it relates to market conduct begins with a complaint resolution mechanism. Some go considerably farther, e.g., Ontario's requirement that each company identify a Consumer Complaint Officers, the appointment of an Insurance Ombudsman, and publication of a Consumers' Bill of Rights.

Supervisory Assessment and Intervention

The functioning of a supervisory system intended to inhibit and manage insolvencies depends on said supervisor having adequate authority to examine companies for solvency problems and to take action when problems are found. Structure Element 14 provides additional details about how a well-functioning system looks:

There should be a number of solvency control levels which trigger different degrees of intervention by the supervisor in a timely manner. The solvency regime should have due regard to the coherence of the solvency control levels and any corrective action that may be at the disposal of the insurer, and of the supervisor, including options to reduce the risks being taken by the insurer as well as to raise more capital.

TABLE 5
SUPERVISORY ASSESSMENT

Contains explicit levels of solvency controls and risk-based corrective action	*Contains reference only to a finite number of levels of (in)solvency*	*Contains no reference to (in)solvency*
Federal, AB, BC	ON2, MB, NB, NWT, NL, PEI, SK, Yukon	NS, QC

[1] Communication with supervisory authorities in Alberta state that this jurisdiction uses the OSFI system of staged response; that information is, therefore, reflected here even though it was not found in publicly available statutes or regulations.
[2] Ontario legislation provides for the superintendent to take possession of a company's assets for the purpose of rehabilitation. This indirectly recognizes the existence of a third category of a firm that "requires rehabilitation."

Generally, the provincial Insurance Acts in Canada provide authority to act in a fashion such as that found in the NWT/Nunavut legislation "if the Superintendent… finds that the assets of an insurer

are insufficient ….” Whether written using words such as “sufficient/insufficient”, “adequate/inadequate”, “solvent/insolvent”, or some other nomenclature, this language essentially provides for two states of financial strength. That limited list of options can severely limit, probably unintentionally, the opportunities for early corrective action available to the supervisor unless an insurer chooses to cooperate.

The effectiveness of intervention strategies of a supervisory authority also depends on the availability of penalties that he/she may be empowered to impose to elicit and potentially enforce cooperation. A tremendous range of penalties is found across Canada with the federal statute among the strongest. Section 1027 of the *Insurance Companies Act* makes failing to comply with any order or direction an offense and provides for punishments to individuals as high as $1,000,000 or 5 years in prison; punishment for an entity can reach $5,000,000. By way of contrast, Section 93(1) of the New Brunswick statute states that violating their *Insurance Act* can result in a penalty of between $50 and $500.

Disclosure

Disclosure takes a variety of forms in Canadian statute, including requirements that licensed insurers conduct an annual meeting and that policyholders be provided with financial statements and/or reports of the auditor and actuary. Manitoba, for example, requires[5] that “[a] summary of the valuation certified by the actuary, and a statement as to the financial condition of the society disclosed by the valuation” to be mailed to each insured member. In other instances, however, disclosure requirements are more passive. An example is British Columbia’s requirement that copy of its most recent annual financial statement and auditor’s report be kept at each office and that anyone can examine such documents free of charge.

This section deals with disclosure by the supervisory official directly to the public. Structure Element 15 delineates a delicate balance between the need for transparency:

> The supervisory regime should specify which solvency information should be made public to enhance market discipline and provide strong incentives for insurers to conduct their busi ness in a safe, sound and efficient manner which treats policyholders fairly.

and the need to encourage cooperation by ensuring that certain types of information remain confidential:

Information provided to the supervisor and subject to confidentiality supports and fosters openness on commercially sensitive issues between the supervisor and the insurer.

Overall, Canada's provinces have generally enacted statutes that incorporate no more than one half of this.

TABLE 6
SUPERVISORY DISCLOSURE

Clearly identifies what is to be disclosed and what is confidential	*Clearly identifies what is to be disclosed or what is confidential*	*NEITHER Clear about what is to be disclosed nor what is confidential*
Federal, AB, QC	BC, NB, NL, PEI, Yukon	ON, MB, NWT, NS, SK

Only three jurisdictions are operating their supervisory authority under legislation that captures both the public's need for information and the need for confidentiality to provide time for supervisors and companies to work together to solve some types of problems and prevent others.

An additional requirement of Structure Element 15, i.e., that "[t]he regime should be open and transparent as to the regulatory requirements in force, and be explicit about its objectives and the level of safety that it requires" has not been explicitly considered in this report. In general, the extensive nature of insurance regulation suggests that there is considerable information available as to the regulatory requirements in place. To repeat an earlier observation, however, much of Canadian regulation in this area is rules-based and as a result may spend less time codifying objectives and level of safety. Certainly these matters would have been discussed at the time the current rules were established, but a rules-based approach may cause them today to be obscured in legislative history.

4. IMPLEMENTING REGULATION

The effectiveness of any system of oversight is determined by more than its statutory authority. The implementing regulations authorized by the statutes play a critical role in the day-to-day operations of the supervisory process and in the effectiveness of solvency regulation. While not completely generalizable, the importance of implementing regulations becomes greater as one proceeds through

Levels 1, 2, and 3 of the IAIS Framework. This is particularly true where the enabling legislation says that a supervisor "may" undertake specific actions rather than "must" undertake them.

5. CONCLUSIONS

The detailed results provided above are summarized in Table 7 using a simple scoring system with two points assigned to those jurisdictions where the statutes largely comply with IAIS solvency structure; one point assigned to jurisdictions where the statutes include important elements of the IAIS solvency structure; and no points used to indicate a jurisdiction whose statutes are missing most important elements of the IAIS solvency structure. The federal regulator (OSFI) is the only one with statutory authority that provides both sufficient power and flexibility to be considered as meeting the core principles of IAIS.

TABLE 7
SUMMARY OF CANADIAN SOLVENCY LAWS WITH STRUCTURE ELEMENTS OF IAIS

	Pre-conditions	Financial Risk Mgmt.	Director Fit-ness	Internal Controls	Supervisory Assessment	Supervisory Disclosure	TOTAL (Avg.)
Federal	2	2	2	2	2	2	12 (2.00)
AB	2	1	2	2	2	2	11 (1.83)
BC	2	2	2	2	2	1	11 (1.83)
ON	2	2	1	2	1	0	8 (1.33)
QC	2	2	1	1	0	2	8 (1.33)
MB	2	0	2	2	1	0	7 (1.17)

NB	2	0	0	0	1	1	4 (0.67)
NWT	1	0	0	0	1	0	2 (0.33)
NS	1	0	0	0	0	0	1 (0.17)
NL	2	0	0	0	1	1	4 (0.67)
PEI	2	0	0	0	1	1	4 (0.67)
SK	1	1	0	0	1	0	3 (0.50)
Yukon	1	0	0	0	1	1	3 (0.50)

Key:

- Two points indicate the jurisdiction's statutes largely comply with IAIS solvency structure.
- One point indicates the jurisdiction's statutes include important elements of the IAIS solvency structure.
- Zero points indicates the jurisdiction's statutes is missing most important elements of the IAIS solvency structure.

At the provincial level, the insurance supervisory system falls short of the international standards to varying degrees and, by extension, the practices of the federal insurance regulator. Alberta and British Columbia come closest to the desired structure with Ontario and Quebec not far behind. Over half of all Canadian provinces exhibit extensive deficiencies.[6] The key purpose of this review is to highlight the extent to which statutory authorities across Canada omit some key aspects, potentially leaving that jurisdiction's supervisory authority with its hands tied, if and when problems were to occur.

With the shortfalls identified, what remains is to implement changes as the political situation and available resources permit. In the long run, such a proactive strategy can be expected to reduce problems that adversely affect insurance consumers and allow a reduction or reallocation of resources that would otherwise be required. This can be achieved under the Canadian model through modifications of either direct regulatory activities of the supervisor or, in some instances, through elements of self-regulation that are prevalent in Canada and often are overseen by the regulator. At least

two options are available to provinces that need to address specific areas of regulatory deficiency:

- The province can elect to restrict their activities solely to regulating market conduct for insurers, and rely on the federal insurance regulator to undertake financial solvency regulation for provincially licensed insurers. In practice, this could require local insurers to seek a federal license.
- The province could provide the additional resources needed to bring its system of solvency supervision up to the standards of the International Association of Insurance Supervisors, and the practices of Canada's federal insurance regulator.

Overall, the maintenance of a level playing field in the regulation of financial solvency and corporate governance among all insurance companies in Canada is an important principle of fairness. Also, any material deviation in the quality of solvency regulation between the two classes of insurers -- federally and provincially licensed – may ultimately demand that the respective guarantee funds (PACICC and Assuris) consider assessing a risk premium for member insurers who are not subject to solvency supervision that meets international standards. It is hoped that using the core principles of the globally developed IAIS standards at all levels of Canadian supervision will aid in the achievement of the objectives of fairness and equity.

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Appendix: Summaries from IAIS Documents

This research builds extensively on three papers published in recent years by the International Association of Insurance Supervisors (IAIS). While all can be found in their entirety on the IAIS website (at http://www.iaisweb.org/index.cfm?pageID=37), the major findings from the three key standard-setting papers also are presented below.

Common Structure for the Assessment of Insurer Solvency

The paper follows on from the earlier Framework, Cornerstones and Roadmap papers and describes the overall IAIS risk based approach to the assessment of insurer solvency. Three Framework levels are identified, each with several structural elements linked to cornerstones.

Framework Level 1: Preconditions for Solvency Assessment

This section outlines the requirement for an institutional and legal framework, well developed and effective financial market infrastructure, efficient financial markets and adequate authority and capacity for the supervisory authority.

Framework Level 2: Regulatory Requirements

This Level encompasses three blocks of topics: the financial block, the governance block and the market conduct block. The primary focus of this Level is on the financial block. Governance and market conduct are addressed but are more fully explored in other IAIS work.

> *Financial requirements:* This section focuses on the financial requirements in a solvency regime, and more precisely the role and determination of reserves (technical provisions) and required capital, expands on a number of key elements in the Framework and Cornerstones papers. Ten structural elements, related to cornerstones II, III, IV, V, VI and VIII are addressed in this section.
>
> *Governance requirements*: The supervisory regime should require insurers to have and maintain corporate governance policies, practices and structures and undertake sound risk management in relation to all aspects of their business. Sound governance is a prerequisite for a solvency regime to operate effectively.
>
> *Market Conduct:* The supervisory regime should require insurers to have sound market conduct policies and procedures. The regime should be transparent as to how policyholder expectations should be expressed and reflected in solvency assessment.

Framework Level 3: Supervisory Assessment and Intervention

Related to Cornerstone VII, there should be a number of solvency control levels which trigger different degrees of intervention by the supervisor in a timely manner. The solvency regime should have due regard to the coherence of the solvency control levels and any corrective action that may be at the disposal of the insurer, and of the supervisor, including options to reduce the risks being taken by the insurer as well as to raise more capital.

A New Framework for Insurance Supervision: Towards a Common Structure and Common Standards for the Assessment of Insurance Solvency

This Framework serves to clarify and enhance the interrelationship between the solvency standards and the other IAIS Principles, Standards and Guidance Papers of the IAIS. Figure 1 in the main body of this paper is an illustration of the Framework.

The Framework for insurance supervision encompasses the overall spectrum of insurance and insurance supervision and is compatible with the approach taken in Basel II. Consisting of three groups of issues: financial issues, governance issues and market conduct issues, it incorporates three different responsibilities related to these issues: preconditions for effective insurance supervision, regulatory requirements, and supervisory action.

Towards a Common Structure and Common Standards for the Assessment of Insurer Solvency: Cornerstones for the Formulation of Regulatory Financial Requirements

Insurer solvency takes a central position in risk management by insurers and in insurance supervision. In all, eight cornerstones are outlined.

Cornerstone I: emphasises the need for an insurer to meet its liabilities under all

reasonably foreseeable circumstances, in the short and long-term

Cornerstone II: outlines that in order to achieve that aim there should be clarity on the main risk factors an insurer faces, their possible impact, and the way in which these risks are reflected in the regulatory financial requirements

Cornerstone III: stresses the need for explicit prudence in the regulatory financial requirements

Cornerstone IV: emphasises that in formulating regulatory financial requirements and undertaking solvency assessment, there is a need to attach appropriate and consistent values to assets and liabilities

Cornerstone V: makes clear that a solvency regime should be specific on the determination of technical provisions

Cornerstone VI: outlines the need for a clear understanding by both the insurer and the supervisory authority of the expected cost of meeting the insurer's liabilities and the main determining factors thereof. This is a prerequisite to attaining insight into the level of prudence of the insurer's solvency position and of the technical provisions.

Cornerstone VII: indicates that there is a further need to define a number of control levels for assessing the financial condition of an insurer

Cornerstone VIII: acknowledges that the structure of the insurance markets may call for a menu of approaches for the assessment of insurer solvency.

Notes

1. Correspondence confirms that no insurers are incorporated in either the Northwest Territories or the Territory of Nunavut. Therefore, while these jurisdictions are included in this review, the reader should recognize that the effects in the marketplace are minimal.

2. AB, BC, ON, NS, NL, QC.

3. This does not preclude the possibility of such protection being included in a statute that deals with a much broader set of government appointees.

4. Condon (2007) reviews the academic literature "concerning two recent innovations in philosophies of regulation (i) principles-based regulation and (ii) risk-based regulation." Both approaches represent attempts to improve upon prescriptive, rules-based approaches to regulation. However, the two approaches appear not to be mutually exclusive. For example, an attempt to classify the IAIS standards concludes that those insurance-specific standards generally recommend a principles-based view but also encourage the supervisor to ask risk-based questions. It is, therefore, somewhat confusing to try and overlay the taxonomy of Condon (2007) with that of the IAIS.

5. Section 314(3).

6. This statement should by no means be interpreted to say that the companies doing business without a federal license are poorly run. The vast majority of insurers are operated in a manner that demonstrates sound business practices and, therefore, would be in compliance with these legal requirements if the jurisdiction chose to prescribe them.