

Address by

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Bonjour

I am pleased to be back before this prestigious forum for the second time in my current term as Chair of the Canadian Council of Insurance Regulators (CCIR) and à titre de Surintendante de l'encadrement de la solvabilité à l'*Autorité des marchés financiers*.

Going over the synopsis for this panel, some words struck me. Keywords like:

2007 – extraordinary challenges

2008 – regulators now face two tasks - make sure – better identify – eliminate – reduce

2009 – everything can be improved – what challenges are the most important?

Over the next minutes, while you will graciously endure the voice, the interruption for water and the occasional coughing spell, I would like to share with you some of my thoughts on 2 of the main challenges regulators are facing and if you don't mind I will also briefly give an update on actions taken by the CCIR Quebec since last year.

Today, in 2010, we have an obligation to implement the necessary tools to enable us to quickly recognize the early warning signs of a looming crisis or other threat to financial system stability.

No continent, country or jurisdiction can be considered an island because they are so closely intertwined.

Regulators, therefore, must work together and better co-ordinate policy-making designed to foster stability and reduce systemic risk.

We must be proactive and poised to react promptly to any red flag or threat to market operations.

Tomorrow's problems will not be the same as yesterday's.

Much of the world's brain power has been allocated to business and investing in recent years. New deals, new products, new opportunities will doubtless abound, but so will new and unknown risks.

So, if we regulators, are to meet our goal of providing services that are on a par with the standards practised in all financial market sectors, we must hire skilled staff whose knowledge and expertise will be tailored to constantly changing needs. Such expertise does not come cheaply if, it is willing to come to public service at all.

Changes, new and increasingly complex products, collaboration and co-ordination among global players, compel regulators to ensure that our resources have a firm grasp of all facets of insurance industry regulation and supervision.

In order to keep pace with market changes, product complexity and distribution patterns, staff must continue to upgrade their skills to remain on top of developments.

Merely ticking the boxes has not been an option for some time now.

Today's environment demands profound reflection, research and expanded analysis, especially because of the interconnectivity between industries and participants.

So, attracting, training and keeping staff will be a major and growing challenge for regulators in the years to come.

And, as our costs are your costs, this is an industry's challenge as well.

Regulators are not the only ones to have raised this issue. In her latest public report released a few days ago, Sheila Fraser, Canada Auditor General made the same observation about the supervision of large Canadian banks. In her report she pointed out that an increase in the number and complexity of financial activities and products on top of the implementation of international standards and regulatory requirements could create human resource challenges.

In fact, there's fierce competition for staff in the private sector, and regulators are having a hard time attracting and retaining certain qualified employees. Due to budgetary constraints, we may not be able to offer competitive salaries and/or the external training employees need to stay ahead of the curve in this highly specialized field.

Another major challenge we are facing is to define a regulatory framework that promotes our goals of fostering growth of the financial sector and protecting consumers of financial products and services.

What is the best way to oversee the financial system? As we all know, opinions are divided between the principles-based approach and the rules-based approach.

What it really boils down to is either imposing strict rules or providing regulated entities with guidance that give them operational flexibility .

In a post-crisis period such as the one we have just come through, everyone calls for stricter, tighter rules. Yet, when the waters are calm, they feel that principles are sufficient. Which is best?

The US regulatory framework of the past 50 years, primarily rules-based, did not prevent the financial crisis from reaching U.S. shores. AIG was brought down by credit guarantees which were apparently tucked away from the prying eyes of regulators – all within the rules.

At the other end of the spectrum, the more principles-based approach in the United Kingdom did not yield the expected outcomes.

FSA, the UK integrated regulator, is a recognized leader in principles-based regulation; but, the collapse and subsequent nationalization of Northern Rock bank and the subprime mortgage loan crisis seriously undermined its credibility. Why did this approach fail?

It could be said that because of the scope of the financial and economic crisis, failure was inevitable regardless of the regulatory structure in place.

In his March 2009 report, FSA Chairman Lord Turner insisted that the FSA had not failed because it had adopted principles-based regulation. Instead, he blamed the FSA's non-interventionist philosophy, which assumed that the markets could regulate themselves and that market discipline would be able to contain and manage risk.

The reality is quite different. We all know that there is a wide gap between theory and practice – and the financial industry is no exception. Hence the dichotomy in regulatory and supervisory approaches.

The ideology behind the development of rules is based on precision, clarity, certainty and, I would even say, operationality.

Principles, on the other hand, are underpinned by an ideology of fairness, flexibility and awareness.

Principles-based regulation and self-regulation are not antagonistic approaches, but nor are they synonymous.

Don't the complexity of financial markets and the rapid changes that shape them

preclude having regulation that is rigid and unable to respond to changing situations?

In Québec, we think so.

Over the past several years, the AMF has made a major shift in its regulatory approach to the insurance sector. The philosophy underlying the AMF's regulatory structure favours a principles-based rather than a specific rules-based approach. These principles are underpinned by a set of prudential rules and guidelines.

We have chosen to adopt a flexible framework that we believe is better adapted to the constantly and rapidly changing financial markets and this, by removing many of the prescriptive standards from Québec's insurance act.

To fully realize the benefits, it is not enough to develop principles-based regulation and leave our regulated entities alone to interpret the standards and guidelines we publish. Our guidelines must flesh out the core principles that form the basis of our regulatory structure, and implementation is crucial.

Intensive interaction with our market players is at the very core of the success of the principles-based approach. It is through transparent, accessible and ongoing communication with our clientele that we ensure a uniform interpretation by our financial institutions.

For us at the AMF, when we refer to the core principle of sound and prudent practices, we expect market players to show us that they are complying with this principle. We don't tell them how we want them to comply; they must demonstrate that they are compliant. In other words, "Don't tell us, show us." They are responsible for finding solutions and setting up the mechanisms appropriate to ensure adherence to the main guiding principles.

Principles-based regulation therefore, delegates the details of regulation to the industry, as the underlying assumption, is that the industry has the best information and is, in the best position to assess and support its risks.

And now, allow me to give you a brief update on different measures and actions we, at the AMF, have been taken in recent months.

In terms of risk management, following the publication in May 2009 of the Principles for sound stress testing practices and supervision by the Basel Committee on Banking Supervision (BCBS), in December 2009, OSFI published a guideline setting out its expectations for the use of stress testing by federally regulated financial institutions.

Our guidelines already included a section outlining our expectations regarding sound practices in the use of stress tests, without going into great depth.

As a result, in 2011, we will be publishing a new stress testing guideline for financial institutions (deposit institutions and insurers). The guideline will complement the existing supervisory framework.

We are also an active member of the IAIS Governance and Compliance Subcommittee and we lead the team tasked with reviewing the IAIS Core Principles, Standards and Guidance on Suitability of Persons.

The final version of this supervisory standard on fit and proper requirements was adopted at the Annual IAIS Conference.

Our work with IAIS paved the way for the development of a similar forthcoming AMF guideline which we expect to publish a draft by the first quarter of 2011.

One final point I would like to review briefly is the harmonization of our regulations Canada-wide and internationally.

The CCIR is currently mapping out a new strategic plan. Industry stakeholders were asked for their input and, in particular, their expectations regarding the harmonized solutions proposed as a response to the issues raised by differences in policies and regulations in effect in each province.

The governments of each province rely on their regulatory bodies – CCIR members – to advise them on insurance-related issues.

The work of the CCIR therefore, helps regulators to advise and make recommendations to their respective governments.

Whereas this translates into the adoption of less discordant and more harmonious regulation in most cases, there is still room for further harmonization.

However, even minimal harmonization reduces compliance costs for the industry.

We will pursue our efforts over the coming years, not only within the CCIR but also by collaborating with the financial sector regulatory bodies that are part of the Joint Forum.

As Chair, I am also proud of the work that CCIR has done – and continues to do – in fostering coordinated responses to regulatory issues – both industry-wide and company specific.

Without getting into any embarrassing details, let me say that more than one company has found it useful and efficient, to have the various provincial regulators work through CCIR - often through a lead regulator or two – rather than having to



deal with ten or twelve of us separately.

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

It was broadly based on the risk-based supervisory approach for prudential regulation where regulators prioritize issues based on their potential impact 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.

This approach 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.

As you can see, much headway has been made. Regulators are focused on recommending the appropriate regulatory and supervisory standards to ensure the protection of consumers of financial products and services and the stability of the financial system.

The recent crisis confirms the need to strengthen the regulatory and supervisory architecture for financial systems. This is where we are channelling our efforts.

It would be unrealistic to believe that we could eliminate financial market complexity or make it disappear. Instead, we need to look for means to develop an understanding -- one that is both more comprehensive and better defined -- of the

increasingly interdependent components co-existing within financial markets.

Over the past few years, the strength of Canada's financial system has earned high praise, but we must not rest on our laurels. Neither Québec nor Canada can be considered safe from upheavals that could affect the more vulnerable or less conservative areas of our financial systems.

We must continue our efforts to remain at the forefront of high-level normative and regulatory developments.

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