Adjustments and clarifications

Title	Life Insurance Capital Adequacy Test 2023 – Adjustments and clarifications
Category	Capital Adequacy Requirements
Date	June 30, 2023
Sector	Life Insurance and Fraternal Companies

This communication sets out adjustments and clarifications to the Life Insurance Capital Adequacy Test (LICAT) 2023 guideline and associated instructions and forms since their publication in July 2022. Items reflected on this list may be incorporated in the LCA and LCQ Filing Instructions and a future version of the LICAT guideline, as appropriate.

Summary of adjustments and clarifications

Any questions should be addressed to LICAT-TSAV@osfi-bsif.gc.ca.

1. Volatility adjustment (LICAT section 2.1.1)

OSFI remarks

With respect to the volatility adjustment for changes in cost of guarantee liabilities, section 2.1.1 of the LICAT 2023 guideline states that “a one-time election of whether to use this option must be made within three months after the adoption of IFRS 17, and cannot be changed thereafter”.

OSFI is clarifying when and how insurers should communicate their election decision to OSFI.

Clarification

Insurers with an IFRS 17 effective date of January 1, 2023 should make the election by March 31, 2023, and insurers with an IFRS 17 effective date of November 1, 2023 should make the election by January 31, 2024. Insurers should contact their OSFI lead supervisor to inform them as to whether or not they will elect to use the volatility adjustment by the deadline.

Updated date

January 2023

2. Owner-occupied property (LICAT sections 2.1.1 and 5.3.1)

OSFI remarks

An amendment to IAS 16 allows entities to elect to measure owner-occupied properties in certain circumstances as if they were investment properties measured at fair value through profit or loss following IAS 40, Investment Property.

OSFI is clarifying the capital treatment of these owner-occupied properties measured at fair value in accordance with IAS 40.

Clarification and impact on LCA/LCQ returns

Pages 50.300 and 20.400 of the LCA

If, under IAS 16 (paragraphs 29A and 29B), an insurer elects for an owner-occupied property to be measured on a fair value basis, the property should be treated as an investment property under the LICAT. More specifically, required capital for real estate risk should be calculated following LICAT section 5.3.1 with zero value for the leases in force component and reported through the Investment Real Estate section on LCA 50.300.

These owner-occupied properties should be excluded from the calculation of the amount to be reversed related to owner-occupied properties in Adjusted Retained Earnings (LICAT section 2.1.1 and LCA 20.400 line 2040010030).

Updated date

January 2023

3. Cryptoassets (Page 20.300 of the LCQ)

OSFI remarks

OSFI published an advisory on the interim capital treatment for cryptoasset exposures on August 18, 2022, effective at the beginning of an insurer's fiscal Q2 2023 reporting period, with earlier adoption encouraged. Per the advisory, Group 1 cryptoasset exposures receive a capital treatment consistent with that of comparable traditional assets, including credit, market and/or other risks. Group 2 cryptoasset exposures, including the absolute value of short positions, the full notional amount of long option positions, and the full notional amount of long forward contracts, are deducted from Tier 1 capital.

OSFI is clarifying where the Group 2 cryptoasset exposures are to be reported on the LCA/LCQ returns.

Clarification and impact on LCA/LCQ returns

Page 20.300 of the LCQ

Cryptoasset exposures deducted from capital should be reported as intangibles (LCQ 20.300 line 2030010120). There is no impact on the LCA.

Updated date

January 2023

4. Capital composition and limitations (LICAT section 2.3)

OSFI remarks

Section 2.3 of the LICAT 2023 guideline lists three capital composition limits. The first limit requires that the aggregate of the items specified should equal or exceed 75% of Net Tier 1 capital.

OSFI is adjusting the calculation of this limit to include a new item added to Gross Tier 1 with respect to unregistered reinsurance in LICAT 2023.

Adjustment and impact on LCA/LCQ returns

Tax adjustments and amounts recoverable on surrender related to policy-by-policy negative reserves ceded under unregistered reinsurance (i.e. item 11, LICAT section 2.1.1) should be included in the list of specified items for the first capital composition limit (i.e. as a new item 1.i in section 2.3).

The result is reported on LCQ 20.100 line 2010010290. There is no impact on the LCA.

Updated date

January 2023

5. Outstanding premiums and agents' debit balances for branches (LICAT section 12.2.5)

OSFI remarks

OSFI is clarifying the treatment of outstanding premiums and agents' debit balances in the determination of Assets Required for branches.

Adjustment

OSFI is adjusting section 12.2.5 of the LICAT 2023 guideline, to clarify the treatment of outstanding premiums and agents' debit balances for the purpose of calculating Assets Required in respect of a branch's insurance business in Canada.

To align the insurance contract liabilities for LICAT purposes with those reported in the insurer's financial statements under IFRS 17 and to ensure consistency of treatment for all life insurers, item 19 of section 12.2.5 of the LICAT Guideline - agents' debit balances and outstanding premiums - will be deleted.

Updated date

June 2023

6. Reduction in negative reserves deduction / assets required for stop-loss arrangements

OSFI remarks

Section 6.8.5 of the LICAT 2023 guideline describes how a ceding insurer may reduce its insurance risk capital requirements for risks it has reinsured under stop-loss treaties.

OSFI is adjusting LICAT 2023 to add guidance on the capital treatment for stop-loss treaties where an insurer is requesting a reduction in the Gross Tier 1 capital deduction or the amount included in Assets Required, with respect to negative reserves.

Adjustment

The following applies where these stop-loss treaties are registered reinsurance arrangements:

- The reduction amount for each reinsurance treaty is subject to prior approval by OSFI.
- The aggregate reduction amount for all such arrangements is limited to 5% of Net Tier 1 capital, or Available Margin less Other Admitted Assets.
- Credit Risk requirements under LICAT section 3.1.7 and Operational Risk requirements under LICAT section 8.2.3 apply and exposure values will be confirmed as part of the approval process.
- Reinsurers, in aggregate, must fully reflect the equivalent Available Capital deduction or the amounts included in Assets Required that the ceding insurer would have included in its LICAT ratio calculations.

Where these stop-loss treaties are unregistered reinsurance arrangements, the insurer should contact OSFI for specific guidance on determining the capital treatment.

Updated date

June 2023