Canadian Life & Health Insurance Association

Association canadienne des compagnies d'assurances de personnes

Submission to the

DEPARTMENT OF FINANCE CANADA ON ITS CONSULTATION ON PROPOSALS TO STRENTHEN CANADA'S FINANCIAL SECTOR

September 11, 2024

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INTRODUCTION

The Canadian Life and Health Insurance Association ("CLHIA") is pleased to provide comments on the Consultation Paper on Proposals to Strengthen Canada's Financial Sector to the Department of Finance Canada ("the Department"). In our submission, we have structured our comments to align with the five themes set out in the consultation paper. We focused our comments on the proposals that are most of interest to our industry. Where we did not have comments to provide, we have remained silent on those proposals.

WHO WE ARE

The CLHIA is the national trade association for life and health insurers in Canada. Our members account for 99 per cent of Canada's life and health insurance business. The industry provides a wide range of financial security products such as life insurance, annuities, and supplementary health insurance.

Protecting **29 million Canadians**

27 million
with drug, dental and other health benefits

22 million
with life insurance averaging $246,000 per insured

12 million
with disability income protection

$114 billion in payments to Canadians

$44 billion
in health and disability claims

$16 billion
in life insurance claims paid

$54 billion
in annuities

$9.3 billion in tax contributions

$1.5 billion
in corporate income tax

$1.4 billion
in payroll and other taxes

$1.9 billion
in premium tax

$4.5 billion
in retail sales and payroll taxes collected

Investing in Canada

$1 trillion
in total assets

90%
held in long-term investments

SUPPORTING A COMPETITIVE MARKET STRUCTURE AND EXPANDING CONSUMER CHOICE

1. Strengthening the Ministerial Application Process

The Department of Finance is considering legislative measures to modernize the application process and better reflect the expectations that Canadians have toward financial institutions and the financial sector, including by:

- Requiring applicants to hold public consultations in respect of applications that raise material public interest considerations (for example, to consider potential competition or regional issues) and report on the outcome of those consultations to the Minister of Finance. This process would be separate from the existing public inquiry process for certain types of applications.
- Clarifying that the Minister of Finance has the authority to take into consideration an applicant's compliance with applicable domestic or foreign regulatory requirements when making a decision (for example, compliance with obligations related to taxation or anti-money laundering), and that her authority to impose terms and conditions or require undertakings as part of an approval extends to matters related to employment.

The Department is seeking views on whether additional considerations are warranted, and on the circumstances in which public consultations should be required, as well as how consultations should be conducted.

Our industry does not support the requirement of applicants to hold public consultations in respect of applications that raise material public interest considerations.

For one, we are concerned that this requirement would add delays and complexity to the business plans of companies. Companies do not have the expertise to be able to determine what would be deemed a "material public interest" issue that would require a public consultation.

Second, there is a risk that consultations held by companies would be viewed as conflicted, unfair or insufficient, rendering them of little utility. Companies would be opening themselves up to criticism that the consultation was completed in the best interest of the company.

There are already processes in place within the public sector to seek comments from the public without an appearance of a conflict of interest. For example, the Competition Bureau has processes in place to permit the public to weigh in on business decisions that have material public interest considerations (e.g., mergers and acquisitions). Furthermore, section 27 in the *Insurance Companies Act* (ICA) already sets out criteria for the Minister of Finance to consider incorporation of a new company or society. As part of this, there are processes in place for members of the public to object to new applications. We believe these existing processes are sufficient.

Finally, it is not standard business practice for private sector companies to hold public consultations. Companies do not have the internal resources to hold public sector consultations.

MODERNIZING THE FINANCIAL SECTOR FRAMEWORK

1. Prohibiting or Restricting Interlocking Directorates in the Financial Sector

The Department of Finance is seeking views on prohibiting or restricting interlocking directorates within the financial sector, given the unique role of FRFIs in the Canadian economy.

As written, the proposal is far reaching and could be interpreted in a broad and contradictory way, depending on the context. Finance Canada should specify the prohibitions or restrictions on interlocking directorates. It is important that a "one size fits all" approach is not taken with the assumption that all interlinkages can be detrimental.

We recommend that any restrictions or prohibitions on interlocking directorates in the financial sector be tied to situations where there are clear conflicts of interest, competing businesses and/or are linked to federally regulated financial institutions (FRFIs) above a certain size.

Competing businesses

The industry does not support a restriction in situations where the directorates are operating in different sectors and where they are not in competition with one another.

As an example, an individual could be a director of a life and health insurance company that does not engage, nor are they affiliated, with a property and casualty insurer, and vice versa.

In these situations, knowledge and experience in one sector of the financial industry can be helpful and beneficial when applied to another sector of the financial industry, without giving rise to the competition issues cited in the consultation paper.

Size of FRFI

In current practice, there already are few-to-no scenarios where a board member could serve on multiple large Canadian FRFI boards given the multitude of conflicts of interests that would be tied to investments or asset management businesses as well as life insurance and group benefits businesses.

However, regarding smaller FRFIs, there are scenarios where this could happen – particularly when the pool of investors of a small FRFI would be too narrow to create conflicts of interest with a larger FRFI. Creating too restrictive of a prohibition could have the unintended consequence of reducing the available pool of directors who serve on the board of non-financial Canadian public companies and who might also be able to serve on the boards of both large and small FRFIs – particularly smaller FRFIs whose parent companies are from other sectors.

This kind of restriction or prohibition could also have an unintended consequence where highly qualified people, who could serve as directors on public company boards, would not be willing to serve on the boards of smaller, more narrowly focused FRFIs because it could restrict their ability to be on the board of a major Canadian public company that is a FRFI.

Nature of FRFI

Given the particular member base of most fraternal benefit societies (fraternals), these entities are not likely to share internal directors of another fraternal. However, they may recruit an experienced property and casualty, or other industry, director to the Board where there are cross-knowledge benefits.

2. Updating Public Holding Requirement Thresholds

> The Department of Finance is considering updating the threshold at which the public holding requirement is triggered and is seeking views on what the threshold should be.

The ICA requires a company with more than $2 billion in equity to have shares with at least 35% of the voting rights listed and traded on a recognized stock exchange and not held by any major shareholders. This threshold was last raised in 2007. We believe that the threshold should now be increased to at least $5 billion in equity. There should also be an ability for a company that exceeds the threshold to subsequently fall below in the future and no longer be subject to the restriction.

In addition, we believe that there should be an explicit exemption for a FRFI that is the subsidiary of another FRFI and satisfies the public float requirement under its governing legislation, as we do not believe there is a policy reason to require such institutions to seek a statutory exemption from the Minister.

3. Updating Statutory Thresholds

> The Department of Finance is considering measures to update several key statutory thresholds:
>
> - Increasing limits on specialized financing activities;
> - Limits on investment powers; and,
> - Under the *Insurance Companies Act,* the ownership of farmland, timberland and similar assets.
>
> The Department is seeking views on:
>
> - What these thresholds should be;
> - The supporting rationale for the change; and,
> - Whether certain thresholds are better suited to regulatory guidelines than legislation.

Specialized financing activities

Under section 5 of the *Specialized Financing (Life Companies) Regulations*, the threshold for specialized financing activities is $250 million. This threshold has been in place for more than 20 years and needs to be revisited. CLHIA members would support increasing the threshold to reflect the growth in the financial sector over the last two decades. The new threshold should be materially increased as it has not been changed since 2001.

Limits on investment powers

As noted in our previous submission, CLHIA members believe it is important that they have the ability to invest in areas that are adjacent to the insurance sector. With the rapid pace of technological change, it is critical that companies have greater flexibility to undertake and leverage broader investments to deliver financial services in new and innovative ways. For example, investing in new technology applications to provide better services for consumers (e.g., applications to submit claims).

In addition, Canadian life insurance companies should be enabled to invest more freely in other assets, such as housing. Pensions and other investors with long-term investment needs already invest in these assets to diversify and strengthen their portfolios while supporting economic activity in Canada.

We would recommend modifying the investment limits in s. 493(1) of the ICA to allow for more flexibility in investments and to bring it in alignment with other sectors.

We also recommend that the federal government consider legislative changes that would allow insurers to engage in activities in areas that are adjacent to the insurance sector. This would allow for life and health insurers to better respond to the rapid pace of new technology and the changing needs of Canadians.

Ownership of farmland, timberland and similar assets

Under section 493(1) of the ICA, insurance companies are restricted in their ability to own more than 10% voting / 25% equity of a non-financial services corporation, or 25% equity of a non-incorporated, non-financial services entity. This requires complex structures to be put in place for investments in farmland and timberland assets to achieve ICA compliance.

We believe consideration should be given to increasing these thresholds to allow insurance companies to invest more in farmland and timberland assets. This would allow for greater capital to support farmland and timberland operations, would support local communities by offering employment in these areas, and would provide expertise in sustainable practices. It would also allow a company greater diversification opportunities for assets which are a good match for long-term insurance liabilities.

Other Thresholds for Consideration

CLHIA members would also recommend consideration of reviewing the following:

1. *Equity holdings for non-widely held insurers*

The ICA and section 3 of the *Investment Limits (Insurance Companies) Regulations* provide that the investment limits in sections 506 to 508 of the Act do not apply to federally incorporated insurance

companies that are mutual companies or are widely held companies and which have equity of $5 billion or more.

The provisions apply to insurers that are not widely held, including Canadian subsidiaries of large multinational insurers that are subject to both OSFI regulation over their Canadian operations and the prudential regulation of their home regulator. For these insurers, the ICA provides that regulations may be made setting out real property limits (section 506), equity limits (sections 507) and the aggregate equity and real property limits (section 508) that such a company may hold. These provisions impose a limit on the amount of real property and equity securities that an insurer can have in its investment portfolio without consideration of other risk mitigating circumstances.

Given that the prudential regulation requirements, corporate governance, capital standards, and risk mitigation expectations have evolved significantly since the regulations were initially drafted and are the same for both widely and non-widely held insurers, it is not appropriate to continue the distinction made by section 3 of the Regulations.

2. *Equity holdings used to hedge insurance policies*

Some insurance companies provide products containing investment options whereby policyholders can choose among a list of indices in which the savings component of their policy may be linked (i.e., universal life insurance policies). The risk of market fluctuations on these products is borne entirely by the investor and not by the insurer. These equities/real estate limits potentially preclude companies from achieving an appropriate asset-liability matching for risk pass-through deposits under universal life policies.

Insurers strive to appropriately match underlying equities/real estate to its policy liabilities. However, the current framework counts such investments against the limit on the amount of real property and equity securities insurers can have in their investment portfolio. Some insurers are “bumping up against” the limits set out in the *Investment Limits (Insurance Companies) Regulations*. The consequence of the regulation as drafted would be to prevent appropriate asset-liability matching and increase equity risk for the insurer. Since the investment risk lies with the policyholder in these cases, it would be appropriate and consistent with the OSFI LICAT Guideline to carve out insurer purchases of equities/real property, which are made to hedge universal life insurance policy liabilities and similar products where the risk is entirely borne by the policyholder.

3. *Commercial loans held by an insurer*

The definition of “commercial loan” in the ICA has not been amended since 1992 and is extremely broad. In particular, the definition includes in part (c) investments in securities (e.g., units in a fund). This results in the statutory commercial lending limit applying to private credit investments, which can provide investment grade financing for infrastructure, real estate, projects and the public sector. This broad definition also means that certain “commercial loans” could be subject to the real property limit (section 506) or equity investment limit (section 507), which we believe was not the original intention of government.

We would also note that the market has evolved significantly since 1992. Many new types of investment options now available to life companies, which may be considered “commercial loans”. These investment types are significantly less risky and therefore should be encouraged for life companies as opposed to restricted. For example, private credit investments that could be included as commercial loans can generate compelling risk adjusted returns and lower volatility, and benefit from the prevalence of features that could include covenants, collateral, seniority and a cohesive lender group. Recent data shows that the private credit market is now US$1.5 trillion in assets under management. This market has shown resilient performance through economic cycles and is expected to continue to grow, doubling by 2028 to US$3.5 trillion, after doubling in size since 2018 and tripling since 2014. As a result, private credit is an increasingly important asset class to an insurer’s asset mix, as it has historically exhibited higher returns, less volatility, and provides diversification benefits, which ultimately accrues to Canadian life insurance policyholders through more competitive pricing.

The commercial lending limit was initially introduced as an overriding restriction to the "prudent person" approach to investments. Given the passage of time, the definition no longer reflects the market and limits insurance companies from making prudent investments that strengthen an insurer’s balance sheet and benefit policyholders. We also note that legislation governing insurance companies in the U.S. or the UK does not place limits on commercial lending.

Accordingly, we recommend removing or increasing the statutory commercial loan limit to allow for more flexibility in life insurance company investments and for alignment with the current and projected state of markets. Alternatively, we recommend that the definition of “commercial loan” be re-examined to remove part (c) in its entirety given the changing nature of investments since the 1992 definition was drafted, and the fact that many of these investments would already be addressed by the section 506/507 limits.

If it is decided to not remove part (c) of the definition, we recommend amendments to part (c) to ensure it does not have unintended consequences. For example, based on the current wording, if a limited partnership (LP) was created for the purpose of building infrastructure, an insurer’s investment in the LP units would be considered a commercial loan given that units are not typically “widely distributed”. However, a direct investment by the insurer in that same infrastructure would not be counted as a commercial loan.

4. A More Transparent Financial Transactions Applications Process

> The Department of Finance is considering measures that would provide, upon request, a written update to an applicant if no decision has been made within 120 days of receiving a complete application, to match Canada’s international trade commitments.

The CLHIA supports a more predictable and transparent process for financial transaction applications. Currently, there is a lack of transparency on the timelines for the review of applications. A lack of transparency on timelines is costly and can cause unintended consequences, such as companies needing to adjust their internal planning processes and expected approval timelines.

It is important to note that other government entities and regulators post target timelines for certain applications. For example, the Ontario Securities Commission has posted timelines for response to applications (e.g., new business applications will receive a response within 30 working days). Furthermore, the Competition Bureau has also posted timelines for responses for certain processes (e.g., will provide a response within 14 days for mergers).

In addition, there needs to be more transparency on issues needing to be addressed in the application process. A transparent process would help to facilitate the ability for participants to address concerns by OSFI and the Department of Finance and to help manage the timelines associated with the review of proposed transactions.

ADAPTING TO GEOPOLITICAL RISKS

1. *Enhancing the Oversight of Financial Sector Risks Related to National Security*

> The Department of Finance is considering measures to enhance the oversight of financial sector risks related to integrity and security, including national security, and the creation by statute of a committee to facilitate consultations among members on how to address these risks and provide authorities for the exchange of information with necessary safeguards.

Our industry would be supportive of this proposal provided that information shared in this committee is shared with the private sector as well. This would allow FRFIs to better be able to detect, understand, and take steps to protect themselves against potential threats to their integrity and security.

Additionally, we would encourage the federal government to ensure that this committee include law enforcement and other agencies. Given their expertise, they can play an important role in determining emerging risks and where activities may cause concerns to the security and integrity of the financial sector.

UPHOLDING WORLD-CLASS REGULATION

1. *Enhancing Federal, Provincial, and Territorial Collaboration*

As noted in our previous submission, CLHIA members believe there is an opportunity for the federal and provincial governments to work together on expectations and oversight of the financial services sector.

Insurers are unique in that they are regulated both federally and provincially. Increasingly, federal and provincial regulators have overlapping and duplicative expectations when it comes to addressing risks. One example of this is with respect to information security reporting requirements. Having different reporting expectations in each province and federally is very burdensome for insurance companies, especially where reporting requirements are expected in a short time frame. Insurers should be focused on addressing incidents rather than worrying about duplicative reporting of incidents to multiple regulators.

Another example is the creation of a beneficial ownership registry to help protect Canadians against money laundering and terrorist financing and deterring tax evasion and tax avoidance. The beneficial ownership registry would make information public regarding the beneficial owners of federal corporations to facilitate information-sharing and data validation across federal and provincial governments.

We believe that mechanisms, such as the one noted above, should be developed where regulators and governments across the country share information so that companies are not subject to duplicative notification requirements and are not receiving and responding to duplicative requests.

2. A Strong and Predictable Regulatory Framework

> The Department of Finance is seeking views on providing regulatory predictability and on improving the understanding of regulatory actions and impacts. Such provisions could include:
>
> - Coordinated periodic announcements on likely forthcoming regulatory actions;
> - Conducting and publishing impact statements of regulatory actions;
> - Developing a forum for coordinating and collaborating on international issues; and,
> - Sharing of information about integrity and security risks.

Coordinated periodic announcements on likely forthcoming regulatory actions

CLHIA members would support coordinated, periodic announcements on forthcoming regulatory actions by the federal government. Having coordinated announcements allows companies to better prepare and plan for upcoming regulatory changes that have significant impacts on their business.

For example, OSFI is currently piloting a new approach to the way it releases regulatory guidance. In its approach, the federal regulator will release regulatory guidance one day of each quarter that is determined in advance. Companies will be given sufficient time to respond to the regulatory guidance (e.g., three months). The schedule for the regulatory guidance release is provided in its annual risk outlook and semi-annual risk outlook. This new approach provides companies with a more predictable and transparent process, which allows companies to better schedule internal work and resources.

CLHIA members would be supportive of a similar approach by the federal government with respect to changes to the financial institution statutes.

Conducting and publishing impact statements of regulatory actions

CLHIA members would support the publication of impact statements of regulatory actions, provided that the statements can help reduce regulatory burden on the financial sector.

As noted in a report by the C.D. Howe Institute, Canada's regulatory burden has increased significantly over the past decade. This has resulted in higher compliance costs and decreased

competitiveness. It is therefore important that there is a balanced approach to regulation that ensures regulatory actions address financial stability and consumer protection while fostering innovation and market efficiency.

Having impact statements of regulatory actions can help mitigate this problem. However, we also believe it is important that, before regulatory actions are taken, the government should well define the issue it is trying to address with the new regulatory action and should ensure it does not create additional burden.

Developing a forum for coordinating and collaborating on international issues

There is currently no central coordinating role that organizes Canadian representation at international standards-setting and policy-making forums. In recent years, provincial regulators have participated in these international forums (e.g., International Association of Insurance Supervisors, Financial Stability Board) and shared views that only reflect comments from their respective jurisdiction. There needs to be better coordination in who represents Canada at these international forums to ensure the Canadian financial services policy imperatives are properly represented.

Sharing of information about integrity and security

CLHIA members would benefit from information sharing on integrity and security as it would allow FRFIs to better be able to detect, understand, and take steps to protect themselves against potential threats to their integrity and security.

We would encourage the federal government to set up a means to share information with affected financial institutions on issues related to integrity, security, and foreign interference. Any information shared would need to be confidential.

3. Artificial Intelligence

The Department of Finance is undertaking work to strengthen federal leadership on the safe and responsible use of AI in the financial sector, led by an AI expert. This effort would aim to:

- Engage a broad range of domestic and international stakeholders;
- Identify and assess potential risks of AI; and,
- Develop a federal strategy to harness the advantageous capabilities of AI in the financial sector, while mitigating potential risks.

The Department is also seeking views on which areas should be prioritized in this work regarding the use of AI in the financial sector.

Coordinate with other Canadian and foreign jurisdictions

We recognize the importance of responsible use of AI to ensure consumer confidence in the services offered to them. However, when a financial institution uses AI, like any other technology, it must

already comply with the applicable legislative and regulatory framework that governs the activities of life and health insurers. Any policy or legislative approach to AI should not create redundancies, contradictions, or confusion to the existing legislative and regulatory framework, nor should it add to the regulatory burden on life and health insurers. We recommend that Finance Canada coordinate with other Canadian and foreign jurisdictions that are examining AI and its responsible use (e.g., Canadian Council of Insurance Regulators (CCIR)), Privacy Commissioners, etc.).

A balanced and measured approach

It is important that any legislative or regulatory requirements are measured and balanced so that expectations do not inhibit innovation. The policy and/or legislative approach to AI should achieve the right balance between consumer protection and the latitude needed for healthy competition and innovation in the financial sector.

Legislative and/or regulatory approach should be technology neutral

We recommend that the policy and/or legislative approach to AI be technology neutral. The evolution of AI is constant, global and multisectoral. Any legislative or regulatory approach to AI should not be tied to a specific technology due to the rapid rate at which the technology is evolving. Such an approach could hinder the ability of financial institutions to innovate and could quickly lead to obsolete technology.

CONCLUSION

Thank you for the opportunity to provide our comments on the Consultation Paper on Proposals to Strengthen Canada's Financial Sector. Should you have any questions or wish to discuss further, please do not hesitate to contact Susan Murray, Vice-President, Government Relations and Policy, at smurray@clhia.ca.

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