Office of the Superintendent of Financial Institutions Canada | Bureau du surintendant des institutions financières Canada

Guideline

Subject: **Minimum Capital Test**
For Federally Regulated Property and Casualty Insurance Companies

No: **A** **Effective Date:** **January 1, 2015**

Subsection 515(1) of the *Insurance Companies Act (ICA)* requires Federally Regulated Property and Casualty Insurance Companies (property and casualty companies) to maintain adequate capital. Subsection 608(1) of the *ICA* requires foreign property and casualty companies operating in Canada on a branch basis (foreign property and casualty companies) to maintain an adequate margin of assets in Canada over liabilities in Canada. The Minimum Capital Test (MCT) Guideline is not made pursuant to subsections 515(2) and 608(3) of the *Act*. However, the minimum and supervisory target capital standards set out in this guideline provide the framework within which the Superintendent assesses whether a property and casualty company maintains adequate capital pursuant to subsection 515(1) and whether a foreign property and casualty company maintains an adequate margin pursuant to subsection 608(1). Notwithstanding that a property and casualty company may meet these standards, the Superintendent may direct the property and casualty company to increase its capital under subsection 515(3) or the foreign property and casualty company to increase the margin of assets in Canada over liabilities in Canada under subsection 608(4).

This guideline outlines the capital framework, using a risk-based formula, for target and minimum capital/margin required, and defines the capital/assets that are available to meet the minimum standard. The MCT determines the minimum capital/margin required and not the level of capital/margin required at which property and casualty companies must operate.

Foreign property and casualty companies are reminded that the MCT is only one element in the determination of the required assets that must be maintained in Canada by foreign property and casualty companies. Foreign property and casualty companies must vest assets in accordance with the Adequacy of Assets in Canada test as prescribed in the *Assets (Foreign Companies) Regulations.*

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Chapter 1. Overview and General Requirements

The Minimum Capital Test (MCT) Guideline applies to Canadian property and casualty insurance companies and foreign property and casualty companies operating in Canada on a branch basis, collectively referred to as P&C insurers. Chapter 3 of this guideline, *Foreign Companies Operating in Canada on a Branch Basis,* defines assets available for foreign property and casualty companies operating in Canada on a branch basis (foreign companies). The MCT Guideline uses generic expressions that are meant to apply to both Canadian P&C insurers and foreign companies; e.g., capital available also refers to assets available for Branch Adequacy of Assets Test (BAAT) purposes, capital required refers to margin required for BAAT purposes and capital adequacy refers to margin adequacy for BAAT purposes.

This chapter provides an overview of the MCT Guideline and sets out general requirements. More detailed information on specific components of the capital test is contained under subsequent chapters.

Further guidance concerning some of the requirements of the MCT Guideline may be found in other guidelines and advisories available on OSFI's website under the Property and Casualty Insurance Companies section.

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1.1. Overview

1.1.1. Minimum and target capital requirements under the MCT

Under the MCT, regulatory capital requirements for various risks are set directly at a pre-determined target confidence level. OSFI has elected 99% of the expected shortfall (conditional tail expectation or CTE 99%) over a one-year time horizon as a target confidence level.[1]

The risk factors defined in this guideline are used to compute capital requirements at the target level. The resulting MCT capital requirements are then divided by 1.5 to derive the minimum capital requirements. The MCT ratio is expressed as the capital available over the minimum capital required.

1.1.2. Risk-based capital adequacy

P&C insurers are required to meet the MCT capital requirements at all times. The definition of capital available to be used for this purpose is described in chapter 2 and includes qualifying

[1] As an alternative, a value at risk (VaR) at 99.5% confidence level or expert judgement was used when it was not practical to use the CTE approach.