

From: HarrisMartin's None

Date: March 3, 2011

Canadian Reinsurance Regulatory Regime to be Significantly Strengthened in 2011-2012

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****I. Introduction****

Late last year, the Office of the Superintendent of Financial Institutions (Canada) (OSFI), the Canadian federal prudential insurance regulator, released final versions of administrative guidance which, once implemented in 2011 and 2012, will significantly strengthen the regulation of reinsurance business in Canada. The guidance is comprised of Guideline B-3 Sound Reinsurance Practices and Procedures (the Guideline) and Guidance (the Guidance) on the use of Reinsurance Security Agreements (RSAs). OSFI's issuance of the Guideline followed the release, in August 2010, of a consultation draft (the Draft Guideline), which had in turn reflected a long-awaited paper, released in March 2010, on OSFI's regulatory and supervisory approach to reinsurance. The Guideline applies to all federally-regulated insurers and reinsurers and fraternal benefit societies (each, a FRI) in respect of reinsurance cessions, retrocessions and, where applicable, assumption reinsurance transactions. Once fully implemented, the Guideline will significantly enhance OSFI's oversight of reinsurance arrangements and impose significant new internal requirements on FRIs.

Meanwhile, issuance of the Guidance followed the August 2010 release of a consultation draft (the Draft Guidance), which was accompanied by a letter (the Letter) summarizing OSFI's rationale for discontinuing the previously-utilized mechanism of standard form reinsurance trust agreements (RTAs) and outlining OSFI's new approach to RSAs. The Guidance applies to all FRIs in respect of reinsurance cessions (and retrocessions) with reinsurers not licensed in Canada, and also outlines OSFI's expectations of FRIs in connection with the RSA process. Once fully implemented, the Guidance will significantly increase the administrative burden on FRIs seeking to reinsure with unlicensed reinsurers and may, as a result, significantly discourage the use of unlicensed reinsurance.

This article provides an overview of, and commentary on, the Guideline and the Guidance, with particular emphasis on the changes from the Draft Guideline and Draft Guidance, respectively.

****II. Implementation Timeline****

OSFI is encouraging each FRI to implement the principles and expectations in the Guideline as soon as practically possible and to comply with Principle 1 (respecting reinsurance risk management policies), including securing board approval of its policy, by July 1, 2011. Once the policy has been approved, each FRI is expected to comply with the balance of the Guideline, including the filing of its first required reinsurance declaration with its board, by July 1, 2012.

For multi-year contracts that do not naturally come up for renewal prior to July 1, 2012, OSFI expects that each FRI will take all commercially reasonable efforts to make such contracts compliant with the Guideline by that date. By comparison, the Draft Guideline required compliance in all respects by January 1, 2011, which the industry argued did not provide sufficient lead time.

OSFI is further expecting ceding companies, as a matter of best practice, to take steps to enter into RSAs compliant with the Guidance as soon as possible, and that all new agreements should comply with the Guidance beginning July 1, 2011. OSFI expects companies to take all commercially reasonable efforts to replace, prior to January 1, 2012, existing multi-year agreements that do not naturally come up for renewal prior to that date. By comparison, the Draft Guidance required new RSAs to comply by January 1, 2011 and the replacement of existing contracts by January 1, 2012. In both cases the industry similarly argued that sufficient lead time was not provided. The designated OSFI Relationship Manager will follow each company's efforts and progress with respect to the implementation of the Guideline and Guidance.

****III. The Reinsurance Guideline****

In general terms, the Guideline is intended to create a reinsurance governance regime that:

- reflects OSFI's elevated expectations with respect to sound reinsurance practices and procedures through principles-based guidance; and
- provides benchmarks to ensure a minimum level of consistency across FRIs and heightens the level of supervisory scrutiny of FRIs' reinsurance arrangements.

****Historical Background ****

OSFI's governance framework for reinsurance was historically comprised of:

- OSFI's Guideline on Corporate Governance, which applies to all FRIs and emphasizes the need for an effective board and the development of sound risk management practices, generally;
- the previous Guideline B-3, which was revoked effective January 1, 2010, and which applied only to unregistered life reinsurance cessions and focused on the cedant's assessment of the creditworthiness of the reinsurer; and
- the Reinsurance (Canadian Companies) Regulations and Reinsurance (Foreign Companies) Regulations under the Insurance Companies Act (Canada) (the Act), applicable to property and casualty FRIs and which impose specific limits on their ability to cede risks/premiums. The specific quantitative limits under those Regulations will be revoked effective June 30, 2011.

OSFI noted that although the Canadian federal supervisory regime for reinsurance was perceived to be robust, certain aspects have fallen increasingly out-of-step with international regulatory best practices and that many of the core elements of OSFI's regulatory framework for reinsurance have existed since the 1990s without substantive reform or update. Further, much of the current regulatory regime was not applied to the life insurance sector. Meanwhile, the nature of insurance and reinsurance operations for both life and property and casualty insurers has been rapidly evolving and has become much more technically advanced, increasingly segmented and globally diversified.

Specifically, OSFI noted that the current framework was ripe for significant supplementing and modernization as it did not:

- address critical elements of reinsurance arrangements (negotiation, approval, timing, contractual, etc.), which often follow industry practice rather than necessarily being consistent with prudent regulation;
- integrate an insurer's reinsurance program into its broader, enterprise-wide risk management practices and procedures;
- offer any express guidance to FRIs with respect to developing reinsurance risk management programs which reflect legal and counterparty risks involved with cessions to unregistered reinsurers (for example, there was historically no regulatory requirement for a cedant to conduct due diligence on the creditworthiness of a reinsurer);
- provide any guidance with respect to contract language and clauses increasingly common to reinsurance agreements but which can also lead to coverage ambiguity and adversely affect policyholders in the event of insurer insolvency; and

- require reinsurance agreements to contain a variety of important elements such as “insolvency” clauses.

In addition, OSFI historically provided cedants regulatory capital credit without having formally established a broad set of standards to ensure companies were appropriately managing their reinsurance risks. OSFI noted that this is contrary to regulatory practice in a number of other jurisdictions, where the existence of an acceptable insolvency clause in a reinsurance agreement, among other critical elements, is required before capital credit can be taken.

****Key Principles****

The Guideline is centered on four principles intended to assist FRIs in developing prudent approaches to managing their insurance risks. Although the focus on principles-based approach is to be commended, certain of the principles are actually quite prescriptive. The four key principles are:

1. An FRI should have a sound and comprehensive reinsurance risk management policy (RRMP) subject to the oversight of the FRI’s board and implementation by the FRI’s senior management.

The nomenclature of reinsurance risk management “policy” (connoting a set of rules or guidelines) is a change from the Draft Guideline, where the reference was to a “plan” or “program” (connoting a series of steps or actions to be completed). OSFI expects that the RRMP will form an integral component of the FRI’s overall enterprise-wide risk management plan. The RRMP should reflect the scale, nature and complexity of the FRI’s business, and have regard for its risk appetite and risk tolerance. OSFI expects the RRMP to document the significant elements of the FRI’s approach to managing risks through reinsurance, including the purpose and objectives for seeking reinsurance, risk diversification objectives, risk concentration limits, ceding limits and its practices and procedures for controlling reinsurance risks.

In a footnote to the Guideline, OSFI states that a FRI generally should not, in the normal course of business, cede 100 percent or substantially all of its risks in the main areas in which it conducts business as, absent extenuating circumstances, this could weaken the underwriting standards and discipline at the ceding FRI. A FRI may, however, occasionally cede a portion, or even 100 percent, of a specific line of business or a particular type of risk that is ancillary to its core business where, for example, it is underwriting the business for purely marketing relationship purposes. One hundred percent cessions of existing lines of business may, depending on the circumstances, also be acceptable, perhaps including the circumstance where the insurer is exiting the applicable line of business.

The RRMP should detail, for example:

- the FRI’s policy on the use of registered versus unregistered reinsurance;
- the roles and responsibilities for those officers charged with implementing the RRMP; and
- the process for ensuring that the RRMP is updated to reflect changing market conditions.

Consistent with a principles-based approach, the Guideline no longer requires, as did the Draft Guideline, that the RRMP also detail the methodologies and processes for selecting, documenting, approving, implementing, monitoring and reporting on reinsurance arrangements.

Additionally, the FRI must assess the adequacy and effectiveness of the reinsurance arrangements to ensure that exposures to large and catastrophic losses are adequately addressed. This may require stress testing of exceptional, but plausible, scenarios.

The RRMP should be overseen by the board and, at a minimum, the board should review and approve the RRMP as part of its annual review of the enterprise-wide risk management plan. The board may delegate responsibility for the RRMP to a committee of the board. Senior management has the responsibility of ensuring that the RRMP is operationalized through the dedication of adequate resources and implemented by the risk management and business line officers and managers charged with day-to-day responsibility for the RRMP. The board and senior management should also ensure that appropriate policies, procedures and internal controls exist to monitor the effectiveness of, and operational compliance with, the RRMP on an ongoing basis.

2. A FRI should perform a sufficient level of due diligence on its reinsurance counterparties on an ongoing basis to ensure that the FRI is aware of its counterparty risk and able to assess and manage that risk.

A FRI should evaluate the ability of all current and prospective reinsurance counterparties to meet liabilities under exceptional, but plausible, adverse events, on an ongoing basis. Similarly, a FRI which is a reinsurer should conduct its own due diligence on the risk management and risk assessment criteria of the companies ceding to it. The level of due diligence should be commensurate with the level of exposure to the particular counterparty and should not be any less thorough if the counterparty is a related party. The evaluation would not generally rely solely on third parties and, where appropriate, the FRI should conduct its own due diligence on the financial strength and capabilities of all current and prospective reinsurance counterparties. This assessment should be updated throughout the period during which claims subject to reinsurance could be made under the primary policy.

OSFI expects a higher level of diligence to be conducted in respect of current and prospective reinsurance with unregistered reinsurers or cedants not regulated by OSFI. OSFI expects this to consider the regulatory and supervisory regime and the legal and insolvency frameworks of the unregistered reinsurer's home jurisdiction (which should include the quality of the regulatory and supervisory regime, compliance with international standards and best practices, and the adequacy of the insolvency laws governing proceedings in the unregistered reinsurer's home jurisdiction). This requirement will likely impose significant new due diligence burdens on most FRIs proposing to cede to unlicensed reinsurers and may, as a result, significantly discourage use of unlicensed reinsurers.

3. Terms and conditions of the reinsurance contract should provide clarity and certainty with respect to the reinsurance coverage.

A FRI should have processes and procedures in place to ensure that a comprehensive, written, binding reinsurance contract is executed prior to the effective date of the reinsurance coverage. The contract should be unambiguous and there should be complete and final agreement on all material terms and conditions, documented in writing by all parties prior to the effective date. For many ceding companies, this requirement may impose substantial new practical requirements as compared to prior practice.

That said, OSFI recognizes that there may be situations where a comprehensive contract is only executed by the parties after the effective date and that during the interim period a slip, cover note or other summary document will typically be evidence of the arrangement. In that circumstance, in order to mitigate the associated risks during that interim period, OSFI expects FRIs to (i) obtain contractually binding summary documents prior to the effective date of the reinsurance coverage, including, but not limited to, electronic copies or original hard copies, of signed documents that address the key provisions, and any material issues most likely to arise; and (ii) ensure that all comprehensive reinsurance contracts, including any amendments thereto, bear the duly authorized signature of both parties within a relatively short time frame having regard for the complexity and materiality of the agreement (for example, within 120 days of execution). In the event that it is necessary and appropriate for a FRI to enter into a side letter or other arrangement that is ancillary to and forms part of the main reinsurance contract, the FRI should, in addition, be transparent with stakeholders about such arrangements, ensure that such amendments are appropriately reflected in its financial statements, and ensure that the amendments do not adversely change the terms or conditions of the original contract to the detriment of policyholders.

4. A ceding FRI should not be adversely affected by the terms and conditions of a reinsurance contract.

In the Guideline, OSFI notes that the terms and conditions of the binding insurance agreement should provide that funds will be available to cover policyholder claims in the event of the cedant's or reinsurer's insolvency. Accordingly, reinsurance contracts should include an "insolvency" clause and particular attention should be paid to the appropriate use of "off set" or "cut-through" clauses, the structure of "funds withheld" arrangements and other types of similar terms or conditions that may frustrate the scheme of priorities under Canada's Winding-Up and Restructuring Act (WURA). (An insolvency clause states that the reinsurer remains liable for its predetermined share of a policyholder claim even though the ceding insurer is insolvent. Under funds withheld arrangements, assets that would normally be paid to the reinsurer as consideration under the reinsurance

agreement are instead withheld and retained by the ceding company as a form of security, enabling capital credit for unregistered reinsurance).

In the Guideline, OSFI indicates that ceding companies should ensure that reinsurance contracts contain an insolvency clause and should not contain other terms and conditions that limit a troubled or insolvent cedant's ability to enforce the agreement or that may adversely affect the treatment of any claims of the cedant's policyholders. (For example, off-set and cut-through clauses may allow certain creditors or policyholders to obtain preferential treatment over other claims, contrary to the scheme of distribution in the WURA). In the case of off-set clauses, for example, where the ceding company is a foreign insurance company authorized under the Act to insure in Canada risks, the reinsurer should not have any right of off-set against the obligations of the ceding company other than those related to the ceding company's insurance business in Canada. Consequently, ceding companies will need to fully and carefully consider the appropriateness, in each circumstance, of including such types of off-set and/or cut-through clauses.

If the reinsurance contract provides for a funds withheld arrangement, the contract must clearly provide that, in the event of the cedant's or reinsurer's insolvency, the funds withheld, less any surplus due back to the reinsurer, must form part of the property of the cedant's general estate, or part of the assets in Canada of a foreign insurance company as defined under the WURA and the Act.

Finally, and potentially contrary to common practice, the Draft Guideline required that all contracts related to reinsurance coverage be subject to Canadian laws or the laws of another jurisdiction acceptable to OSFI (after receiving a submission from the FRI's counsel as to why the choice of foreign law would not disadvantage the FRI), that any dispute should be subject to the non-exclusive jurisdiction of Canadian courts and that any foreign counterparty has taken steps to ensure that legal process may be served against it in Canada. The Guideline now provides more appropriate flexibility and requires only that the reinsurance contract stipulate a choice of forum, choice of law and the appointments of agents for service of legal process that are necessary to ensure the contract and any disputes arising from it are subject to the laws and courts of a Canadian province, or another jurisdiction of, in the reasonable opinion of the FRI, equivalent or greater reliability and certainty which has a natural connection to the transaction.

****Administrative Matters****

In connection with the adoption of the Guideline, OSFI has indicated that a FRI will be required to maintain and provide to OSFI, upon request, its RRMP and a complete description of all its reinsurance arrangements, including levels of reinsurance, the due diligence performed on counterparties and the proportion of registered versus unregistered cessions. An entity is no longer to be required, as under the Draft Guideline, to promptly inform OSFI if it makes a material change to its RRMP or if it anticipates that a problem is likely to arise, or has arisen, under its reinsurance arrangements that may affect its, or its reinsurer's, current or future capacity to meet its obligations. Rather, the Guideline only requires that the FRI advise OSFI if it becomes aware of any reinsurance issues that could materially impact its financial condition.

With respect to capital, if a FRI fails to meet the principles set out in the Guideline, on a case-by-case basis OSFI may refuse to grant regulatory capital/asset credit for the reinsurance arrangement, or may, commensurate with the risks, use its discretionary authority under the Act to adjust the FRI's capital/asset requirements or target solvency ratios in order to compensate for the applicable reinsurance arrangement. Further, federally-approved provincial/territorial reinsurers may lose OSFI recognition for certain purposes under the Act if they fail to meet the expectations set out in the Guideline.

The Guideline imposes a further reporting requirement in that a senior officer of the FRI will be required to make an annual reinsurance declaration to the board/Chief Agent to confirm that the FRI's reinsurance risk management practices and procedures meet the standards set out in the Guideline, except as otherwise disclosed in the declaration. Further, the declaration is to include an attestation that the reinsurance arrangements effect a risk transfer and are appropriately accounted for. This is also a change from the Draft Guideline, which would have required that the attestation state that the arrangements convey a true transfer of risk, are properly documented and binding on the reinsurer and that all reinsurance arrangements with related parties are on terms and conditions at least as favourable to the FRI as market terms and conditions. Where a deviation from

the Guideline has taken place during the course of the year, the nature and extent of the deviation and the measures taken or proposed to correct or mitigate the risk associated with such deviation, should also be documented and disclosed to the Board and to OSFI in full.

****IV. The Reinsurance Security Agreement Guidance****

****Historical Background****

OSFI's August 2010 Letter advised that it would no longer develop or be party to standard form RTAs. Previously, OSFI had developed standard form RTAs to which OSFI was a party and which FRIs were required to use in order to be eligible for regulatory capital/asset credit in respect of risks reinsured with unlicensed reinsurers. However, in recent years legal commentators questioned whether the trust arrangements effectively constituted security interests under applicable provincial personal property security legislation, which would thus have been subject to compliance with the perfection requirements under such legislation in order to achieve priority in the event of the insolvency of the reinsurer.

OSFI's desire to change its role is understandable, as OSFI does not practically have the expertise or resources to continuously monitor and assess all applicable provincial legislation. Nor, conceptually, should such drafting or monitoring be OSFI's role or responsibility, and indeed, by comparison, OSFI does not draft or become a party to commercial agreements entered into by the deposit-taking institutions it regulates.

In the Letter, OSFI noted that its decision to discontinue use of RTAs was supported by a number of factors, including the desire to:

- require FRIs to better manage their own risks related to unlicensed reinsurance;
- provide FRIs flexibility to create their own forms of security agreements;
- as noted above, harmonize with the practice for other security and collateral arrangements utilized by deposit-taking institutions;
- recognize that the use of an appropriate standard form agreement is a fact-specific determination and that the creation of a first-ranking, perfected security interest depends on more than just the form of the agreement;
- maintain access to Canadian courts; and
- as noted above, minimize OSFI's costs and responsibility associated with reviewing all applicable personal property legislation and securities transfer legislation (as would have been required in connection with the development of a standard form RSA).

****New Approach****

OSFI will now require FRIs to negotiate and enter into suitable arrangements and take all necessary practical and operational measures to create and maintain a valid and enforceable security interest that has priority over any other security interest in assets of an unlicensed reinsurer that are held in Canada. Further, FRIs will be required to provide a legal opinion addressed to the FRI (but not OSFI, as the Draft Guidance had required), and on which OSFI will be entitled to rely, asserting that such an interest has been created in its favor.

In the Guidance, OSFI indicated that it will permit capital/asset credit for reinsurance agreements in certain circumstances including where the following criteria, among others, are met:

- the assets of the unlicensed reinsurer are pledged to the FRI pursuant to a security agreement made under provincial law;
- the pledged assets are held in Canada (and not, as confirmed in the Guidance, in a foreign depository) by a collateral agent, which must be a Canadian financial institution not affiliated with the unlicensed reinsurer;
- all relevant documentation is binding on the parties and legally enforceable in all relevant jurisdictions;
- the ceding company takes all necessary steps to obtain and maintain a valid, and enforceable security interest that has priority over any other security interest in the collateral;

- if the pledged assets are financial assets to which securities transfer legislation applies, the collateral agent maintains control of the assets on behalf of the FRI;
- in respect of a particular RSA, the ceding company obtains a legal opinion, addressed to it, 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 favor for the type of assets covered by the opinion; and
- the credit quality of the reinsurer and the value of the collateral must not have a material positive correlation (for example, securities issued by the reinsurer or any related entity would provide little protection and would therefore be ineligible).

Once the opinion is obtained, the related RSA will be required to be filed with the OSFI Securities Administration Unit within 15 days.

OSFI expects FRIs to have a policy, approved by the board or a committee of the board, requiring management to confirm to the board/committee from time to time (but at least once every two years) that a valid and enforceable security interest that has priority over any other security interest in the pledged assets continues to exist in the FRI's favour, including where changes have been made to applicable provincial/territorial personal property security legislation or securities transfer legislation. It would appear that this reconfirmation obligation will require FRIs to obtain reaffirmation of existing opinions every two years, which will impose an additional significant administrative burden and cost on FRIs. For FRIs that are branches, OSFI expects that the Chief Agent will ensure that the branch has an approved policy.

Consistent with a principles-based and "prudent person"-type approach, the Guidance, unlike the Draft Guidance, no longer stipulates in a schedule the types of assets permitted to be pledged, but rather requires ceding companies to include in their policy the types of prudentially acceptable pledged assets and the limits (e.g. credit ratings as outlined in the capital/assets guidelines; counterparty concentration; foreign denominated securities) as well as the practices and procedures for managing and controlling risks related to pledged assets. OSFI will require monthly reporting, through the applicable collateral agent and in a standard form, with respect to the market value of assets subject to each RSA.

OSFI expects that the RSA will, at a minimum:

- include a reference to the applicable statute pursuant to which the RSA is made;
- provide that the pledged assets shall be held in Canada, in a location permitted under the provincial statute pursuant to which the RSA has been made;
- provide that the reinsurer agrees to deliver to, and maintain with, the collateral agent, as collateral under the RSA, assets having a market value at all times at least equal to either a specific amount or an amount determined by formula.

Unlike the Draft Guidance, the Guidance no longer prohibits the collateral agent from acting as agent for the reinsurer and for the ceding company (which did not reflect the current securities transfer legislation in respect of securities in the possession of a securities intermediary), or requires that the pledged assets be held by the collateral agent in one or more accounts identified in its records as separate and distinct from other accounts of the collateral agent.

For each particular RSA, OSFI expects the accompanying legal opinion to include:

- an assertion that the security interest in the pledged assets is valid and enforceable against all other creditors of the unlicensed reinsurer, including in the event of insolvency;
- a reference to the applicable provincial statute pursuant to which the arrangement is made;
- confirmation of the validity and enforceability of the security interest in the context of the applicable rules governing conflicts of laws; and
- an assertion that this security interest has priority over any other security interest.

Importantly, and as discussed in greater detail below, OSFI has indicated, unlike in the Draft Guidance, that the opinion may be subject to customary qualifications. The opinion must be provided by a lawyer who has expertise in the area of personal property security legislation in the province where the assets are held or who is reasonably relying on the legal opinions of

those who have such expertise. Where the ceding company approves a new type of asset not already covered by the accompanying opinion, the company will be required to obtain an additional opinion with respect to the new type of asset.

****Commentary****

As noted above, the new approach is commendable in the sense that it gets OSFI out of the business of drafting or being a party to commercial contracts. To that extent, OSFI's approach is consistent with that taken with respect to the deposit-taking sector.

However, abandoning the use of a standard form agreement will impose substantial new burdens on FRIs seeking to utilize unlicensed reinsurers, as FRIs will now be required to negotiate the forms of (i) RSAs having regard to both the applicable provincial law and the laws of the jurisdiction of the unlicensed reinsurer, (ii) related opinions under applicable provincial law and (iii) appropriately (although not expressly required by the Guidance), related opinions under the laws of the jurisdiction of the unlicensed reinsurer. Further, FRIs will face the uncertainty of whether OSFI, upon a review of a FRI's RSA and related opinions, would challenge the form/acceptability of the RSA and related opinions and deny capital/asset credit on that basis.

Consequently, the new regime may significantly discourage the use of unlicensed reinsurers, as the increased internal and external costs may make many such arrangements uneconomical. Practically, FRIs may wish to attempt, including through their industry associations, to settle a number of standard form RSAs and related opinions for use in connection with the small number of domiciles of the leading unlicensed reinsurers.

Although the Letter and Guidance take a principles-based approach and are intended to provide FRIs with increased flexibility, certain requirements under the Guidance are actually quite prescriptive and, further, inconsistent with the approach taken for banks in respect of collateral for derivatives. It is not clear why it is necessary that RSAs be made under provincial law, that the pledged assets be held in Canada or that the collateral agent be a Canadian financial institution, as none of those requirements apply to banks in the context of derivatives. With respect to the requirement for legal opinions from a number of jurisdictions, over time hopefully it will be possible for FRIs, including through their industry associations, to collectively develop and rely on general advice and opinions such as those published by the International Swap Dealers Association in respect of swaps in relation to various jurisdictions. Stikeman Elliott lawyers are already assisting clients in negotiating RSAs opposite some of the leading Canadian custodians and are pleased to assist cedants, reinsurers and custodians in this regard.

While OSFI obviously has an interest in the quality of the collateral pledged, it could address this issue directly rather than by imposing constraints relating to the form and jurisdiction of the pledge. In general, security arrangements are more flexible and allow for the taking of the security in other jurisdictions. As in the case of deposit-taking institutions, the onus should reasonably be on the FRI to satisfy itself that it has taken all appropriate steps and obtained all necessary documentation under applicable foreign law. As a result of recent developments under Canadian and foreign law, it has become much easier to obtain valid and perfected security in certain foreign jurisdictions.

The lack of any grandfathering of existing RTAs will require FRIs, in the case of multi-year agreements not naturally coming up for renewal before January 1, 2012, to use commercially reasonable efforts to obtain the cooperation of their unlicensed reinsurers in order to replace existing RTAs with new RSAs by that date. This could impose a significant commercial risk on FRIs, as they could be forced to reopen negotiations and face the prospect of being forced to agree to less favourable terms than at present. OSFI accepts that, in certain circumstances, it may not be commercially practical or desirable for cedants to seek to reopen/replace existing RTAs.

We note that the required types of opinions are typically subject to standard assumptions and exceptions with respect to priority, and to a qualification with respect to enforceability under insolvency laws, all of which OSFI will ideally appreciate and accept, given the new indication in the Guideline that opinions may be subject to customary qualifications.

Finally, it is not yet clear whether OSFI's RSA mechanism and form will be acceptable to any provincial insurance regulators asserting co-jurisdiction over capital/asset levels supporting risks located in their provinces and written by federally-licensed insurers also licensed and carrying on business in the applicable province (or, conversely, whether any required provincial

mechanism/agreements will be satisfactory to OSFI), although it is understood that discussions are to occur in that connection.

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