

# Guidance

Interpretation

Approach

Information

Decision



**Effective Date:** January 1, 2023

**Identifier:** No. PC0047INT\*\* (previously listed as Superintendent's Guideline 08/04)

## Minimum Capital Test Guideline for property and casualty insurance companies and reciprocals - January 2023

### Purpose

This Guidance provides the Financial Services Regulatory Authority of Ontario's (FSRA's):

- i. Interpretation of the requirement for an insurer to hold capital "in an amount that bears not less than a reasonable relationship to the outstanding liabilities, premiums and loss experience of the insurer" as set out in s. 102 (8) of the *Insurance Act* (Ontario) (**the Act**). This Guidance also addresses exemptions to the filing requirements set out in s. 102 (1) of the Act for property and casualty (**P&C**) insurers that are not incorporated in Ontario under the discretion of the Chief Executive Officer of FSRA (**CEO**) pursuant to s. 102 (12).<sup>[11](#)</sup>
- ii. Approach to assessing the capital adequacy and solvency of Ontario P&C insurance companies incorporated in Ontario and reciprocals organized under the Act (**insurers**). The Approach component of this Guidance sets out FSRA's internal practices to evaluate the minimum capital and supervisory targets, and internal operating target set by insurers.

## Scope

The 2023 FSRA Minimum Capital Test (MCT) Guideline for P&C Insurance Companies and Reciprocal (2023 FSRA MCT Guideline) is applicable to all insurers licensed in Ontario pursuant to s. 102 (8) of the Act. The following insurers are exempted from the filing requirements (e.g., annual statements) under s. 102 (1):

- federally regulated P&C insurers
- P&C insurers that are incorporated in other provinces, if they are already filing the MCT in their province using the Office of the Superintendent of Financial Institutions' (OSFI) MCT Guideline or an equivalent MCT framework

As of January 1, 2023, FSRA will be adopting the 2023 OSFI MCT Guideline, which is harmonized across Canada. As such if the insurers described above meet the capital requirements of OSFI or another provincial regulator, then they would be in compliance with the requirement to hold sufficient capital under s. 102 (8) of the Act.

Although under the Act, farm mutuals (otherwise referred to as mutual insurance companies under the Act) are not required to comply with the minimum capital requirements set out in the guideline, the CEO of FSRA requires farm mutuals to file the MCT as part of their returns pursuant to the authority set out under s. 101 (1) of the Act.

Reciprocal exchanges are also required to file their quarterly returns with FSRA.

## Rationale and background

The MCT is a harmonized capital adequacy solvency test that is applicable to provincially and federally regulated insurers across all Canadian jurisdictions. It was developed to ensure consistency across Canada when assessing the capital adequacy of insurers.

The MCT has been applied to licensed insurers in Ontario since 2004. The existing [2019 MCT Guideline for P&C Insurance Companies](#) adopted the OSFI MCT Guideline (effective on January 1, 2019) for P&C insurers<sup>[2]</sup>.

On January 1, 2023, International Financial Reporting Standard 17 – Insurance Contracts (IFRS 17) will be implemented globally and apply to all insurance companies, including Ontario

insurers. As a result, in July 2022, OSFI released a revised 2023 MCT Guideline to replace the existing 2019 MCT Guideline for P&C Insurance Companies, to take effect on January 1, 2023, and reflect the new accounting standard. In revising the MCT Guideline, OSFI engaged extensively with insurance stakeholders, including Ontario insurers, to define regulatory capital requirements under IFRS 17. FSRA is now adopting the OSFI 2023 MCT Guideline so that it is applicable to Ontario-incorporated insurance companies and reciprocals. FSRA's adoption of OSFI's MCT Guideline is consistent with other provincial regulators and supervisors in Canada, and international best practices for insurance supervision set out by the International Association of Insurance Supervisors (IAIS).

Section 102 (8) of the Act requires licensed insurers to “maintain capital or assets (in compliance with such requirements as may be prescribed by regulation governing the level of capital or assets to be maintained) in an amount that bears not less than a reasonable relationship to the outstanding liabilities, premiums and loss experience of the insurer.” Section 2 of Ontario Regulation 259/04 (Minimum Capital Test) under the Act prescribes that insurance companies must maintain capital in compliance with the requirements set out in the MCT Guideline made by the CEO of FSRA, therefore, giving this MCT guideline the force of law.

## Interpretation

The interpretation portion of this guidance sets out FSRA's interpretation of the requirement set out under s. 102 (8) of the Act for insurers in Ontario to “...maintain capital or assets (in compliance with such requirements as may be prescribed by regulation governing the level of capital or assets to be maintained) in an amount that bears not less than a reasonable relationship to the outstanding liabilities, premiums and loss experience of the insurer.”

In addition to the legislative powers under the Act, s. 2 of Regulation 259/04 thereunder, allows FSRA's CEO to specify minimum capital requirements for Ontario insurers in a guideline that has force of law. Section 1 (1) of the Regulation (259/04) indicates that the guideline made by the CEO of FSRA may be amended from time to time.

### **Supervisory target capital ratio and internal target capital ratio**

To facilitate its compliance with the requirements set out in the 2023 FSRA MCT Guideline, each insurer shall establish an internal target capital ratio (internal target) recommended by its management and approved by its Board that maintains ongoing capital above the supervisory

target, after considering its risk profile and plausible variations in capital and operating results which may arise (including due to stress), to thereby avoid supervisory intervention. Notwithstanding, the CEO of FSRA may require an insurer to increase its capital based upon the insurer's individual risk profile.

Insurers are required to inform FSRA immediately if they anticipate falling below their internal target and to lay out their plans, for FSRA's approval, to return to their internal target. FSRA's approach to evaluating the adequacy of the internal capital target will include consideration of all relevant factors including any unusual conditions in the market environment.

FSRA will continue to review the operations of insurers on a case-by-case basis. Insurers must submit to FSRA, where applicable, any application, notice, or forms for which treatment is not covered in the forms and instructions appended to the 2023 MCT Guideline, dated effective January 1, 2023, or for which the recommended treatment seems inadequate.

### **Exemption from filing requirements**

Section 102 (12) of the Act permits the CEO of FSRA to "...in writing, exempt completely or in part any insurer or any category of insurer from any or all of the filing requirements imposed under this section [s. 102 (1)] for the period of time specified in the exemption." As set out in the Scope section of this Guidance, federally regulated P&C insurers and P&C insurers incorporated in other provinces are exempted from the filing requirements under s. 102(1) of the Act, pursuant to s. 102 (12) of the Act. This exemption avoids duplicative prudential oversight and filing requirements, as these insurers must file and prove they have adequate capital with OSFI or their provincial regulator.

### **FSRA to adopt OSFI's MCT Guideline (January 1, 2023)**

FSRA will be adopting the 2023 OSFI MCT guideline so that it is applicable to Ontario insurers effective January 1, 2023, subject to the modifications noted below, which are required in the CEO's opinion due to differences in law or as otherwise set out hereafter.

### **Modifications to OSFI's MCT Guideline dated effective January 1, 2023**

1. For the purposes of the 2023 FSRA MCT Guideline, the following references in OSFI's 2023 MCT Guideline shall be deemed to be a reference to the identified term in the 2023 FSRA MCT Guideline as follows:

- The federal Insurance Companies Act, (the ICA) and any provision of the ICA, shall be deemed to be reference to the *Insurance Act*, R.S.O. 1990, c I.8, as amended; and any equivalent provision under the Act, as applicable
  - “Property and casualty insurer,” “federally regulated property and casualty insurer,” or any abbreviation or variation of these terms shall be deemed to be a reference to “property and casualty insurer”
  - OSFI, the “Superintendent of Financial Institutions” or a reference to any staff of OSFI shall be deemed to be a reference to FSRA, the CEO of FSRA, the staff of FSRA, as the case may be, and to be applicable to FSRA
2. Any guideline that is issued by OSFI that is referenced in OSFI’s 2023 MCT guideline and listed in the attached Guideline is adopted and applies to the extent that:
- a) the other guideline is necessary for assessment of the capital requirements set out in OSFI’s 2023 MCT Guideline
  - b) it is consistent with the Act and regulations under the Act
  - c) it becomes effective on or before January 1, 2023
3. Note: Reinsurance limits are governed by Ontario Regulation 129/08 (Reinsurance)

## Audit requirements

Under s. 102 (3) of the Act, insurers are required to engage their auditor to report on the condition of affairs of an insurer annually in the manner required by the CEO. The CEO requires that a separate auditor’s report on the MCT be filed annually no later than 90 days after the insurer’s fiscal year end, prepared in accordance with IFRS standards.

## Approach

This section describes the practices which FSRA will use to assess an insurer’s adherence to the provisions of the Act noted above as identified in the Interpretation section of this Guidance.

Insurers are required to use the OSFI-designed MCT forms to file their P&C returns on a quarterly basis, providing details of their minimum capital requirements as prescribed in the MCT guideline. FSRA monitors each insurer's capital adequacy and compliance with certain related requirements through reviews of the MCT forms. Through this process, insurers with inadequate capital levels are identified and the appropriate supervisory action is taken to ensure that the insurer remains in compliance with the provisions of the Act and this Guidance.

Additionally, FSRA assesses an insurer's capital adequacy requirements on a consolidated basis, in accordance with FSRA's supervisory approach. The consolidated entity includes the insurer and its directly or indirectly held subsidiaries, which carry on business that the parent could carry on directly in accordance with the Act. The consolidated assessment helps ensure a holistic evaluation of the capital resources required to adequately underpin the insurer's risks and protect its policyholders.

## Effective date and future review

This guidance will become effective on **January 1, 2023**. This guidance will not have a sunset or review date; however, FSRA will continuously monitor and engage the sector as necessary and may consider amendments if OSFI changes its guideline or if something materially changes in the Ontario insurance sector.

## About this Guidance

This document is consistent with [FSRA's Guidance Framework](#). As Interpretation Guidance, it describes FSRA's view of requirements under its legislative mandate (i.e., legislation, regulations, and rules) so that non-compliance can lead to enforcement or supervisory action. As Approach Guidance, it describes FSRA's internal principles, processes, and practices for supervisory action and application of CEO discretion where applicable.

## Appendices and reference

**Appendix A:** [OSFI 2023 MCT Guideline](#)

**Effective Date:** January 1, 2023

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<sup>[1]</sup> The capital requirements set out in s. 102 (8) apply to all insurers licensed under the Act (including insurers incorporated in other provinces or federally). However, s. 102 (1) of the Act provides exemptions to filing requirements for certain insurance companies that are not incorporated in Ontario, as described in the Scope section below.

<sup>[2]</sup> [Minimum Capital Test Guideline for Property and Casualty Insurance Companies](#)