



Financial Services
Commission
of Ontario

Commission des
services financiers
de l'Ontario

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**Investments by Insurers
Guideline**

Superintendent's Guideline No. 1/02

Investments by Insurers Guideline

I Application

This guideline is issued under subsection 433 (1.1) of the *Insurance Act, R.S.O. 1990, c.1.8*, (the Act).

Insurers investing in common shares, preferred shares, or mutual or pooled funds under clauses 433 (1) (m), (n) and (t) of the Act must comply with this guideline.

It should be noted that this guideline applies to the entire investment portfolio of the insurer.

II Investment Policy

Every insurer is required to have a written investment policy describing the objectives for its investments and the overall risk philosophy of the insurer. The policy must take into account the strength of the insurer's capital, its liability structure, and its ability to absorb potential losses.

The policy must note the liability structure of the insurer and the anticipated demands for funds and address how maturity profiles are to be established on the portfolios of investments in light of these demands.

The policy must establish limits on the insurer's exposure to a person¹, and to interest rate risk, and currency risk. In setting these limits, the insurer must consider its exposure under a variety of potential scenarios.

The policy must describe the insurer's criteria for investment grade and provide a list of conventional ratings that would satisfy such criteria. For this, an insurer may use ratings from recognized rating agencies for establishing quality criteria. For non-rated investments, internal criteria would need to be established and should be similar to those applied by rating agencies.

Procedures

The insurer must have written internal procedures outlining how the investment policy will be implemented and monitored. Specifically, the procedures must:

- identify responsibilities and accountabilities;
- set out the process for recommending, approving, and implementing decisions; and
- prescribe the frequency and format of reporting.

¹ For the purposes of this Guideline, "**person**" includes an individual, corporation, association, partnership or organization.

The procedures must address exposures arising from both on-balance sheet and off-balance sheet items and be effective in monitoring and controlling the insurer's exposure to fluctuations in interest rates, foreign exchange rates, and market prices.

In addition, the procedures must describe the method for classifying investments and the basis for valuing investments that are not regularly traded. Custodial arrangements of these assets in accordance with subsections 437(4), (5) and (6) of the Act must also be described.

The insurer must ensure that the policy is implemented by persons, either on staff or under contract, who have the appropriate level of expertise. Potential sources of conflict of interest must be identified and procedures must be in place to ensure that those involved with the implementation of the investment policy understand where these situations could arise and how they would be addressed.

Limits

The investment policy must identify acceptable ranges for investments in different types of instruments (e.g., cash, commercial paper, bonds, debentures, equities, real property). Where necessary, these broad categories should be further subdivided.

The policy must set limits on investments according to their quality or investment grade.

Where applicable, limits must be established on exposures to various industries and geographic regions.

The insurer must establish limits to contain the risks arising from potential changes in currency or interest rates. In order to avoid exceeding the limits set by the Act due to a change in the total assets held, it is suggested that the insurer's investment policy establish limits lower than the maximum permitted under the Act.

Approval

At least once a year, the board of directors of the insurer or a subcommittee appointed by the board must review and approve the investment policies. The board or subcommittee may delegate the day-to-day implementation and monitoring to management, however, ultimate responsibility rests with the board. The board or subcommittee must be advised immediately, in writing, of any deviations.

Providing Information to the Superintendent of Financial Services (Financial Services Commission of Ontario)

The insurer is not required to file policies and procedures with the Financial Services Commission of Ontario (FSCO). However, the written policies and procedures should be available for review immediately upon request by FSCO.

The insurer is expected to maintain information on its investment portfolio presented in a

manner that facilitates analysis, for example:

- a comparison of outstanding amounts against the limits established in its policies;
- an analysis of asset quality and concentration; and
- an analysis of asset-liability matching.

Where the information required to perform this analysis is not available through the filing of statutory returns, FSCO may request supplemental information that expands on the areas of greatest risk.

III Limits and Restrictions for Investments under Clauses 433(1)(m), (n) and (t) of the Act

Although the insurer must consider the characteristics of the overall investment portfolio, attention must be given to investments in common shares, preferred shares and mutual funds both in isolation and aggregate form.

Common Shares

The aggregate limit for all investments in common shares must not exceed 25% of the total assets of the insurer (clause 435(1)(e) of the Act).

Preferred Shares

Although the limits for investments in preferred shares are those imposed generally under section 435, insurers are cautioned that preferred shares carry risks similar to those associated with common shares. Investment policies for preferred shares must recognize these risks.

Mutual or Pooled Funds

Mutual or pooled funds consists of different types of underlying securities. In order to meet the restrictions and limits imposed by Part XVII of the Act, the underlying securities must be broken down according to the types of investments described in clauses 433(1)(a) to (s) and subsection 433(4) (the basket clause) of the Act, and added to investments otherwise held under these clauses.

For example, if a mutual fund has investments in government bonds and real estate then government bonds would be added to other investments in government bonds (clause 433(1)(a)) and real estate to other real estate for the production of income (clause 433(1)(r)). There are no limits imposed by the Act on government bonds, however, investments in real estate are subject to restrictions imposed by clause 433(1)(r) and subsection 433(4) of the Act.

Where the underlying securities of a mutual or pooled fund consist of investments described in clauses 433(1)(a) to (s) but cannot be accurately attributed to a particular

clause due to constant changes in the portfolio of the mutual or pooled fund, the underlying securities must be treated as common shares.

Note: Insurers investing in mutual or pooled funds which use derivative instruments, for example, swaps, options and futures, must notify the Superintendent of such investments.

IV Other Investing Limits and Restrictions for Insurers

It should be noted that the insurer must continue to comply with the statutory investment limits and prohibitions set out in Part XVII of the Act and that this guideline is in addition to those requirements.