



Canadian Life  
and Health Insurance  
Association Inc.

Association canadienne  
des compagnies d'assurances  
de personnes inc.

January 11, 2011

John Stevenson, Secretary  
Ontario Securities Commission  
20 Queen Street West  
Suite 1900, Box 55  
Toronto, Ontario  
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Me Anne-Marie Beaudoin  
Secrétaire de l'Autorité  
Autorité des marchés financiers  
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Dear Sir/Madam:

**Canadian Securities Administrators Consultation Paper 91-401 on Over-the-Counter Derivatives Regulation in Canada**

The Canadian Life and Health Insurance Association is pleased to provide comments on the Canadian Securities Administrators Consultation Paper 91-401 on Over-the-Counter Derivatives Regulation in Canada.

Established in 1894, the Canadian Life and Health Insurance Association (CLHIA) is a voluntary trade association that represents the collective interests of its member life and health insurers. These members account for over 99 per cent of the life and health insurance in force in Canada and contribute to the financial well-being of millions of Canadians by providing a wide range of financial security products. The Annex to this letter provides a brief overview of the industry's role in Canada's economy.

The regulatory status of over-the-counter (OTC) derivatives is important to the life insurance industry. Canadian life insurers have become significant end-users of derivatives to manage the financial risks associated with both their obligations to policyholders and the investment portfolios designed to meet those liabilities.

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Many insurance products such as traditional life insurance, fixed annuity products, disability insurance, critical illness insurance and long term care insurance require insurers to manage interest rate risk that is very long in duration. Customized OTC derivatives are utilized to better manage the cash flow timing and maturities of policyholder obligations.

Many individual variable insurance contracts now offer lifetime income guarantees. These guarantees are hedged with a combination of customized swaps and options.

In order to diversify investment portfolios, insurers often purchase foreign currency denominated fixed income securities issued by non-Canadian companies. Customized currency swaps are utilized to reduce exposure to fluctuations in currency values related to these investments.

The following comments only respond to the issues raised in Consultation Paper 91-401 at a high level. The CLHIA looks forward to providing further input as the discussion on OTC derivatives regulation in Canada develops.

### **Clearing**

To begin, we wish to emphasize that OTC derivatives are used by Canadian life insurers to mitigate risk. The CLHIA does not believe that clearing is required for OTC derivatives as this relates to usage by the Canadian life insurance industry. While clearing of standardized OTC derivatives can reduce the risks associated with trading OTC derivatives, it also introduces new risks and costs. The largest single concern with clearing standardized derivatives relates to the likely requirements for initial and variation margin. As the investment portfolios of life insurance companies contain long dated corporate securities to support the long term nature of their liabilities, it would be difficult for life insurers to hold the liquidity necessary to post the types of collateral that clearinghouses might demand. The strain on balance sheets could fundamentally alter a life insurer's decision of whether or not to hedge risk.

If clearing of standardized OTC derivatives were required, in order to reduce the strain on life insurers' balance sheets, the list of eligible collateral would need to include the types of assets that life insurance companies hold, for instance, high grade corporate bonds. Having a single cross market clearinghouse would also maximize the ability to net posted collateral and reduce the demand for margin.

### **Trade Repositories**

The CLHIA supports the proposal to require post trade reporting of OTC derivative transactions to a centralized trade repository. The CLHIA agrees that this would assist with creating greater market transparency and the prevention of fraud and other market abuses. Given the infrastructure demands of reporting, the responsibility of sending trade information to the repositories should lie with the swap dealers or market makers



for both cleared and uncleared transactions. Efficiencies may be achieved by designating clearinghouses to act as data repositories.

Having multiple repositories would reduce the aggregation benefit of reporting. The CLHIA would support the development of a global trade repository. If regulatory and market developments result in the development of a Canadian trade repository, consideration should be given to approaches to avoid duplicate reporting of cross jurisdiction trades. Clearly, reporting to multiple provincial trade repositories should be avoided.

The cost versus benefit analysis of real-time reporting of OTC derivative transactions needs to be examined. Real-time reporting could reduce the ability of market participants to execute large trades. Consistent with proposals in the U.S. and the U.K., a threshold should be developed to allow for delayed reporting of large transactions.

### **Electronic Trading**

CLHIA supports the use of electronic trading of standardized OTC derivative transactions. End-users should have the ability, but not the requirement, to use electronic platforms as they may not have the trading volumes or IT infrastructure necessary to support electronic trading of derivatives. Electronic trading of derivatives can be done in two forms, either publicly displayed or via request for quote (RFQ). Publicly displayed execution, while increasing price discovery, will only allow for trading of the most standardized OTC derivatives. Any customization of trades would require the ability to use an RFQ. It is important to note that life insurers use customized OTC derivatives to hedge specific risks which would not be possible on an electronic trading platform which requires a high degree of standardization.

### **Capital and Collateral**

Capital should be used as a tool to encourage the clearing of standardized OTC derivatives. Higher capital requirements should only pertain to derivative trades when additional risk is inherent in the transaction and not to all uncleared trades. Customization of a swap does not in and of itself create additional risk, but it may result in an inability to clear the trade. CLHIA does not support the penalizing of a firm with higher capital charges for transacting derivatives trades that are unclearable.

Any regulations would need to ensure that the margin posted to a clearinghouse/broker is segregated from a clearinghouse/broker's own accounts. Additionally, a client's margin should not be pooled with other clients of the clearinghouse/broker. Pooling introduces additional risk to other pool members.



### **End-User Exemptions**

Transactions between affiliated end-users should be exempted from clearing requirements. Also, the combined risk of the positions that an insurer holds do not create an increased economic risk.

Additionally, any new regulation would need to exempt existing OTC derivative positions from clearing. Creating margin requirements on pre-existing trades would put an unforeseen burden on market participants.

### **Enforcement**

CLHIA supports the development of rules concerning standards of practices and business conduct for dealers, advisers and representatives. Any rules should recognize that the OTC derivatives market is undergoing significant changes and any regulations in this field must be flexible enough to adapt to a fluid global regulatory environment. Market conduct regulations should differentiate between swap dealers/market-makers and end-users.

### **International Harmonization**

Derivatives regulation in Canada needs to be integrated with regulation in other G20 countries. Canada cannot create an unlevel playing field by either leaving the OTC derivatives market unregulated or by enforcing regulations on entities or transactions that are already regulated by other jurisdictions. Information sharing among international regulators and cooperation agreements are necessary to achieve an efficient and effective regulatory framework.

The CLHIA looks forward to further consultation regarding the development of the recommendations contained in Consultation Paper 91-401.

If you require any additional information at this time, please feel free to contact me by e-mail at [JWood@clhia.ca](mailto:JWood@clhia.ca) or by telephone at 416-359-2025.

Yours truly,

James Wood  
Counsel

Attachment

# Life and Health Insurance in Canada

## About the Life and Health Insurance Industry in Canada

The life and health insurance industry contributes to the financial well-being to more than 26 million Canadians by providing a wide range of financial security products such as individual and group life insurance, annuities, pensions, RRSPs, RRIFFs, disability insurance and supplementary health insurance. The industry is a major investor in Canada's economy with total assets of \$475 billion. This pool of capital is one of the country's most important sources of long-term investment capital. The industry employs 132,000 Canadians across the country.

Canada's life and health insurance industry is sound and well capitalized -- it is well positioned to meet the obligations of its policyholders despite the challenges of the current economic climate. Canadian life and health insurance companies' credit standing remains strong and amongst the very highest in the corporate world.

## Key Industry Statistics – 2009

	<u>Canada</u>
Benefit payments	\$58.6 billion
Canadians with coverage for:	
Financial protection (any product)	26 million
Supplementary health benefits	23 million
Disability income protection	11 million
Life insurance	21 million
Individual Annuities (RRSPs, RRIFFs, etc.)	3.6 million
Group RRSPs	2.0 million
Pensions	1.0 million
Assets	\$475 billion
Life Insurance ownership	\$3.5 trillion
Employees & agents	132,000
Head offices	96

## Contributions of the Industry

Life and health insurers make significant contributions to the country's economic and social well-being. The industry:

- **provides a wide range of financial security products to more than 26 million Canadians**
- **makes benefit payments of nearly \$59 billion annually** to Canadians. Over 90% goes to living policyholders as annuity, disability or health benefits. The remainder goes to beneficiaries as death claims.
- **is a major investor in Canada's economy** with assets of \$475 billion in the country.

- **plays an important role in meeting the financing needs of all levels of government** in Canada with government securities accounting for 17% of total assets.
- **is a significant contributor to public finances in Canada.** The industry paid almost \$3 billion in taxes during 2008, with over \$1.5 billion paid to provincial governments. In addition, the industry collects and remits retail sales tax payable by policyholders on group insurance premiums which amounted to over \$1.5 billion in Ontario and Quebec.
- **is a major employer** with 132,000 Canadians earning some or all of their livings from the industry.
- **contributes to small business.** The products of life and health insurers and the consultative role of life insurance agents help small and medium-sized businesses attract and retain a skilled workforce.
- **is internationally successful.** In more than 20 countries around the world, Canadian life and health insurers have an outstanding track record of competing in foreign markets, with over \$74 billion or just over half of their worldwide premiums generated abroad.
- **develops products to reflect and to anticipate changing consumer needs and expectations** such as "index-linked" life insurance policies; innovative approaches to group insurance ("cafeteria" and "spending account" options); flexible retirement options; and innovative and expanded health insurance (critical illness and long term care).
- **takes industry-wide initiatives to protect consumers** by developing guidelines, voluntarily and proactively, to respond to emerging issues.
- **has an independent OmbudService for consumers** of life and health insurance products called the OmbudService for Life and Health Insurance (OLHI). Consumers with questions or complaints can call, free of charge, the OLHI for bilingual information and assistance about the life and health insurance products and services.

## About the CLHIA

The Canadian Life and Health Insurance Association Inc. (CLHIA), established in 1894, is a voluntary trade association that represents the collective interests of its member life and health insurers. Our members account for over 99% of the life and health insurance in force in Canada and administer more than half of Canada's pension plans. For more information about the CLHIA and the life and health insurance industry visit [www.clhia.ca](http://www.clhia.ca)

