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The Impact of the Global Financial Crisis on Policyholders and Market Conduct Issues

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Bonjour

It is with great pleasure that I have accepted to speak today both as the Superintendent, Solvency with the Québec *Autorité des marchés financiers* also known as the AMF and as Chair of the Canadian Council of Insurance Regulators (CCIR).

And it is through this group known as the CCIR and, with the very Québec vision of the AMF, that I will share with you today our thoughts on the impact of the global financial crisis on our policyholders.

I will draw on my two roles to give you a brief description of the Canadian insurance market as well as the oversight and monitoring authorities present in it.

There are two levels to the oversight and regulation of the Canadian financial sector. First, the federal Office of the Superintendent of Financial Institutions (OSFI) is responsible for prudential regulation of the majority of insurers – and of other financial institutions - in Canada. The provincial and territorial insurance regulators, 13 in all, are the market conduct regulators, as well as the prudential regulators for the smaller number of insurers that are provincially registered.

In some provinces, including my own Quebec, regulators have mandates that include other financial institutions – like pensions, credit unions, mortgage brokers, etc. And in two provinces – again including Quebec – securities regulation is also under the same umbrella.

To make all this work smoothly across the country, regulators have formed several nation-wide associations – for the insurance sector, this organization is the CCIR.

The Canadian Council of Insurance Regulator is an interjurisdictional association where regulators work together to keep provincial regulation harmonized where possible and to deal with common issues.

Regulators from all 13 provinces and territories as well as OSFI belong to and - more importantly – actively participate in the CCIR.
To meet its mandate, the CCIR takes on many issues and projects, but, of particular importance to today's discussion are CCIR's recent work on formulating a common approach to risk-based market conduct regulation and our ongoing work to improve product disclosure to policyholders.

Governments across the country look to their regulatory bodies – the CCIR members – as their primary advisors on insurance issues. The work the CCIR does, to research, consult, draft, propose, recommend and review issues of common interest, assists regulators in forming the advice they take to their governments.

The Canadian market is very diversified in terms of its financial institutions and of its provincial regulators.

L'*Autorité des marchés financiers* is the only fully integrated regulator in Canada.

We oversee insurers, deposit institutions – other than banks, which are under the exclusive jurisdiction of the federal regulator – securities and the distribution of financial products and services.

This integration presents undeniable advantages in terms of harmonization with the development of regulatory structures, which are set up within the same organization.

This, helps promote inter-sectoral coherence, thereby reducing the probability of arbitrage which can occur within financial conglomerates in particular.

This integrated structure also allows us to view institutions globally. The evolution, if not to say complexification, of financial institutions requires that the regulator be able to see beyond the structures, to be on the lookout. In terms of supervision, it gives us a complete portrait of an institution or even a very detailed one if the situation so requires.

Now that we are set up, allow me now to draw your attention to the main theme of our panel.

Here are some figures which illustrate the effects or lack of, of the financial crisis on Canadian life insurance policyholders. The data presenting the premiums collected by life insurers over the years before, during and after crisis, shows very little variation between the Québec and Canadian data.

At the Canadian level, there was a slight drop in the premiums collected in 2008, possibly due to changes in the composition of the portfolios of those insured who, may have moved from products with an investment portion to more traditional products.

However, there is no evidence of large scale surrenders or movement of funds from insurers that might have suggested churning or other market misconduct during the financial crisis.
As well, the increase in premiums in 2009 is an indication that Canadians' confidence, in the insurance sector at least, remained high throughout the crisis.

The data representing the premiums collected by property and casualty insurers during the same years shows for both, the Québec and Canadian figures, a progression and this, notwithstanding the turbulence which shook the markets.

This data clearly illustrates that the financial crisis did not bring financial ruin to many Canadians. We were still very unlikely to abandon our automobile and house insurance.
This type of insurance is characterized by products that are relatively standard and necessary, even mandatory in some cases; products that appeal to the generally risk-averse Canadian psyche.

For both life and P&C insurance, the data confirms that Canadian policyholders were not seriously affected by the financial crisis or by the climate of uncertainty which prevailed.

True, many saw their investments and pension savings take a sharp drop, but, while there was a shift away from more risky investments, concern never developed into panic.

At most, some people reacted to what they saw in countries more significantly affected – usually to their own detriment as Canadian markets rebounded fairly rapidly to pre-crisis levels.

During the crisis, we saw a 25% to 40% drop in stock prices, we lost jobs, saw whole manufacturing sectors brought to their knees, and have run up a large deficit to stimulate the economy. Although Canada didn't drown, it certainly got its feet wet! But we know, it might have been much worse.

The post-crisis analyses which have been conducted all led to similar conclusions: Canada is one of the countries least affected by the financial crisis.

The same analyses attributed this performance to the Canadian culture which has generally been fairly conservative and prudent in money matters.

Indeed, we often heard the financial scene in Canada being referred to as "boooring." Today we say proudly that BORING IS GOOD.

As it has been often sited recently, the Canadian capital requirements kept our banks strong throughout the crisis. Less well known, but also true, is that this worked for our insurers as well.

In general, the institutions we regulate, control their appetite for risk and, manage their level of tolerance for all the risks they face, very conservatively.

I truly believe Canadian regulators can take some of the credit for this good outcome. For the past decade, we have been emphasising the importance of managing risk in a sound, prudent and holistic manner, and our efforts paid off during the crisis.

As regulators, we set up frameworks, such as capital adequacy rules, which incite caution and attempt to target risks as specifically as possible.

This risk-based methodology allows us to impute to the institutions capital levels based on how much risk they wish to bear.

As this methodology can be strict in terms of the required capital, it often leads insurers to review their business strategies and adjust their risk tolerance levels accordingly.

These rules have made it difficult for institutions to ignore or underestimate the inherent risk in the business they transact.

But, before staining our shoulders patting ourselves on the back, maybe we should also acknowledge that Canada might simply have been lucky. True, we were in pretty good shape and not so vulnerable to the forces that created THIS crisis. But who knows!

Will we be as lucky the next time when, some new forces create a crisis and trigger an unprecedented climate of fear, uncertainty, or even despair for consumers? Indeed, with recovery stalling in places, we may ask whether the current crisis has indeed passed.

Throughout the country, knowing that we needed to do what we could to be ready for whatever might come next, regulators took immediate steps to maintain and even reinforce the necessary confidence of all participants in the financial system.

With this in mind, at the AMF, we stepped up our oversight, both on and off-site, and increased the pace of our reviews.

We intensified the scope of our interventions and took advantage of the situation to broaden our vision. In this sense, rather than being limited to the insurer, we stretched our oversight to a more macroeconomic outlook.

The surrounding markets, the nature of relationships with other types of financial institutions were always part of our scope but, the crisis gave them a new meaning.

The crisis emphasized the need for us to be on the lookout; lookout for quickly being able to identify potential damage that could be suffered by an industry—in this case insurance—damage resulting from problems experienced by another industry, such as deposit institutions.

One of the issues we were asked to consider today was whether the crisis increased tension between prudential and market conduct regulators. Certainly, it could have been a possibility if the best interest of individual policyholders would have conflicted with the best interest of an insurer. However, nothing like this occurred, in part, I believe, because the CCIR had set up the Regulatory Collaboration Committee which, as its name implies, facilitates open communication between the chief prudential regulator, OFSI, and the market conduct regulators the provincial regulators. Lead by Quebec, this committee deals with technical standards, training, emerging issues and enforcement issues, but its greatest value, I believe, is line of communication and mutual understanding.

In the midst of the crisis, the CCIR published an important document on risk-based market conduct regulation.

The document is broadly based on the risk-based supervisory approach for prudential regulation where, regulators prioritize issues based on their potential impact (risks) to the achievement of desired regulatory outcomes.

This approach, initially used for prudential aspects with a focus on the highest standards of corporate governance, can easily be transposed for market conduct regulation.

It also emphasised the need for quick regulatory response to issues and the need for regulators to work together to be more efficient and effective.

We were therefore, in the fortunate position of having already worked out methods of communication and coordination through the CCIR, when issues arose.
For example, within days of being informed of the suspension of redemptions from a large real estate fund run by an insurance company – a move that left some people with no access to necessary income - CCIR members were meeting to discuss what was to be done and were dealing as one with the insurer to the benefit of both policyholders and the insurance company.

Could this financial crisis which has been broadly analyzed, commented on and described as one of the most serious in modern history, have any positive aspects? Let me take you down this road less travelled for just a moment.

It is a sad truth that when a regulation works well to control a practice that was abused in the past, it may look to some people as though these abuses have disappeared and the regulation is no longer needed.

In the same vein, it is also a sad truth that regulators often hear their good work referred to as a “burden” that hinders business.

It was gratifying, therefore, when financial institutions around the world watched the crisis unfold and, for once, all understood, and even welcomed, the regulators’ wish to strengthen regulatory requirements.

Thus, when we proposed additional regulatory requirements to Québec’s industry, and those requirements represented changes in the way they did things and sometimes, even a significant investment, the industry understood and agreed to comply. Now that’s positive!

This crisis will have made us push our limits and see beyond them, it will have made us erase from our mind the word impossible and imagine the unthinkable. We now know that even the most unlikely and the most pessimistic scenario can occur.

As regulatory authorities, we know now that we must see beyond complex structures and we must be in position to challenge and test.

In order to do so, we need leading edge analysis tools and the appropriate platform to support them. We need knowledgeable resources allowing to push our quantitative analyses beyond the limits we had until now. We need training for the field teams to keep up with the times. And the list can go on and on. And it comes in significant additional costs…While most of us have been the target of budget cuts, the crisis and its aftermath at least has given us what I call antenna time. We have to be listen to and taken into consideration.

But beyond the systems and structures, the aspect which to my mind is the most positive is certainly the fact that, on both sides of the fence, regulators and industry, we're seeing a renewed attitude and a new transparency, a wish to cooperate, to understand in order to make it, in order to be ready for the next wave, in order to move fordward.

The crisis also brought/ forced the regulators to develop bonds with each other.

More than ever, we know now that the institutions we oversee do not operate in a vacuum. They are related to each other, through structure, investment, business venture, outsourcing and others.

In Canada, we use the CCIR to help us gain a Canada-wide view, but we need to do more. As regulators, we have a duty to open discussions and help create complete profiles of the institutions we all oversee – each of us in our own backyard. This broadened dimension will let us see globally, without ignoring the importance of applying the information to our respective markets and clientele.

Think globally, act locally.

The role of the regulator in the financial market has been brought to the forefront. While most people would think that we do not add to a company's bottom line, I do think that the crisis has demonstrated our value proposition: we did help make it possible for financial institutions, and, therefore, their customers, to weather the storm.

The AMF is doing a number of things to "make the most of it."

Recently, we have begun working toward a framework about treating consumers fairly with our draft *Commercial Practices Guidelines.* These draft guidelines, set out the AMF's expectations, that insurers set up within their organization a culture of sound commercial practices, based on integrity, strong governance and impeccable ethical conduct.

Additionally, over the past few years the AMF has developed an updated supervisory framework, setting out its expectations, with respect to sound and prudent management

practices and sound commercial practices which are expected from institutions. Our ultimate goal is to make the directors and executives of these institutions accountable. This framework, which was essentially based on best national and international pratices, also takes into account the lessons learned from the financial crisis.

Based on what we consider to be the pillars of our framework, namely Governance, Integrated Risk Management and Compliance (GRC), we have developed several guidelines which cover topics such as securitization risk, liquidity risk and outsourcing risk.

In response to the need to build relationships with other regulators and broaden our horizons, the AMF has intensified its participation in task forces both nationally and internationally.

We are involved in several working committees on insurance at the national level through the CCIR. One of these is looking into updating capital requirement standards for insurers, strongly based on the European Solvency II standard.

Internationally, we have become very involved with the IAIS Governance and Compliance Subcommittee, the Market Conduct Subcommittee and the Insurance Fraud Working Group.

As well as intensifying our external presence, we have intensified our strategic oversight efforts within Quebec. We believe it is more important than ever to be proactive and on the offensive.

I believe the financial crisis had unsuspected positive aspects but, as we are all aware, it also had its darker side. In the aftermath of the crisis, the opportunities for fraud are often increased a hundred fold, as are the opportunities for unsound commercial practices.

With interest rates continuing at record low levels, some consumers may be enticed by scam artists offering high rates of return on “sure things.”

Even reputable firms may produce products not easily understood by a consumer. One anecdote had an annuity product with a costly 15 year income guarantee being sold to a man in his 90's – how likely was he to be able to enjoy that guarantee?

Setting up frameworks, programs and structures cannot prevent bad practices and malice. They must inevitably be supported by initiatives aimed at helping consumers protect themselves. The more consumers are informed, the more they will be able to question their representative or financial institution, understand the products offered and assess the risks associated with certain financial products.
This is where financial literacy comes in.

There is a general consensus that, despite the availability of an abundance of educational materials to support financial literacy, many Canadians lack some or all of the skills, knowledge and confidence necessary to be financially literate.

Much more than a popular idea, financial literacy is a matter of culture. Financial literacy means having the knowledge, skills and confidence to make responsible financial decisions. Increasing a society's level of financial knowledge – like increasing its standard of living or public health – is a long-term project. Sustained efforts by as many people as possible are required in order to succeed.

Regulators have an important role to play in financial education.

First, they must ensure that consumers CAN make informed choices in the face of the increased complexity and diversified range of available financial products and services.

Consumers must receive objective and high-quality information which meets their specific needs. Various projects are being carried out nationally to tighten the rules and attitudes regarding the offering of financial products and services.

Assuring the suitability of a product for a consumer has gained significant prominence. Financial market participants must ensure that the products they offer meet the needs expressed by consumers.

Even with the most appropriate initiatives, we can never expect to achieve our goals if consumers aren't interested and engaged.

Consumer interest is tied to local and regional realities and distinctiveness: players already set up who work with particular client groups. In other words, we must ensure that programs can be adapted to the realities of certain clients and not try to standardize initiatives.

At the AMF, we devote a great deal of effort to consumer education and assistance. Through television adds, town meetings, brochures and joint ventures with the industry, our principle is to always remind consumers that they have both the rights and the responsibilities.

Conclusion

Although it was less affected by the crisis, Canada does not plan to sit on its heels. In this sense, we can say that we've dried out, but we're still wet in our minds!

The financial markets as we know them today are interrelated and dependent upon each other, thereby amplifying the possibility of contagion and ultimately the occurrence of systemic risk. As regulatory authorities, we cannot ignore these new realities which remind us of the importance of our role as regulator in maintaining confidence in the financial markets.

Thank you.