Assurances

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Volume 45, numéro 4, 1978

URI : https://id.erudit.org/iderudit/1103950ar
DOI : https://doi.org/10.7202/1103950ar

Aller au sommaire du numéro

Éditeur(s)

HEC Montréal

ISSN

0004-6027 (imprimé)
2817-3465 (numérique)

Découvrir la revue

Citer ce document

Jack, C. (1978). The new Federal Insurance Law. *Assurances*, *45*(4), 242–251. https://doi.org/10.7202/1103950ar

The new Federal Insurance Law [1]

by

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Important changes to the insurance law of Canada have been made by « An Act to amend the Canadian and British Insurance Companies Act and the Foreign Insurance Companies Act » (25-26 Elizabeth II, chapter 39). The Act was assented to on 14th July 1977 and most of it came into force on that date; certain sections, however, will not come into effect until proclaimed.

An excellent commentary on the amendments by the Superintendent of Insurance may be found in his Report to the Minister on the business of 1976 (Blue Book Vol. I; in English on pages 41A et seq., in French on pages 85A et seq.).

The amendments are the most extensive made to the insurance laws since they were adopted in 1932. They cover a wide variety of subjects and will be discussed in this article under the following headings:

1. Corporate powers and subsidiaries
2. Investments
3. Valuation of assets
4. Valuation of liabilities
5. Miscellaneous

I — *Corporate powers and subsidiaries*

Under this heading, we refer only to Canadian companies. The corporate powers of British and foreign companies are matters for the jurisdictions where they are incorporated.

Under Section 63, an insurance company is not permitted to purchase more than 30% of the common shares of any corporation:

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[1] Nous avons demandé à notre collaborateur, M. Colin E. Jack, de bien vouloir résumer pour nos lecteurs la portée des dernières modifications aux lois qui régissent les sociétés d'assurance canadiennes, britanniques et étrangères au Canada. Il a bien voulu y consentir, et c'est son texte que nous présentons aujourd'hui. Nous le remercions d'avoir mis de l'ordre dans un texte technique et touffu. A.

moreover, a life insurer may not purchase the shares of another life insurer. Further, investments may only be made in corporations meeting certain earnings tests.

Section 64, which applies to non-life insurers, has made the 30% limit, and the earnings tests, inoperative in the case of investments in other insurance companies, life or non-life.

Section 65, which applies to life insurers, has made them inoperative in the case of investments in:

a) foreign life insurance corporations;
b) corporations providing advisory, management or sales distribution services in respect of segregated fund policies;
c) non-life insurance corporations;
d) corporations for acquisition, improvement, leasing or managing of real estate;
e) corporations offering participation in an investment portfolio (mutual funds);
f) corporations providing those in (e) with advisory management or sales distribution services;
g) with approval of the Minister, any corporation carrying on business reasonably ancillary to the business of insurance. (Among business considered to be reasonably ancillary to life insurance have been data processing companies and para-medical examination clinics).

An amendment makes the exception concerning ancillary business corporations applicable to non-life insurers.

Moreover another amendment permits any life or non-life insurer, with the consent of the Minister, to carry on — within its own corporate structure, without having to set up a subsidiary — any business reasonably ancillary to its insurance business. It may also provide administration, advisory and management services to a corporation whose shares it holds under sections 64 and 65.

II — *Investments*

Section 63 of the Act lists the various classes of investments in which Canadian insurance companies may place their funds. Tests are set forth to ensure that assets are of high quality and limits imposed to prevent companies from holding too great a proportion of assets considered likely to fluctuate too widely in value or to lack liquidity. The tests are of importance outside the insurance industry because they are carried over to certain legislation concerning trust companies and pension funds.

British and foreign companies are, generally speaking, restricted to the same classes and subject to the same tests and limits as regards the investments which they are required to deposit or vest in trust for the protection of their Canadian policyholders.

These are some changes in the rules regarding bonds but they are
244 not expected to have any marked effect on investment policy.

Prior to the amendment, investment was permitted in government bonds of Canada, of the United Kingdom (and other countries of, or formerly of, the Commonwealth), of the United States, and of countries in which the company was doing business, including the provinces and states of the above. Specific references to the United Kingdom, etc., and to the United States have been removed so that investments in their government bonds will now be allowed only if the company is doing business in these countries or if permitted under a new clause which provides for countries to be prescribed as eligible by regulation. It appears unlikely that any regulations will be issued under this clause.

Bonds secured by the plant or equipment of a partnership are now eligible as well as those secured by the plant or equipment of a corporation.

The rules concerning corporate bonds not specifically secured have been changed in several ways:

a) Formerly bonds of a corporation were eligible if the preferred or common shares were eligible; now, in addition, the indebtedness of the corporation must not exceed three times the aggregate of the averages over the last five years of the capital, contributed surplus, retained earnings and indebtedness of the company. It is understood that this requirement has been added to render ineligible bonds of « shell » corporations.

b) In the case of bonds eligible by virtue of the past ratio of earnings to interest requirements, interest on current liabilities is no longer excluded in determining these requirements.

c) Bonds guaranteed by a corporation will in future be accepted if its common shares are eligible under the earnings test, (the dividend test does not suffice), provided they would be eligible if issued by the corporation. In the past, only bonds *issued* by the corporation were eligible, if the eligibility of the common stock was the criterion.

The test for common shares, formerly based on dividend payment or earnings in each of the last five years, will now be based on four out of the last five years, including the last year. Since certain tests of bonds and preferred shares are based on the eligibility of the common shares, the relaxation will have some effect on those classes of investments.

It is indicated that tests as regards common stocks and bonds not specifically secured will be made using consolidated accounts.

The limit on the total book value of common stock (including stock in subsidiaries) remains at 25% except that if a company has, for non-life business, assets in excess of the minimum required under the 115% rule (section 103) such excess may be invested in common stock up to a total investment in common stock of 40% of the assets.

The changes concerning investments which will probably have the most important effects on company portfolios are those having to do with real estate.

Formerly, investments had to be made by the company alone or together with another insurance company. Now, a company may join with any other corporation or with the administrator of a pension fund or a deferred profit sharing plan.

The total investment of a company permitted to be made in one parcel of real estate for the production of income is doubled from two percent to four percent of the book value of its assets.

The limit per parcel under the basket clause is also doubled from one percent to two percent of the book value of the assets.

The « basket », formerly seven percent of the book value of assets becomes, in effect, two « baskets » of seven percent each; the first « basket » is for real estate, in which, two out of the seven percent may be real estate other than for the production of income. The second « basket » is for other classes of investments.

The limit on the total book value of investments in real estate is raised from 10% to 15%.

III — *Valuation of assets*

Both life and non-life companies will be required to bring securities, real estate and loans into their annual statements at values that in total do not exceed the aggregate of book values less an investment valuation reserve the amount of which will be determined by regulations.

Regulations may also be made for the determination of book values, of market values of loans, and for reporting gains or losses on disposition of assets.

It is expected that the book values of bonds and mortgages will be the amortized values. The annual change in book value will therefore appear as a positive or negative item in the income account. If a bond is disposed of, the gain or loss will be taken into income in equal amounts over the remaining period of the debt, or over 20 years if shorter.

For stocks, it is expected that a formula will be established whereby gains or losses, realized or unrealized, will be brought into revenue by a gradual process. In this way, they can be recognized without distorting the accounts through fluctuations.

Book value for real estate would be purchase price (plus cost of improvements less depreciation), or such other amount as was accepted by the Superintendent, on the basis of evidence submitted by the company. Presumably this provision might be used to write up real estate if the value is increased due to inflation or to development of the surrounding area. A capital gain or loss on real estate would be an adjustment to surplus and not brought into income.

The market value of bonds and stocks will as in the past mean the value at the year end or, at the discretion of the Superintendent, at a date not more than 60 days earlier. The use of higher values in depressed conditions, which could be authorized by the Minister, is no longer provided for.

The market value of mortgage loans will be determined from the amortized value, which will be adjusted by a percentage determined from the difference between the rate of interest applicable to the mortgage and the average rate applicable to mortgages of the same class in the year of report. In the case of mortgages with an original term of over five years the adjustment will be six times the difference in the interest rates: for example, take a 10% mortgage: if market rates rose to 11%.

the market value would be 94% of the amortized value; if they fell to 9% the percentage would be 106%. For mortgages of five years and less, the factor of 6 would be reduced to 2½.

It is expected that the method of determining the investment reserve will differ as between life and non-life companies, and between Canadian companies and British and foreign companies.

It appears probable that British and foreign companies will, if they wish, be permitted to file balanced statements for their Canadian business in the form used by Canadian companies; if they do so, they will be allowed to calculate their investment reserves by the same formula as Canadian companies. It is expected that branches of a few very large non-resident companies will avail themselves of this provision.

Canadian life companies will probably be required to hold a minimum reserve of 1½% of the book, i.e. amortized value of bonds and mortgages; if their market value is depressed below 85% of book, an additional reserve would be required. The reserve for stocks would be such as to write down book value to market over three years, as is done at present for stocks and non-government bonds. The reserve for real estate would be the excess of market over book value. Excess of market over book in certain classes could be applied against deficiencies in others but this provision would not reduce the 1½% reserve for bonds and mortgages.

British and foreign life companies (except those presenting a statement in Canadian form, as mentioned above) would hold a reserve equal to the market deficiency for bonds, stocks and real estate combined and, if the proportion of mortgages exceeds 40%, a reserve of any market deficiency on the excess.

For non-life companies the emphasis will probably be on liquidity. It is expected that if the proportion of mortgages is less than 20%, no reserve will be required for bonds or mortgages maturing within five years. For other assets a reserve equal to the market deficiency will be required except that the reserve for a market deficiency on stocks may be built over two years. If the proportion of mortgages exceeds 20%, a reserve for any market deficiency on mortgages (but not bonds) maturing within five years will be required.

These rules will apply to all non-life companies (Canadian, British or foreign) and also to the Accident and Sickness branch of a Canadian life company or of a British or foreign life company which submits a statement in Canadian form.

For Accident and Sickness branches of other British and foreign companies, a reserve equal to the overall market deficiency will be required except that if the proportion of mortgages is less than 20%, no reserve will be required for a market deficiency in mortgages maturing within five years.

248 IV — *Valuation of liabilities*

Extensive revisions have been made both for life and non-life insurance.

The valuation of all unmatured obligations under life insurance policies and non-cancellable accident and sickness policies and of claims under accident and sickness policies payable in instalments must be made by the valuation actuary. He must be appointed by the board of directors and a copy of the resolution appointing him must be filed with the Superintendent. For a Canadian company, he must be a Fellow of the Canadian Institute of Actuaries; British and foreign companies may appoint a person who is not a Fellow of the Canadian Institute if they obtain the prior approval of the Superintendent.

The auditor, in his report, may accept the opinion of the valuation actuary.

The reserve shown in all financial statements shall be the same as that shown in the annual statement to the Superintendent.

The actuary will no longer have to use prescribed mortality tables or interest rates. He will be able to use bases which in his opinion are appropriate to the circumstances of the company and acceptable to the Superintendent. Thus, while the Superintendent will have the final say, he will rely largely on the professional judgment of the actuary.

The use of the so-called full preliminary term period of valuation of life insurance policies as a minimum standard for reserves will be replaced by what might be called a 150% modification. This means that initial expenses up to 150% of the net level annual premium may be spread over the duration of the policy and need not be met out of income in the year of issue. The actuary must be satisfied that the expenses so spread have in fact been incurred and that the premiums to be paid by the policyholder will be sufficient to provide the benefits under the policy, the future expenses, dividends on the current scale or with such modifications as are foreseen, and the annual amount required to amortize the expenses incurred but not charged.

To give an indication to investors and others of the strength of the company the statement must show both the reserve based on the minimum standard as well as that on the net level system; in fact, if the actuary uses neither one, he must still show them both in the statement. Any reserves shown, other than the one incorporated into the statement, may be calculated by approximate methods.

The actuary's report must certify that in his opinion the bases used are appropriate to the circumstances of the company and the policies in force, that the method used produces a reserve equal to the minimum standard for any policy and that "the reserve makes good and sufficient provision for all the unmatured obligations guaranteed under the terms of the policies in force".

Under the amended act, the reserve may be reduced where the risk is reinsured in whole or in part. Reinsurance was not previously mentioned in the Act but the forms prescribed for the Superintendent's report made it clear that for life insurance credit could be taken for it, except in so far as policies in Canada were reinsured in companies not federally registered; in non-life insurance credit was allowed for non registered insurance to the extent that deposits were held against it.

In future companies will be able to take credit for policies reinsured with companies not federally registered provided that:

(i) in the case of a provincially incorporated reinsurer, the Superintendent is satisfied as to the financial condition and business practices of the reinsurer;

(ii) in the case of a non-resident reinsurer, security is maintained in an amount, of a nature and under arrangements satisfactory to the Superintendent; in respect of policies in Canada, such security must be maintained in Canada.

The new provisions concerning reinsurance apply to non-life as well as to life insurers.

For accident and sickness business the liabilities must include a reserve certified by the valuation actuary for non-cancellable policies and for all claims payable by instalments. In addition, there must be included a reserve equal to unearned premiums less a deduction for acquisition expenses as determined by regulation.

The solvency test for non-life companies has been relaxed to some extent. On the one hand, assets may be taken in total at book value less the prescribed reserve, if that exceeds market value; on the other, the 115% rule for valuing premiums may be modified when justified by claims experience. If the company expects a claims ratio (claims incurred including adjustment expenses divided by premiums earned) on any class of business less than 80%, the unearned premiums may be entered at 100%; if the expected ratio is 95% or over the 115% rule must be followed. For claims ratio between 80% and 95%, unearned premiums may be taken in at that ratio plus 20%.

To obtain these reductions a company must file an "expected claims ratio" for each class concerned, which may not be less that the actual ratio for the last calendar year. It must be certified by an actuary or by a company officer acceptable to the Superintendent.

The 15% addition will no longer apply to "other liabilities".

V — *Miscellaneous*

Lloyd's and similar associations will in future be brought under the jurisdiction of the Federal Superintendent. This will, of course, have the effect of making reinsurance with Lloyd's deductible as "registered" reinsurance.

Stock companies will be permitted to issue additional classes of shares and to issue any class of shares in series.

Where subscribed stock is fully paid, any existing class of shares may be divided into shares of larger or smaller value. However, if the par value of any share is less than five dollars, the number of votes to which a holder of such shares shall be entitled shall be such as if the total par value of his holding were divided into shares of five dollars.

As has been mentioned certain sections of the amending Act did not come into force immediately; it is expected that they will come into force during 1978. The sections are those referring to Lloyd's and others such associations, and to valuation of liabilities (except those mentioned concerning reinsurance). Although the sections concerning valuation of assets are in effect, it has been found that there has not been enough time to adjust to them; the problem has been solved by prescribing for 1977, investment reserves such that the net result will be that assets will be valued as formerly; the new regulations, expected to be as described above, will be effective at the end of 1978.

Québec au temps de James Patterson Cockburn. Québec, **Recueil Iconographique** de Charles P. de Volpi.

Comme Québec était jolie à l'époque où Cockburn, en garnison à la Citadelle, fit ses aquarelles, ses dessins et ses sépias ! Christina Cameron et Jean Trudel les ont réunis dans un album en blanc et noir; ce qui leur enlève un peu de leur charme, tout en rappelant fidèlement ce qu'était la ville vers 1830. On n'y avait pas encore bâti des horreurs comme l'hôtel Concorde. Ce qu'on appelle le château Frontenac était d'un style faux et d'une époque révolue, il est vrai, avec ses poivrières et ses tourelles, mais d'un aspect gracieux; tandis qu'au Concorde un toit en escalier surplombe un édifice sans grâce. Et puis ce *bunker* où loge le chef de l'État, quelle lourdeur il affecte !

Il était grand temps qu'on nous rappelât Québec à l'époque où l'on construisait pour l'homme et non pour la foule. Le *Québec Iconographique* de Volpi complète l'évocation d'un passé que Cockburn avait noté pour notre plaisir. Pour se convaincre qu'on a détruit le charme de la ville, il suffit de parcourir la haute et la basse ville. Si l'on a restauré la place Royale et ses environs, on a bien massacré la haute ville en voulant la mettre au goût du jour et à ce qu'on a cru être aussi les besoins du jour. Si tel gratte-ciel ne choque pas — bien au contraire — tel autre semble une horreur dans une ville où au siècle dernier on avait un goût hérité d'un passé où comptaient modération, simplicité et adaptation à une vie peu compliquée.