

DRAFT



**AUTORITÉ
DES MARCHÉS
FINANCIERS**

GUIDE RESPECTING THE USE OF GUARANTEE INSTRUMENTS

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Introduction

This guide sets out the criteria respecting the use of guarantee instruments in connection with unregistered reinsurance contracts¹ in order to benefit from credit offsets in respect of capital requirements.

The guide seeks to be straightforward and flexible. It is user-friendly, gathering, in one place, all the criteria for the use of guarantee instruments. Moreover, it is flexible in that it does not impose restrictions on the type of guarantee instruments used, providing insurers with latitude to use other types of instruments which may serve their purposes while providing a satisfactory level of protection.

Scope

This guide applies to insurers contemplated in the Reinsurance Risk Management Guideline.

¹ As defined in Appendix "A" of the *Reinsurance Risk Management Guideline* (Draft published for comment).

Coming into effect and updating

This guide will come into effect on January 1, 2013.

It will be updated based on developments in the criteria for the use of guarantee instruments and in light of the AMF's observations in the course of its supervision of insurers.

1. Guarantee instruments

The *Autorité des marchés financiers* ("AMF") asks that insurers negotiate and enter into appropriate agreements and take all necessary practical and operational measures to establish and maintain valid and prior-ranking security interests so as to benefit from reduced capital requirements in connection with unregistered reinsurance. The agreements must allow the insurer to guarantee the performance of its obligations in Québec.²

Guarantee instruments that may be used within the scope of an application for a reduced capital requirement are trust deeds, hypothecs (also referred to as "mortgages" outside Québec), and letters of credit. The minimum criteria applicable to these instruments are set forth in the following sections. At the request of an insurer, the AMF may consider other guarantee instruments insofar as the insurer demonstrates that its obligations in Québec are satisfactorily guaranteed. To this end, the insurer must take into account the minimum criteria set out in this guide and make any necessary changes in light of the instrument chosen.

Every guarantee instrument, excluding letters of credit, must be accompanied by a legal opinion addressed to the insurer containing the elements set out in section 2 entitled "*Legal opinion.*"

1.1 Trust deeds

Insurers may use trust deeds as guarantee instruments. The deed must be made in accordance with the provisions of the Civil Code of Québec (the "Civil Code") relating to trusts. As such, the following minimum conditions must be met³:

- A valid and enforceable trust deed must be entered into between the insurer and a trustee duly authorized to act as such in Québec;
- The trust patrimony must constitute an autonomous patrimony that is distinct from that of the insurer, trustee or reinsurer and in which none of them has any real right;

² *An Act respecting insurance*, section 269.

³ The Template Reinsurance Trust Agreement will no longer be provided. However, trust deeds currently in effect will remain valid until the date of their expiry or renewal. As of that date, a new trust deed will have to be entered into in accordance with the provisions of this guide.

- The insurer is the settlor of the trust and, as such, must transfer a nominal amount to the trust patrimony it is constituting;
- The reinsurer must intervene in the trust deed in order to add to the trust patrimony assets to be held in Canada by the trustee;
- The trustee must have control and exclusive administration of the trust;
- The assets must guarantee the reinsurer's obligations to the insurer and their market value must at all times be at least equal to the guarantee amount recognized for purposes of capital adequacy guidelines;⁴
- The insurer must file with the AMF a report on the value of the property comprising the trust patrimony as well as all required related information (see section 3 entitled "*Declaration respecting assets*");
- The assets must be free of all liens, charges and encumbrances of any nature whatsoever, excluding the participation charge given to the Canadian Depository for Securities Limited (CDS) on an asset deposited and recorded in book-based form with CDS;
- The assets must not be used as part of a securities lending program;
- The trust deed must provide terms and conditions for the replacement of the trustee, where appropriate;
- The trust deed must also provide terms and conditions for realizing on the security and specify the events of default giving rise thereto, including where:
 - the reinsurer is no longer authorized to carry on the business of reinsurance;
 - a liquidator or receiver of the reinsurer or of any part of the insurance business of the reinsurer has been appointed under the provisions of any statute or pursuant to any agreement between the reinsurer and a third party;
 - the reinsurer defaults in its obligations under the trust deed and does not remedy the default within the time limit provided for therein after receiving written notice from the insurer;
 - the reinsurer defaults under the terms of the reinsurance contract.
- The trust deed must provide that the courts of Québec will have exclusive jurisdiction over all disputes, actions or proceedings related thereto;

⁴ *Autorité des marchés financiers, Guideline on Capital Adequacy Requirements ("MCT"), Property and Casualty Insurance.*

Autorité des marchés financiers, Capital Adequacy Requirements Guideline ("CAR"), Life and Health Insurance.

- The trust deed must contain the customary provisions contained in an agreement of this nature;
- The AMF must be notified in writing of any amendment to the trust deed within 30 days following the amendment. The notice must be accompanied by a copy of the amendment. Where the trust deed is to be terminated, the AMF must be notified in writing at least 30 days before the scheduled termination date.

1.2 Hypothecs

Insurers who rely on hypothecs to guarantee unregistered reinsurance contracts must negotiate and enter into agreements that comply with the provisions of the Civil Code. The agreement must, at the very least, provide as follows:

- The hypothec must guarantee the reinsurer's present and future obligations to the insurer under the terms of the reinsurance contract and must have priority over any other security interest in the hypothecated assets;
- The hypothecated assets must be located in Québec;
- Where the value of the hypothecated assets fluctuates over time, that value must at all times be at least equal to the guarantee amount recognized for purposes of capital adequacy guidelines;
- The insurer must file with the AMF a declaration regarding the hypothecated assets as well as all required related information (see section 3 entitled "*Declaration respecting assets*");
- Upon reasonable notice, the insurer and the AMF must have access, for purposes of examination, to all the hypothecated assets and the documents related thereto;
- If the hypothecated assets are securities or security entitlements governed by *An act respecting the transfer of securities and the establishment of security entitlements*,⁵ the insurer must obtain control of these securities or security entitlements;
- The courts of Québec must have exclusive jurisdiction over all disputes, actions or proceedings related to the agreement;

⁵ R.S.Q., c. T-11.002.

- The agreement must provide terms and conditions for realizing on the security and specify the events of default giving rise thereto, including where:
 - the reinsurer is no longer authorized to carry on the business of reinsurance;
 - a liquidator or receiver of the reinsurer or of any part of the insurance business of the reinsurer has been appointed under the provisions of any statute or pursuant to any agreement between the reinsurer and a third party;
 - the reinsurer defaults in its obligations under the agreement and does not remedy the default within the time limit provided for therein after receiving written notice from the insurer;
 - the reinsurer defaults under the terms of the reinsurance contract.
- The agreement must contain the customary provisions contained in an agreement of this nature.

1.3 Letters of credit

Insurers may rely on letters of credit (LOCs) in connection with unregistered reinsurance contracts. In order to benefit from reduced capital requirements, the insurer must ensure that the LOC:

- Is issued by a Canadian financial institution (where the issuer is a foreign bank, the LOC must be confirmed by a Canadian bank);
- Is denominated in Canadian dollars;
- Clearly indicates the name and address of the beneficiary (the insurer);
- Indicates its effective date;
- Has a fixed term of at least one year and specifies the date and time of expiry;
- Will be renewed tacitly and unconditionally;
- Is irrevocable;
- Sets out the conditions under which the insurer can draw on the LOC, including the possibility of making partial drawings;
- Provides that the amount of the LOC may be reduced only pursuant to drawings made by the insurer in accordance with the terms of the LOC;

- Specifies that non-renewal of the LOC requires written notice of at least three months to the insurer, with a copy to the AMF, and the written notice must contain appropriate protective clauses;
- Allows the insurer to draw on the LOC in the event the LOC is not renewed;
- Indicates the standards and rules applicable to its use;
- Is governed by the applicable laws of Québec and the *Uniform Customs and Practice for Documentary Credits* of the International Chamber of Commerce (UCP 600);
- Specifies that in case of conflict between UCP 600 and the laws of Québec, the latter shall prevail;
- Is signed;
- Must allow the insurer to guarantee the performance of its obligations in Québec;
- Is accompanied by confirmation from the beneficiary (the insurer) that it has not granted a hypothec or other form of security interest affecting:
 - the obligation secured by the letter of credit;
 - the universality of its claims;
 - the universality of its present and future property.

2. Legal opinion

A legal opinion is required for every guarantee instrument, excluding letters of credit. The opinion, addressed to the insurer, with a copy to the AMF, must:

- Confirm, without qualification, that all minimum requirements stipulated for the chosen instrument have been met;
- Confirm that the chosen guarantee instrument is valid and enforceable, has priority over any other security interest in the pledged assets and has been or will be created in favour of the insurer for the type of assets covered by the legal opinion;
- Include a reference to the statute pursuant to which the guarantee instrument is made;
- Confirm that the guarantee instrument is enforceable against every trustee, receiver or liquidator who may be appointed to the reinsurer's property under any statute and that, in such a case, it will remain valid and enforceable and continue to have priority over any other right.

The opinion must be provided by independent legal counsel authorized to practice under the laws of the province or territory where the guarantee instrument is made.

If a new guarantee instrument is made or if assets not covered by the opinion are added to a guaranteed instrument, the insurer must obtain a new or additional opinion.

3. Declaration respecting assets

Unless the AMF indicates otherwise, the insurer shall file with the AMF a declaration as well as an electronic file (text format) containing the following information:

- The market value of each asset covered by a guarantee instrument as at the close of business of the insurer's last business day in the immediately preceding month;
- The date of valuation;
- The AMF's contract identification code;
- The name of the security issuer;
- The "CUSIP" number, if applicable;
- The name of the security;
- The number of units held;
- For fixed income securities, the maturity date, yield and coupon rate.

The declaration must be filed quarterly or at the AMF's request. Where the assets are held by a trustee or third party, the trustee or third party may file the declaration with the insurer or reinsurer, if it so desires.

While the filing of such declaration and related information through a trustee or third party is required to simplify the process, such filing shall remain the responsibility of the insurer.