



Office of the Superintendent of  
Financial Institutions Canada

Bureau du surintendant des  
institutions financières Canada

*OSFI Annual Report 2004-2005*

**BUILDING ON OUR STRENGTHS**



OSFI  
BSIF

Canada 

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Cat. No. IN-2005  
ISBN 0-662-69224-1

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## Letter of Conveyance

The Honourable Ralph Goodale, P.C., M.P.  
Minister of Finance  
Ottawa, Canada K1A 0A6

Dear Minister:

Pursuant to section 40 of the *Office of the Superintendent of Financial Institutions Act*, I am pleased to submit to you the Annual Report of the Office of the Superintendent of Financial Institutions (OSFI) for the period April 1, 2004 to March 31, 2005.

This report also includes the report on the administration of the *Pension Benefits Standards Act, 1985* (PBSA), for the period April 1, 2004 to March 31, 2005, pursuant to section 40 of the PBSA.

Yours sincerely,



**Nicholas Le Pan**  
Superintendent

Ottawa, October 1, 2005

## *Superintendent's Message*

OSFI's achievements during 2004-2005 demonstrate a common thread woven through every activity, initiative and project. It is our strongest asset and we would have little to report on without it. This asset is our people.



I FIRMLY BELIEVE OSFI EMPLOYEES ARE THE STRENGTH OF OUR ORGANIZATION. THEY ARE THE SOURCE OF OUR KNOWLEDGE, OUR EXPERIENCE AND EXPERTISE, AND OUR DESIRE TO BE BETTER. THEY ARE COMMITTED AND DEDICATED. OSFI WOULD NOT BE THE SUCCESS THAT IT IS WITHOUT THEM. THEIR FRANKNESS AND OPENNESS ARE IMPORTANT AS WE IDENTIFY AREAS FOR IMPROVEMENT. I CONSTANTLY WELCOME CONSTRUCTIVE FEEDBACK SO THAT WE AT OSFI CAN GET BETTER AT WHAT WE DO. AND I TURN TO OUR EMPLOYEES FOR IDEAS AND SOLUTIONS TO BUILD ON OUR STRENGTHS. THIS REPORT SALUTES THEIR INITIATIVES, CONTRIBUTIONS AND ACCOMPLISHMENTS.

The theme of this Report, *Building on our strengths*, is intended to be both retrospective and forward-thinking. While it outlines how we built a stronger and more effective organization during 2004-2005, it also serves as a commitment to continuous improvement.

Because of our people's hard work, expertise and dedication, Canadians can rightly be very proud and confident of the safety and soundness of our financial institutions, our private pension plans and our public pension arrangements.

Many Canadians may not be aware that OSFI is recognized both across Canada and around the globe as a world-class prudential regulator. I believe it is important that our many partners and stakeholders understand the critical role our people play in protecting the interests of Canadian depositors, policyholders, pension plan members and their beneficiaries. OSFI's common

values of commitment, teamwork, professionalism and integrity are evident in the daily work of our people. I am proud to be associated with such a dynamic and unique organization that serves Canadians so well.

*Building on our strengths* requires that we measure and assess our performance regularly to ensure we are moving in the right direction. A key measurement in 2004-2005 was an Industry Consultation where senior officials at financial institutions and professionals working in the field were asked to submit anonymously their feedback on OSFI's operations. We made the results of this consultation public. We always consider how to interpret some of these findings and we bear in mind that, as a regulator, it is not our objective to please regulated entities. However, in a sense, this amounts to a report card on how we are doing. The findings showed that 92 percent of respondents were satisfied with OSFI's performance, an increase from 78 percent in 1998. Measuring our performance and success is now a fundamental part of how we do business and it will remain a key priority.

While our mandate does not guarantee against failures, during the year we were faced with a number of challenges, including some problem institutions and pension plans where we intervened successfully without any material loss to Canadians. We have been a major, positive force in contributing to a framework of Canadian and international rules that is the best in its class, and we have cultivated relationships with financial institutions and other regulators in Canada and around the world.

We also worked toward releasing a set of principles on reputational risk management to guide financial institutions in this emerging and important category of risk. Reputational risk management has a higher priority today because business has become more complex, more global and more litigious. We believe that reputational risk should be on everyone's mind. And while some institutions have embraced it, others could do more. OSFI expects financial institutions to be proactive in identifying and managing risks in today's environment.

*Building on our strengths* also means that we took actions internally to enhance our efficiency and effectiveness. Some of these are still a "work in progress" and need fine-tuning, but they are steps in the right direction. We moved ahead with our initiative to reengineer our supervisory processes. Several other processes were improved. In addition, to control our administrative costs, our Ottawa employees lived through months of renovations as we reduced our space requirements.

During the year, we redeployed some employees to meet new priorities. We strengthened two important areas – our private pension plan division as well as our anti-money laundering and anti-terrorism financing unit. This was possible because of our deep bench strength. And while we strive to hold on to our people, we recognize that their expertise is highly sought after by other organizations. To ensure we continue to have a deep pool of talent, OSFI identified a number of its people and launched a leadership development program to invest in its, and their, future.

Together with our partners in government, we took action to strengthen the regulatory structure through smart regulation and streamlining, a necessity as Canada is a relatively small part of international

*Building on our strengths means that we took actions internally to enhance our efficiency and effectiveness. Employees adapted to many changes in their work environment during 2004-2005.*

capital markets. We worked closely with the Department of Finance and the Canada Deposit Insurance Corporation (CDIC) to reduce overlap and duplication in our roles.

Accountability and transparency are important to OSFI. While most of what we do in relation to individual financial institutions and pension plans must remain confidential for us to be effective, this Report continues a trend established several years ago of disclosing more information about how we are achieving our mandate. During the year, for the first time ever, we made our *Plan & Priorities* document generally available and made public several reports where we asked stakeholders for feedback on our operations. We made Parliament more aware of our role, which prompted four invitations to appear before House of Commons and Senate Committees. I welcome this. And we will continue to seek out opportunities to inform interested parties and Canadians about the important work that we do.

Building greater accountability was also evident in the Office of the Chief Actuary (OCA). The OCA, which operates independently within OSFI, provides actuarial services for various key government plans and programs such as the Canada Pension Plan (CPP), Old Age Security program, and pension and benefit plans that cover public servants, Members of Parliament and other groups. The OCA subjected its 21<sup>st</sup> Actuarial Report on the Canada Pension Plan to an external peer review panel. To further strengthen the independence of the process, the OCA chose the Government Actuary Department of the United Kingdom to review the panel's work. The outcome of both processes confirmed the Chief Actuary's conclusions and the professionalism of the work done by the employees of the OCA.

I am pleased with these results, which demonstrate we are doing a job that we can be proud of on behalf of Canadians. But there is no room for complacency. The bar is constantly rising both for us and for the institutions we regulate and supervise. At OSFI, we regularly review projects and initiatives so that we can learn from their outcome and improve.

As I said earlier, OSFI employees and their knowledge are our strongest assets. They bring a depth of capabilities and dedication to the organization and are responsible for its status as a world-class prudential financial services regulator. Without their dedication, professionalism and integrity, OSFI would not be able to effectively discharge its public policy mandate of regulating and supervising federal financial institutions and private pension plans. It is this strength that enables OSFI to contribute to the high level of public confidence Canadians rightly express in their financial sector. I thank them for their efforts and their achievements.



**Nicholas Le Pan**  
Superintendent

# Performance Highlights

OSFI employees are the strength of our organization. They are the source of our knowledge, our experience and expertise and our desire to be better. We turn to them for ideas and solutions on how to build on our strengths. It is because of our people that we are able to set high goals and meet them.

In OSFI's last Annual Report, we outlined our priorities for the coming year. These priorities have been reorganized slightly to align them with OSFI's new Program Activity Architecture (PAA), as mandated by the federal government. In this section we report back on our major accomplishments in each program area.

In brief, here is what we said we were going to do in 2004-2005, and here are some highlights that illustrate what we accomplished.





## *Federally Regulated Financial Institutions*

### **PRIORITY**

EFFECTIVELY IDENTIFY THE CURRENT AND POTENTIAL FUTURE RISKS FACED BY FEDERALLY REGULATED FINANCIAL INSTITUTIONS AND ENSURE TIMELY INTERVENTION TO DEAL WITH PROBLEMS.

### **Steps Taken**

- Stepped up risk assessment and intervention activities in key areas, particularly in the area of reputational risk. Looked closely at highly structured financial transactions, brokered mortgages and reinsurance treaties being negotiated by the larger companies.
- Intervened with a number of problem institutions to improve governance and control practices, and to enhance safety and soundness.
- Performed Composite Risk Ratings (CRR) on most institutions. Assigned a low or moderate CRR to 90% of rated institutions as at March 31, 2005 (versus 83% the previous year); assessed 1% as high risk (versus 0.3% the previous year).
- Mainly as a result of the improved health of the Property and Casualty (P&C) insurance industry, reduced the number of staged institutions (those requiring enhanced intervention) compared to last year. The number of staged P&C companies at year-end was about half of the previous year.
- Enhanced the supervision planning process to better identify and allocate resources to higher-risk institutions.
- Established a new monitoring group to enhance our ability to identify industry trends and provide early identification of system-wide issues.
- Increased resources assessing compliance with anti-money laundering and anti-terrorism financing requirements. Shifted focus from conglomerates to the smaller deposit-taking institution sector. Established a Memorandum of Understanding with FINTRAC to share information, allowing both agencies to work more effectively.
- Continued to enhance relationships with key foreign supervisors as part of OSFI's increasing involvement in supervising global institutions.

## PRIORITY

MAKE TARGETED  
ADJUSTMENTS TO OSFI  
GUIDANCE AND RULES  
APPLYING TO FEDERALLY  
REGULATED FINANCIAL  
INSTITUTIONS.

### Steps Taken

- Clarified elements of the Minimum Continuing Capital and Surplus Requirements (MCCSR) Guideline and initiated dialogue on the future direction of life insurance capital rules.
- Reviewed reputational risk practices and prepared a document covering principles, observations and next steps (released after year-end).
- Finalized guidance on the disclosure of the sources of earnings for insurance companies that publish public annual financial statements.
- Issued policy papers for industry comment on the areas of national discretion and implementation of Basel II. Reviewed and provided feedback on bank implementation plans for Basel II.
- Published guidance on Interest Rate Risk Management that was consistent with international guidance.
- Updated the guideline for the use of inter-segment notes by insurance companies to better reflect industry practices while continuing to uphold valuation standards.
- Continued our commitment to the work of the Basel Committee on Banking Supervision (BCBS). The Superintendent served as Vice-Chairman of the BCBS and as Chairman of the Accord Implementation Group.
- Collaborated with domestic and international standard setters, as well as with financial institutions, to represent the interests of Canadian institutions as they operate in an increasingly global marketplace. This included working with the Canadian Accounting Standards Board on the use of the Financial Instruments Standard.
- Participated with the International Association of Insurance Supervisors through committee work and contribution to cornerstone papers used to help develop future guidance in several areas, including assessment of insurer solvency and asset liability management.
- Developed performance standards for the legislative approvals system, e.g., establishing timeline standards for the processing of applications.

## *Federally Regulated Private Pension Plans*

### PRIORITY

EFFECTIVELY IDENTIFY THE CURRENT AND POTENTIAL FUTURE RISKS FACED BY FEDERALLY REGULATED PRIVATE PENSION PLANS, AND ENSURE TIMELY INTERVENTION TO DEAL WITH PROBLEMS.

### Steps Taken

- Posted a slight decline in the number of pension plans on OSFI's watch list during 2004-2005, from a high of 86 to a low of 82 (52 were defined benefit plans and 30 defined contribution plans). Some plans remedied their problems and were removed from the list, in part through OSFI's actions.
- Identified defined benefit plans with a solvency funding deficit (about 55% of supervised defined benefit plans as at December 2004, compared to 53% in 2003). In part due to OSFI's efforts, almost all of these plans have begun to address their deficits through plan funding.
- Intervened successfully in many cases, both through the courts and by moral suasion, to avoid significant losses to plan members.
- Took actions with underfunded pension plans that continued to take contribution holidays, ranging from strongly encouraging plan sponsors to cease the contribution holidays to requiring enhanced notification to members and requesting early valuation reports.
- Dealt actively with late remittance issues, and worked with plan sponsors, administrators, custodians and other officials trying to find solutions to benefit all parties.
- Increased staff in the Private Pension Plans Division by 25%. Formed a dedicated approval unit to focus on those transactions requiring approval and to reduce time in processing approvals.
- Completed a number of detailed desk reviews on approximately 70% of defined benefit plans and undertook a number of on-site examinations during the year, with a continued focus on governance, disclosure to members and a review of investments.

### PRIORITY

MAKE TARGETED ADJUSTMENTS TO OSFI GUIDANCE AND RULES APPLYING TO FEDERALLY REGULATED PRIVATE PENSION PLANS.

### Steps Taken

- Implemented the Air Canada Solvency Deficiency Funding Regulations (passed by the Government of Canada) and its related portability rules, allowing Air Canada to amortize existing pension funding deficiencies over a ten-year period instead of the usual five-year period.
- Continued to promote responsible pension plan governance. Based largely on OSFI's work, the Canadian Association of Pension Supervisory Authorities (CAPSA) issued guidelines on pension plan governance. OSFI also strongly supported the recently issued guidelines for Capital Accumulation Plans by CAPSA.
- Assessed the implications for federal pension plans of the Supreme Court's 2004 decision in the Monsanto case, which addresses provisions in Ontario's pension legislation for the handling of pension plan surplus amounts on a partial plan wind-up.

## *International Assistance*

### **PRIORITY**

RESPOND IN A FOCUSED AND SELECTIVE WAY TO THE INCREASING DEMANDS FOR OSFI'S TECHNICAL ASSISTANCE, LARGELY FUNDED BY CIDA, AND FURTHER DEVELOP OSFI'S PROGRAM OF HANDS-ON TRAINING.

### **Steps Taken**

- Hosted some 100 supervisors from around the world, including those who participated in OSFI's in-house programs, and provided training to a number of jurisdictions both bi-laterally and multi-laterally.
- Entered into a long-term multi-faceted agreement of technical assistance with one jurisdiction, which had recently been faced with a banking crisis with major economic consequences.
- Worked alongside foreign supervisors "in the field" helping, for example, to implement on-site examination programs in two countries and risk-based supervision in another, as well as providing consultative, legislative and regulatory drafting expertise.
- Continued to be involved in particular with the International Monetary Fund (IMF) / World Bank Financial Sector Assessment Program (FSAP) as expert assessors, working with several jurisdictions that are attempting to correct deficiencies identified during their FSAP assessment, and assisting with the preparation of FSAP self-assessments.



## Corporate Services

### PRIORITY

IMPLEMENT MATERIAL UPGRADES IN THE QUALITY OF INTERNAL GOVERNANCE AND RELATED REPORTING.

#### Steps Taken

- Established the need for an independent Audit Committee, which will enhance OSFI's governance structure, and began to recruit external members.
- Completed a series of internal risk assessments, allowing operational groups to further incorporate enterprise-wide risk management into their planning.
- Developed a performance measurement framework and a suite of performance measures which will be implemented in 2005-2006.
- Updated OSFI's accountability framework in accordance with the new government-wide Program Activity Architecture and used this format for planning for 2005-2006.

### PRIORITY

ACHIEVE THE BENEFITS OF OSFI'S ONGOING INITIATIVES TO ENHANCE INFORMATION MANAGEMENT AND INFORMATION TECHNOLOGY (IM/IT) INFRASTRUCTURE AND PROCESSES.

#### Steps Taken

- Made considerable progress on a joint initiative with other government agencies to streamline data collection from financial institutions. Reduced by 30% the amount of data currently collected on OSFI's Financial Returns.
- Successfully implemented the first phase of a Core Supervision Workflow System to enable reengineered supervisory processes.
- Developed design and implementation plans for technology-enabled reporting and analytics capabilities, supported by industry-leading business intelligence tools.
- Finalized overall architecture and standards for a corporate Electronic Document Management System and implemented it in the Supervisory area to support workflow.
- Redesigned OSFI's web site to present information in a more client-centric and intuitive way.

### PRIORITY

ENSURE THAT OSFI MAINTAINS THE APPROPRIATE SKILLS TO SUPPORT ITS MANDATE.

#### Steps Taken

- Formalized succession planning for critical executive-level positions.
- Introduced a modularized management development curriculum to enhance the skills of OSFI's leaders to better develop staff and to better deliver on their accountabilities.

# Office of the Chief Actuary

## PRIORITY

PROVIDE EXPERT AND TIMELY ADVICE TO THE STEWARDS OF THE CANADA PENSION PLAN (CPP) AND TO THE GOVERNMENT OF CANADA AND OTHER STAKEHOLDERS ABOUT OTHER PROGRAMS REVIEWED BY THE OFFICE OF THE CHIEF ACTUARY.

## Steps Taken

- Tabled the 21<sup>st</sup> Actuarial Report on the Canada Pension Plan, confirming the long-term viability and financial sustainability of the CPP, as well as the adequacy of the legislated 9.9% combined employer-employee contribution rate to pay for future expenditures.
- Received support from an independent peer review process, which confirmed the 21<sup>st</sup> Actuarial Report on the Canada Pension Plan was competently prepared, the assumptions used were reasonable and, as a result, the conclusions were well supported.
- Enhanced the credibility of the review process by seeking input from a foreign actuarial organization. The United Kingdom Government Actuary's Department considered the terms of reference of the independent peer review appropriate to perform an in-depth review of the actuarial work underlying the 21<sup>st</sup> Actuarial Report on the Canada Pension Plan.
- Completed the third annual actuarial review of the Canada Student Loans Program.
- Completed the fourth actuarial study, "National Population Projections", which provides an estimate of the future size and composition of the population of Canada.
- Completed a number of actuarial reports on various plans, including the pension plan for Federally Appointed Judges, the benefit plan financed through the RCMP (dependants) Pension Fund and the Old Age Security program.

## Highlights of the 2004 Stakeholder Consultations

In 2004, OSFI undertook comprehensive consultations with its stakeholders (referred to as “observers”). The results are presented in two reports, both available on OSFI’s web site: *Industry Consultation Findings* and *OSFI’s Approvals Process Consultation Results*.

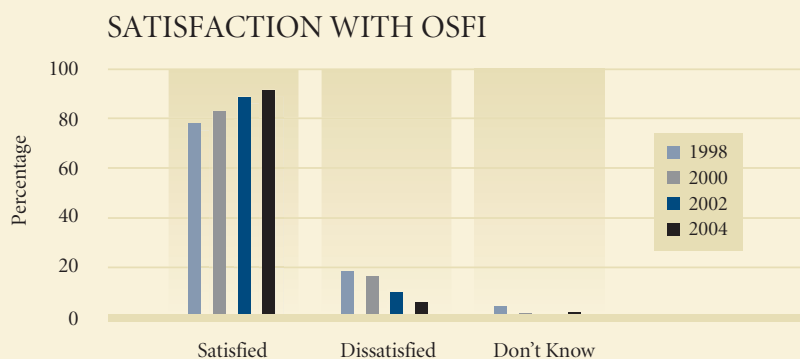
The consultations were performed as part of a regular program of surveys to assess OSFI’s performance. The consultations comprised a series of one-on-one interviews with senior executives and professionals representing a cross-section of the institutions regulated by OSFI. The interviews were conducted by an international research firm on a strictly confidential basis (OSFI does not know who was interviewed).

The objectives of the Industry Consultation were to obtain an overall perspective on OSFI’s performance as a regulator of financial institutions and the challenges OSFI faces in discharging its mandate. OSFI undertook similar consultations in 1998, 2000 and 2002.

The objectives of the Approvals Process Consultation were to obtain an assessment of the effectiveness of OSFI’s approvals process, to measure the effectiveness of previous OSFI initiatives in this area, and to identify key challenges that will need to be addressed in the future. OSFI undertook a similar consultation in 2001.

Overall, the 2004 results are good, showing improvements over time in most key areas. The findings also identify some areas where OSFI can continue to improve, given the dynamic environment in which the institutions and OSFI operate. Given our regulatory role, OSFI does not expect regulated entities to always be happy with OSFI decisions, but these results serve as important indicators of our performance. Highlights include:

***Satisfaction with OSFI as the principal regulator and supervisor of Canada’s financial services sector has increased steadily since tracking began in 1998.***

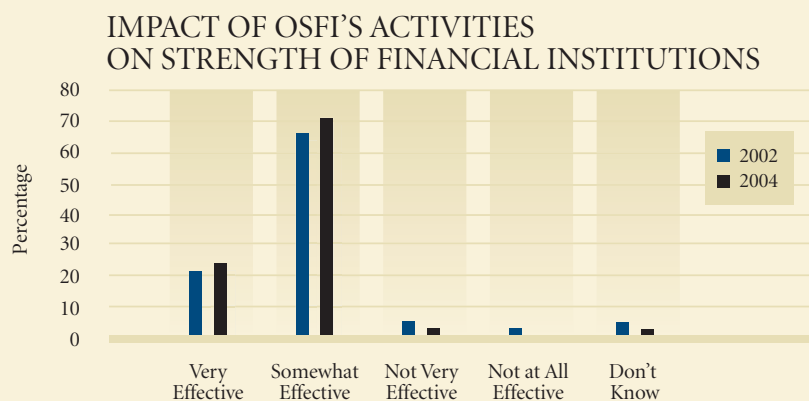


- Satisfaction with OSFI as the principal regulator and supervisor of Canada’s financial services sector is high (92%). There has been a significant and steady increase in reported levels of overall satisfaction since 1998.

- Consistent with previous research, a majority of observers (76%) rate OSFI's performance in contributing to the public's sense of confidence in the financial services industry as good.

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***The vast majority believes OSFI has a positive impact on the strength of Canada's financial institutions.***

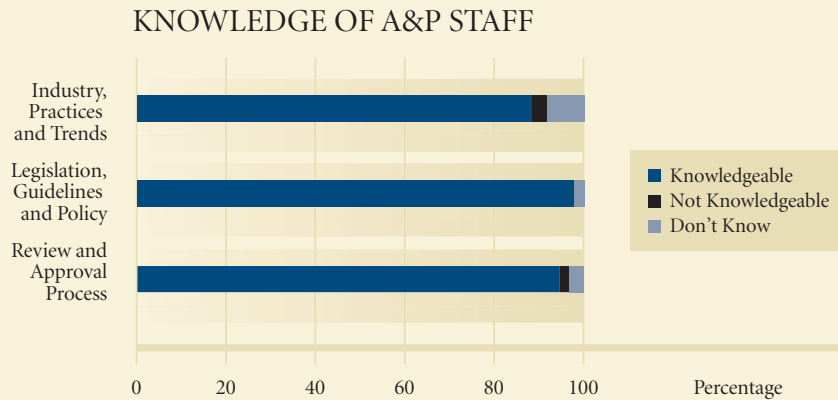


- The vast majority (95%) believes that OSFI's activities have effectively contributed to making Canada's financial institutions stronger than they were in the past.
- 
- The majority of observers (58%) feel that OSFI is doing a good job in striking an appropriate balance between effective prudential oversight and recognizing the need to allow companies to compete.
  - OSFI is perceived to have effective relations with international regulators (80%), and is seen as representing Canadian interests well in international forums (69%).
  - The calibre of OSFI's staff is perceived to have improved over the past three to five years. However, some observers suggest that knowledge levels and experience of staff require further improvement.
  - OSFI is increasingly seen as decisive in its interventions. This perception has grown steadily and significantly over the past four years. Similarly, OSFI's treatment of companies experiencing financial difficulties is increasingly seen as appropriate.
  - A majority of observers (79%) feel that their institution's Composite Risk Rating is appropriate. A number would like further insight into OSFI's approach to establishing the rating.
  - The majority (66%) believes that the speed with which OSFI deals with problem areas and situations is good and has improved over the past two years.
  - Overall satisfaction with OSFI in processing applications from financial institutions is high (98%). The proportion of observers who are "very satisfied" has increased significantly, from 43% in 2001 to 60% in 2004.



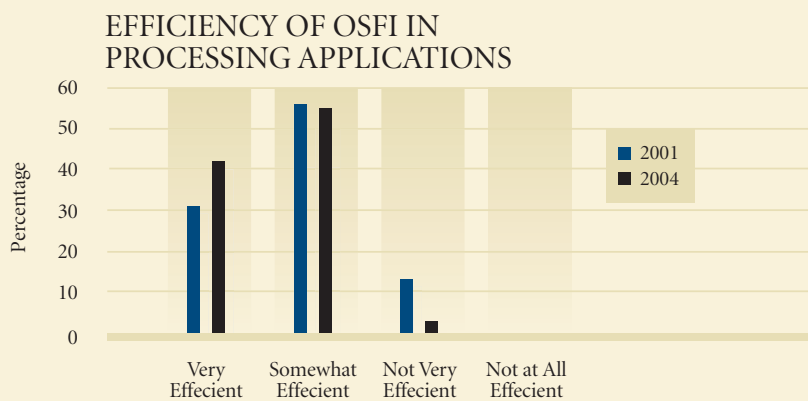
- Assessments of OSFI’s timeliness in processing applications have improved significantly from 2001. In 2004, 70% of observers feel that OSFI takes the “right amount” of time (up from 42% in 2001).
- The vast majority of institutions (82%) know whom to contact within the Approvals and Precedents (A&P) group. Clients describe their relations as collaborative, based on openness and a willingness to engage in dialogue.

***OSFI’s Approvals and Precedents staff are perceived to be highly knowledgeable about their core competencies.***



- OSFI A&P staff are considered to be highly knowledgeable about their core competencies, but somewhat less knowledgeable about the financial services industry, practices and trends. Advice provided by A&P staff is perceived to be highly useful (85%).

***OSFI’s processes for handling applications continue to be perceived as efficient by the strong majority.***



- The majority believes that OSFI’s approval process is timely (94%) and efficient (97%). Both areas are seen to have improved significantly in the past two to three years.

## *Priorities Going Forward*

OSFI's priorities going forward are tied to the program activities OSFI undertakes and contribute directly towards achieving OSFI's strategic outcomes. OSFI has six priorities related to its program activities and two priorities for program support. More details about these priorities may be found on OSFI's web site in the [Plan and Priorities 2005-2008](#) report.

1. Accurate risk assessments of financial institutions and timely, effective intervention and feedback.
2. A balanced, relevant regulatory framework of guidance and rules that meets or exceeds international minimums.
3. A prudentially effective, balanced and responsive approvals process.
4. Accurate risk assessments of pension plans, timely and effective intervention and feedback, a balanced, relevant regulatory framework, and a prudentially effective and responsive approvals process.
5. Contribute to awareness and improvement of supervisory and regulatory practices for selected foreign regulators through the operation of an International Assistance Program.
6. Contribute to financially sound federal government public pension and other programs through the provision of expert actuarial valuation and advice.
7. High-quality internal governance and related reporting.
8. Resources and infrastructure necessary to support supervisory and regulatory activities.

## Role and Responsibilities

OSFI was established in 1987 by an Act of Parliament: the *Office of the Superintendent of Financial Institutions Act*. OSFI supervises and regulates all banks in Canada and all federally incorporated or registered trust and loan companies, insurance companies, cooperative credit associations, fraternal benefit societies and pension plans.

The OSFI Act provides that the Minister of Finance is responsible for OSFI. It also provides that the Superintendent is solely responsible for exercising the authorities provided to him by the financial legislation and is required to report to the Minister of Finance from time to time on the administration of the financial institutions legislation.

OSFI works with a number of key partners. Together, these departments and agencies constitute Canada's network of financial regulation and supervision and provide a system of deposit insurance.

OSFI also provides actuarial advice to the Government of Canada and conducts reviews of certain provincially chartered financial institutions by virtue of federal-provincial arrangements or through agency agreements with the Canada Deposit Insurance Corporation (CDIC).

OSFI derives its powers from, and is responsible for administering, the following legislation:

- *Bank Act*
- *Trust and Loan Companies Act*
- *Green Shield Canada Act*
- *Cooperative Credit Associations Act*
- *Insurance Companies Act*
- *Pension Benefits Standards Act, 1985*

These Acts set out the rules for the structure and operation of federally regulated financial institutions and the standards for pension plans. The various Acts address the unique aspects of the sectors each governs, but are designed to be consistent with each other.

OSFI is funded mainly through asset-based, premium-based or membership-based assessments on the financial services industry and a modified user-pay program for selected services. A small portion of OSFI's revenue is derived from the Government of Canada, primarily for actuarial services relating to the Canada Pension Plan, the Old Age Security program, the Canada Student Loans Program and various public sector pension and benefit plans.

As at March 31, 2005, OSFI employed 426 people in offices located in Ottawa, Montréal, Toronto and Vancouver.

## WHO WE REGULATE

OSFI SUPERVISES AND REGULATES ALL FEDERALLY INCORPORATED OR REGISTERED DEPOSIT-TAKING INSTITUTIONS (E.G. BANKS), LIFE INSURANCE COMPANIES, PROPERTY AND CASUALTY INSURANCE COMPANIES, AND FEDERALLY REGULATED PRIVATE PENSION PLANS. THESE 1,728 ORGANIZATIONS MANAGED A TOTAL OF \$2,720 BILLION OF ASSETS (AS AT MARCH 31, 2005). OSFI ALSO UNDERTAKES SUPERVISION OF PROVINCIALLY INCORPORATED FINANCIAL INSTITUTIONS ON A COST-RECOVERY BASIS UNDER CONTRACT ARRANGEMENTS WITH SOME PROVINCES.

## *Mandate*

OSFI was created to contribute to public confidence in the Canadian financial system.

Under our legislation our mandate is to:

- Supervise federally regulated financial institutions and private pension plans to determine whether they are in sound financial condition and meeting minimum plan funding requirements respectively, and are complying with their governing law and supervisory requirements;
- Promptly advise institutions and plans in the event there are material deficiencies and take, or require management, boards or plan administrators to take, necessary corrective measures expeditiously;
- Advance and administer a regulatory framework that promotes the adoption of policies and procedures designed to control and manage risk;
- Monitor and evaluate system-wide or sectoral issues that may impact institutions negatively.

OSFI's legislation also acknowledges the need to allow institutions to compete effectively and take reasonable risks. It recognizes that management, boards of directors and plan administrators are ultimately responsible and that financial institutions and pension plans can fail.

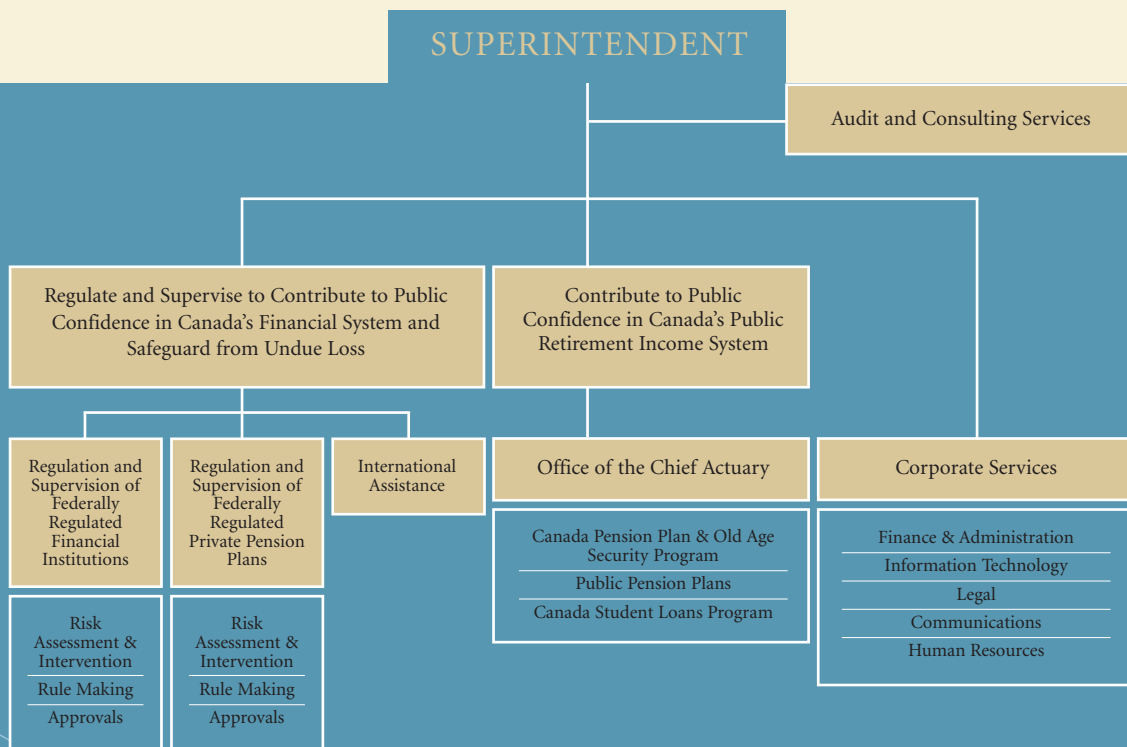
The Office of the Chief Actuary (OCA), which is part of OSFI, provides actuarial services to the Government of Canada.

## How We Meet Our Mandate

From our mandate, OSFI has identified two strategic outcomes:

1. *To regulate and supervise to contribute to public confidence in Canada's financial system and safeguard from undue loss.*  
OSFI safeguards depositors, policyholders and private pension plan members by enhancing the safety and soundness of federally regulated financial institutions and private pension plans.
2. *To contribute to public confidence in Canada's public retirement income system.*  
This is achieved through the activities of the Office of the Chief Actuary, which provides accurate, timely advice on the state of various public pension plans and on the financial implications of options being considered by policy makers.

How OSFI meets its strategic outcomes is set out in the following chart:



as at March 31, 2005

## JOHN DORAN

*Assistant Superintendent,  
Supervision Sector*

**John C. Doran** was appointed **Assistant Superintendent, Supervision Sector**, on May 1, 2000. His responsibilities include overseeing the application of OSFI's Supervisory Framework and supervision programs for federally registered banks and other deposit-taking institutions, insurance companies and private pension plans. Prior to his appointment at OSFI, Mr. Doran served for 12 years as Executive Vice-President and the first Chief Financial Officer of the Canadian Imperial Bank of Commerce (CIBC). Before joining CIBC, Mr. Doran worked in Toronto as Senior Vice-President and Chief Financial Officer for Nabisco Brands Ltd., and as Controller, Canadian Vehicle Sales Division, Ford Motor Company of Canada Ltd.

## DONNA PASTERIS

*Assistant Superintendent,  
Corporate Services Sector*

**Donna Pasteris** was appointed **Assistant Superintendent, Corporate Services Sector**, effective April 8, 2002. She is responsible for OSFI's human resources; financial and corporate planning; professional development and training; information management and information technology; corporate communications; and administrative services. During her career, Ms. Pasteris has held a number of key positions in the private and public sectors, including at C-Mac Industries Inc., Atomic Energy of Canada Ltd., Montreal General Hospital, and McGill University in Montréal.

## JULIE DICKSON

*Assistant Superintendent,  
Regulation Sector*

**Julie Dickson** was appointed **Assistant Superintendent, Regulation Sector**, on January 1, 2000, having joined OSFI on April 1, 1999, as Special Advisor in the Regulation Sector. In her current role, she is responsible for capital and accounting issues; actuarial policies and reviews; regulatory approvals and compliance; guidelines, regulations and interpretations; and international assistance and liaison. Prior to joining OSFI, Ms. Dickson held positions in the Department of Finance, the Privy Council Office and the private sector. She is a member of the Basel Committee on Banking Supervision of the Bank for International Settlements and of the Accounting Standards Oversight Council of Canada.

## NICHOLAS LE PAN

*Superintendent,  
of Financial Institutions*

**Nicholas Le Pan** was appointed to the position of **Superintendent of Financial Institutions** effective September 1, 2001, for a seven-year term. Mr. Le Pan joined OSFI as Deputy Superintendent (Policy) in 1995 after serving the Department of Finance as Assistant Deputy Minister, Financial Sector Policy Branch, and as Special Advisor to the Deputy Minister leading a task force on the supervisory, deposit insurance and policyholder protection regime. Mr. Le Pan is currently head of the Accord Implementation Group of the Basel Committee on Banking Supervision, Vice Chairman of the Basel Committee, a member of the Auditing and Assurance Standards Oversight Committee and of the Council of Governors of the Canadian Public Accountability Board.



## Organization of the Report

This report is organized according to the program activities that support the achievement of OSFI's strategic outcomes.

### **Regulation and Supervision of Federally Regulated Financial Institutions**

The three sub-activities of this program are:

- *Risk assessment and intervention* includes activities to monitor and supervise financial institutions, monitor the financial and economic environment to identify emerging issues and intervene in a timely manner to protect depositors and policyholders, while recognizing that all failures cannot be prevented.
- *Rule making* encompasses the issuance of guidance and regulations, input into federal legislation affecting financial institutions, contributions to accounting, auditing and actuarial standards, and involvement in a number of international rule-making activities.
- *Approvals* of certain types of actions or transactions undertaken by regulated financial institutions. This covers two distinct types of approvals: those required under the legislation applying to financial institutions and approvals for supervisory purposes.

### **Regulation and Supervision of Federally Regulated Private Pension Plans**

This program incorporates risk assessment, intervention, rule making and approvals related to federally regulated private pension plans under the *Pension Benefits Standards Act, 1985*.

### **International Assistance**

OSFI supports initiatives of the Government of Canada to assist emerging market economies to strengthen their regulatory and supervisory systems. This program incorporates activities related to providing help to selected countries that are building their supervisory and regulatory capacity.

### **Office of the Chief Actuary**

The Office of the Chief Actuary provides a range of actuarial services, under legislation, to the Canada Pension Plan (CPP) and some federal government departments, including the provision of expert and timely advice in the form of reports tabled in Parliament.

### **Corporate Initiatives**

These program activities are supported by corporate initiatives undertaken by the Corporate Services Sector, which contribute to the effectiveness and efficiency of OSFI.

Supported by generally healthy economies domestically and abroad, Canadian financial institutions showed improved results in 2004. The banking, life insurance, and property and casualty insurance industries all reported an increase in average return on equity.



## Risk Assessment and Intervention

*Office of the Superintendent of Financial Institutions Act*

*“ . . . to supervise financial institutions in order to determine whether they are in sound financial condition and are complying with their governing statute law and supervisory requirements under that law . . . and to promptly advise the management and board of directors of a financial institution in the event the institution is not in sound financial condition or is not complying with its governing statute law or supervisory requirements . . . and to take the necessary corrective measures . . . to deal with the situation in an expeditious manner.”*

### **Financial Environment**

Canada's major financial institutions are highly international and becoming even more global through acquisitions and/or growth strategies focused on the U.S., Asia and Europe. As a result, economic, political and industry developments outside Canada are of increasing importance, affecting the financial performance, and consequently the safety and soundness, of Canadian institutions.



**LISE NADEAU**  
Senior Supervisor,  
FIG – Montréal,  
Supervision Sector

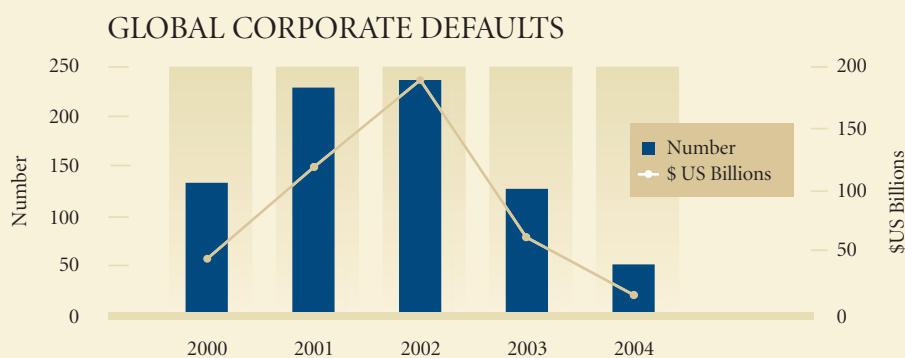
The global economy continued to expand in 2004. Gross Domestic Product growth was notably robust in China and the U.S., Canada's two most important trading partners.

Canada's economy experienced substantial growth in the first half of 2004, led by the natural resources sector, which experienced a surge in energy and non-energy commodity prices. However, an appreciating Canadian dollar resulted in exports decelerating over the final few months of the year, bringing annual growth down to a more moderate level. Meanwhile, low interest rates and buoyant consumer confidence encouraged the household sector to increase indebtedness to record levels, as measured by the ratio of debt to disposable income.

Supported by generally healthy economies domestically and abroad, Canadian financial institutions showed improved results in 2004. The banking, life insurance, and property and casualty (P&C) insurance industries all reported an increase in average return on equity. In the case of the P&C industry, however, there is still some uncertainty about the sustainability of these results, particularly in auto insurance.

Capital levels continued to be strong, providing institutions with a reasonable buffer against unexpected losses while also enabling them to expand operations, raise dividends and, in some cases, repurchase their common shares.

Reduced exposures to large corporate loans, combined with fewer defaults and credit rating downgrades, allowed the major banks to reduce their net provision for loan losses and thus improve the profitability of their corporate lending businesses.



**Improved corporate profits worldwide reduced defaults in 2004.**

Source: Standard & Poor's

Retail banking was the key driver of the banks' operating performance, as the growth in household credit remained robust. In addition, equity markets experienced a broad upswing. The S&P/TSX composite index increased by 12.5% in 2004, with nine of the ten industry groups showing positive returns. Accordingly, financial institutions generated increased earnings from their capital markets and wealth management businesses.

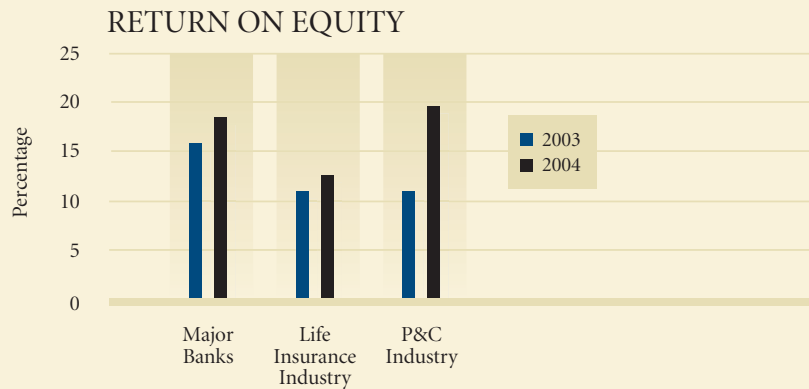


**JULIE TRUDEAU**

Manager, Production Systems Support, Infrastructure and Technology Services, Corporate Services Sector



In response to the changing environment, OSFI supervisors stepped up their risk assessment and intervention activities in key areas. With authorities and investors alike focussing their attention on certain market conduct, control and accounting practices, particularly in the U.S., supervisors have been encouraging financial institutions to place more emphasis on the management of reputational risk. Increased emphasis has also been placed on reviewing the effectiveness with which financial institutions are combating money laundering and terrorism financing activities.

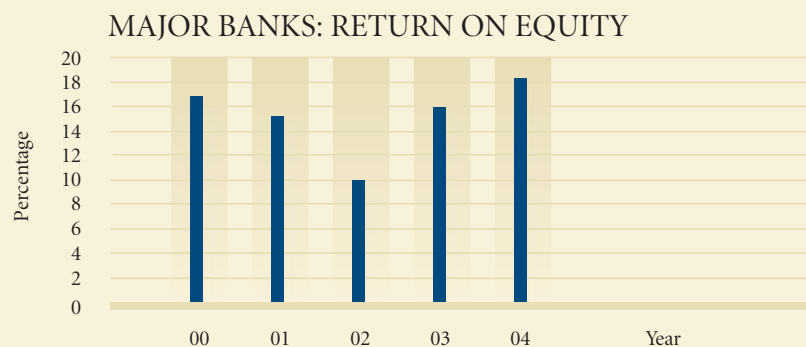


***All financial services industries reported an increase in average return on equity in 2004.***

### ***Major Canadian Banks***

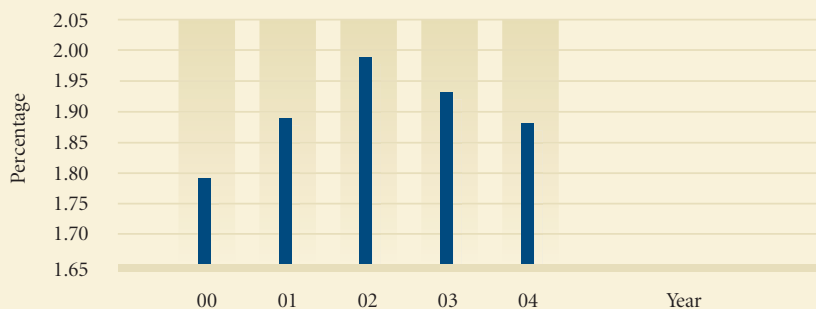
The six largest Canadian banks reported continued strong profitability in 2004, with an average return on equity of 18.3%, compared with 15.9% in 2003.

The improvement in operating performance came, in large part, from lower provisions for loan losses as a result of favourable economic conditions, recoveries, and reductions in the general reserve. Domestic retail banking performed strongly, despite the compression in interest margins resulting from intense competition. Low interest rates throughout much of 2004 fuelled considerable activity in the mortgage and consumer lending arenas. Wealth management posted solid results, buoyed by improved investor confidence and higher asset valuations. Improved capital markets also boosted revenues from the investment and wholesale banking businesses, while results from foreign operations remained mixed, as in previous years.



***The major banks reported strong average returns on equity again in 2004.***

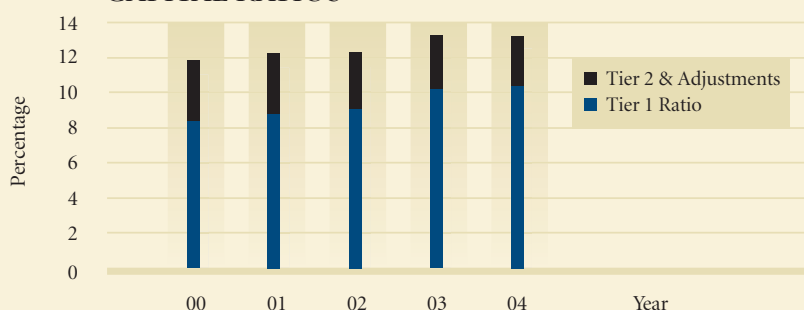
**MAJOR BANKS: SPREAD – INTEREST INCOME LESS INTEREST EXPENSE / AVERAGE TOTAL ASSETS**



**Low interest rates and intense competition continued to squeeze spreads for major banks in 2004.**

Capital ratios continued to be strong. The average ratio of total capital to risk-adjusted assets remained at just over 13% at the end of 2004, well above the Bank for International Settlements' 8% minimum threshold and OSFI's 10% target. These high levels of capital have provided the banks with the resources needed to carry out future acquisitions as well as to continue raising dividends and/or repurchasing their common shares. The higher capital levels also provide downside protection from the overhang of litigation risk related to broker-dealer operations (e.g., Enron) and other unforeseeable events.

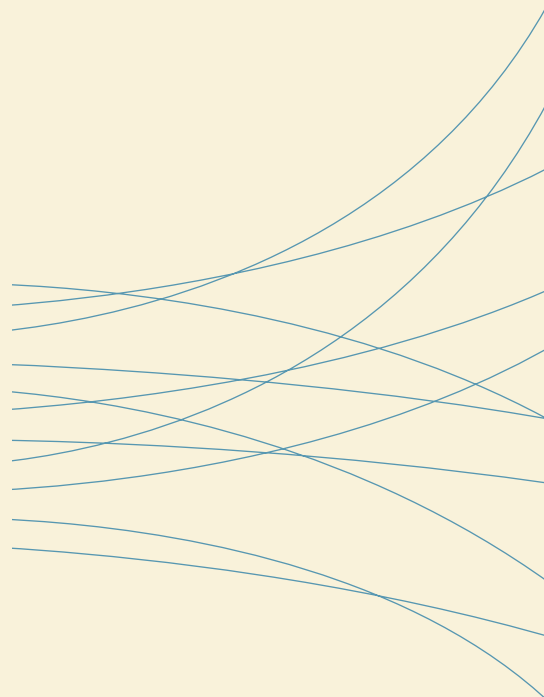
**MAJOR BANKS: RISK-WEIGHTED CAPITAL RATIOS**



**Capital ratios for the six largest banks remained strong in 2004.**

Overall, OSFI was satisfied with the financial condition and risk management practices of the major Canadian banks in 2004-2005. Looking ahead, however, these institutions face several challenges.

Many of the major banks benefited from very low or negative provisioning in 2004, and earnings growth is expected to slow in 2005 as provisions for loan losses bottom out. Although domestic retail operations are expected to be solid, business growth might not be as strong as in the past two years. As well, the big banks as a group are losing market share in residential mortgages and personal deposits to smaller players. On a positive note, increases in the general level of interest rates could allow the banks to improve their net interest margin slightly.





## Overall, OSFI was satisfied with the financial condition and risk management practices of the major Canadian banks during 2004-2005.

Facing weak corporate demand, the major banks may be tempted to take on more credit risk, and possibly more market risk, to maintain revenues. There was already some evidence of easing in underwriting standards in corporate and retail lending in 2004-2005. OSFI supervisors will continue to stress the need for the major banks to have appropriate controls in place to manage this increased level of risk.

Continued strength in the Canadian dollar could hurt the major banks' earnings from foreign operations. It would also have a negative impact on some corporate borrowers, particularly manufacturers, weakening loan quality.

Three of the major banks announced foreign acquisitions in 2004. This adds to risk and to the complexity of supervisory oversight.

Overall, the major banks made good progress in the implementation of Basel II. This international initiative will result in a better matching of capital to risk. Collateral benefits are expected in terms of improved data for risk management purposes and an enhanced focus on areas such as operational risk.

OSFI supervisors continued to place a priority on monitoring the banks' controls around reputational risk and compliance with anti-money laundering (AML) laws, particularly in their U.S. operations.

### *Other Deposit-Taking Institutions*

Smaller domestic deposit-taking institutions and foreign banks have adopted a wide range of business strategies. Accordingly, the factors affecting these institutions are varied and the risks more specific to their individual strategies.

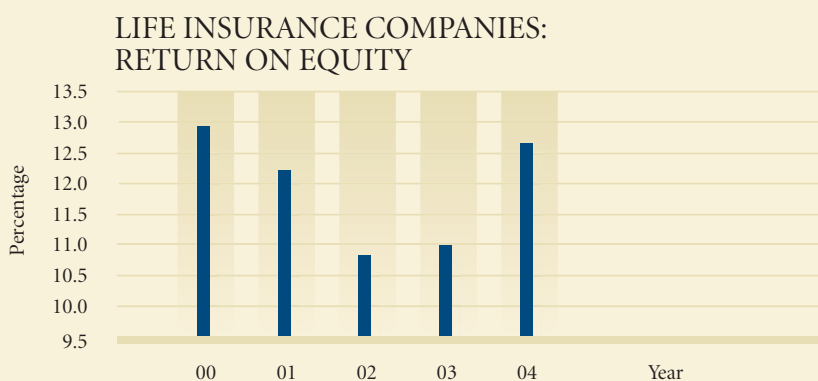
Driven by robust growth in the domestic economy and continued strong demand for household credit in 2004, the smaller deposit-taking institutions showed year-over-year improvements in operating results. While the majority of these institutions did not achieve the return on equity levels of the major banks, a substantially higher number of them attained comparable results than in the previous year. Capital positions remained stable and asset quality improved.

With the growth experienced by several institutions in the smaller deposit-taking sector came a need for enhanced risk mitigation activities. OSFI supervisors also monitored anti-money laundering (AML) compliance within this group and provided feedback to individual institutions as necessary.

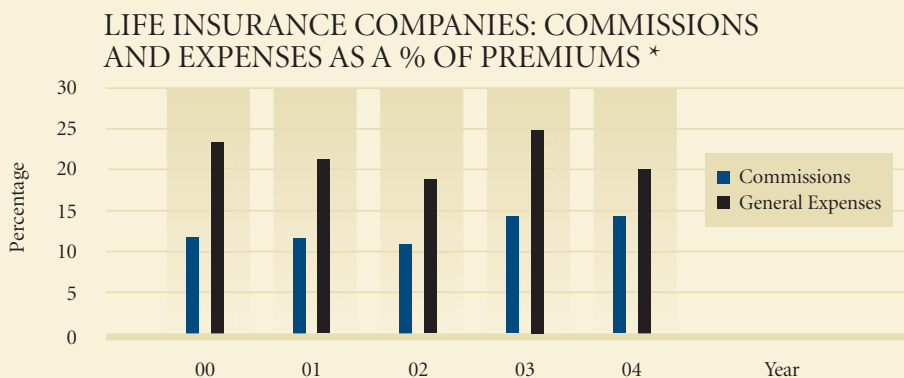
## Life Insurance Companies

The Canadian life insurance industry continued to report solid financial results in 2004, with average return on equity increasing to about 13%. The three largest life insurance companies generally outperformed the industry, reflecting differences in geographic coverage and economies of scale.

Stable earnings from most product lines helped sustain profitability. Although domestic life insurance sales were relatively flat, revenues from segregated funds showed good growth with the recovery of equity markets. Investment returns also increased from the levels achieved the previous year.



*The life insurance industry increased its profitability in 2004.*



\* 2002 results exclude reinsurers.

*Continued expense control contributed to the life insurance industry's strong performance in 2004.*

The three largest life insurance companies all reported significant increases in net income from both domestic and international operations in 2004. The contribution from U.S. operations spiked to over one quarter of total net income, reflecting a stronger U.S. economy, as well as the impact of recent acquisitions.

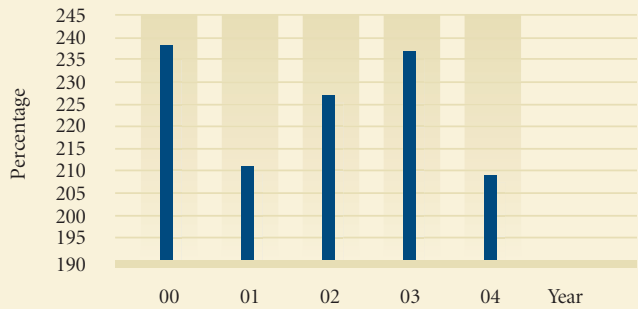
Although recent acquisitions reduced capital levels for life insurance companies, overall they remained very high. OSFI has established a supervisory target ratio for Minimum Continuing Capital and Surplus Requirements (MCCSR) for Canadian companies. The average MCCSR





**THAD NEWMAN**  
*Specialist Supervisor,  
FIG – Vancouver,  
Supervision Sector*

### LIFE INSURANCE COMPANIES: MCCSR RATIOS



***While recent acquisitions have reduced MCCSR ratios for life insurance companies, they remained well above OSFI thresholds.***

ratio for Canadian life insurers in 2004 was 209%, significantly above the supervisory target capital level of 150%. Overall, asset quality was also strong.

Although the life insurance industry continued to perform well in 2004, there was further consolidation in Canada as some of the smaller foreign players decided to leave the market. These trends may continue if smaller institutions continue to face challenges competing effectively in Canada.

A future challenge is the lack of top-line revenue growth in their domestic protection businesses. As a result, expense control will continue to be an area of focus for profit growth.

Low interest rates and volatile equity markets will continue to affect institutions with guaranteed-investment-return products and those with exposures to death benefit and maturity guarantees on segregated fund products. OSFI supervisors have been monitoring the ongoing efforts of companies to adjust to these conditions, and indicators have generally been positive.

Managing reputational risk represents another challenge to the industry. For example, scrutiny of insurer-reinsurer relationships has increased, with instances uncovered in the U.S. of improper accounting of financial reinsurance and the inadequate disclosure of transactions with affiliated reinsurers. OSFI has been actively reviewing reinsurance treaties negotiated by the larger companies. As well, supervisors are

The Canadian life insurance industry continued to report solid financial results in 2004, with average return on equity increasing to about 13%. The three largest life insurance companies generally outperformed the industry, reflecting differences in geographic coverage and economies of scale.

reviewing institutions' policies and practices for managing the risks associated with various types of strategic partnerships (e.g., third-party service providers, investment funds).

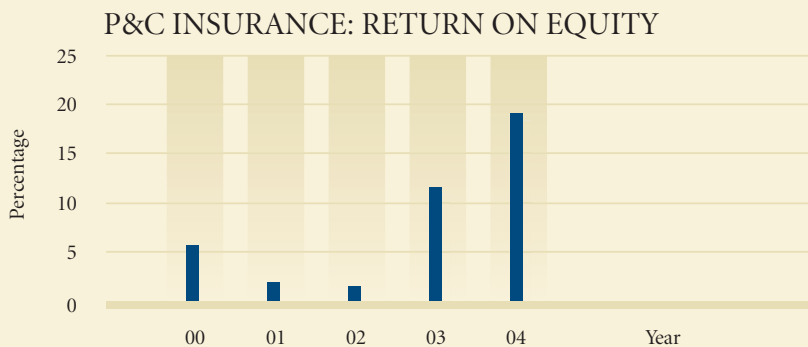
Going forward, the industry also needs to remain vigilant on actuarial matters. The reliance that auditors place on reports prepared by appointed actuaries is under review. There needs to be a focus on the quality of publicly disclosed information on actuarial liabilities, and OSFI supervisors have been reviewing the adequacy of life insurers' practices for reporting actuarial changes.

### Property and Casualty (P&C) Insurance Sector

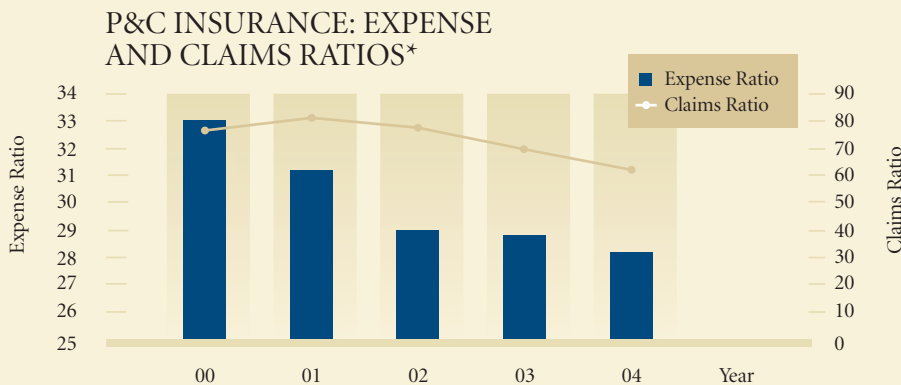
After a major improvement in 2003, the property and casualty insurance industry continued on a positive track in 2004. Net income doubled over the previous year's level. Average return on equity was 19.1%, compared with 11.6% in 2003, and only 1.4% in 2002. However, performance improvement was not uniform across all insurers or lines of business.

The Facility Association (residual automobile insurance market) rebounded in 2004, reporting a \$500 million profit offsetting a \$500 million loss the previous year. The number of drivers insured through the Facility Association dropped significantly.

**JUDY ORLANDO**  
 Administrative Assistant,  
 FIG – Vancouver,  
 Supervision Sector



***P&C industry profitability increased substantially in 2004, primarily due to improved underwriting results.***



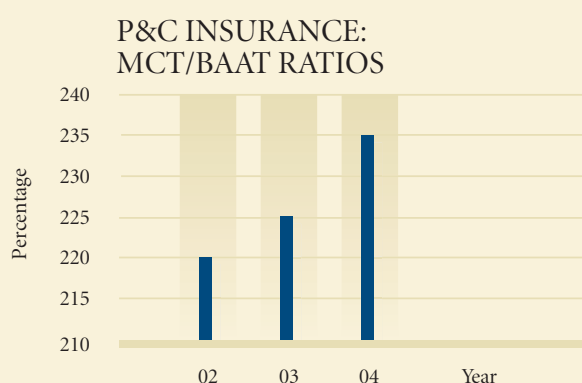
\*Ratio of expenses and claims to earned premiums.  
***Rate increases and a reduction in auto insurance claims frequencies have improved P&C underwriting results.***



In 2004, the number of P&C companies on OSFI's watch list of financial institutions dropped significantly due to the general improvement in the health of the P&C industry and OSFI's intervention activities.

The dramatic increase in the P&C industry's overall profitability is primarily attributable to improved underwriting results. Automobile insurance continued to show the largest turnaround. As a result of government reforms in several jurisdictions – intended to reduce claims costs – the industry's average loss ratio dropped to 68% from a high of 90% a couple of years earlier. Higher investment income also boosted the industry's profitability. The effect of discounting on the level of actuarial liabilities was negligible.

Capital adequacy continued to strengthen in 2004 as result of higher earnings and an influx of new capital. The Minimum Capital Test (MCT) for Canadian companies, or Branch Adequacy of Assets Test (BAAT) for foreign companies operating in Canada on a branch basis, increased on average by 10% to a level of 235%. This is well above OSFI's minimum supervisory target of 150%.



***MCT/BAAT ratios continued to strengthen in 2004 due to higher earnings and an influx of new capital.***

In 2003, P&C companies accounted for a large portion of OSFI's watch list of financial institutions. In 2004, the number of P&C institutions on the watch list dropped significantly due to the general improvement in the health of the P&C industry and OSFI's intervention activities. Given a number of uncertainties, OSFI continues to monitor the industry closely.

The automobile insurance market, which accounts for more than half of all premiums collected, remains uncertain. The low claims frequency in Ontario is not expected to last. Also, the new "grid" system for automobile rating in Alberta has not been in effect long enough to allow the industry to assess its actuarial assumptions.

The impact of catastrophes outside Canada on international reinsurers can have a major effect on domestic markets and particularly on the pricing of risk. The hurricanes in Florida and the Caribbean, cyclones and earthquakes in Japan and the tsunami in Asia in 2004 do not appear to have had a material impact on pricing, but this could change if these types of events continue to occur.

In late October 2004, the New York State Attorney General sued Marsh & McLennan, the world's largest insurance broker, for bid-rigging and receiving profit commissions from companies with which it does business. While OSFI has been monitoring this situation closely, it is not yet clear to what extent the U.S. investigation will affect the way business is conducted in Canada.

## *Supervisory Policies*

### **Financial Institutions**

OSFI's risk-based supervisory framework enhances our ability to identify and intervene on a timely basis when a financial institution's practices are imprudent or unsafe. The methodology involves assessing the risks inherent in an institution's significant activities, assessing how effectively those risks are being managed and monitoring the institution's financial condition.

Where appropriate OSFI uses the work of an institution's risk management control functions, including its board of directors and senior management, to ensure suitable policies and processes are in place and are being followed at all levels to effectively manage and mitigate risks to acceptable levels. OSFI relies on the work of the external auditors for the fairness of the audited financial statements and on the work of appointed actuaries for the adequacy of policy liabilities.

Supervisory work also includes periodic on-site reviews to test operating and controls, and to confirm the adequacy of risk management and governance practices of institutions. In line with OSFI's early intervention mandate, problem companies are subjected to a higher level of review and intervention as appropriate.

## OSFI'S SUPERVISORY TEAMS

The supervision of each financial institution is the responsibility of a designated Relationship Manager (RM) – the institution's main contact at OSFI. The RM is required to know the institution intimately and maintain a current assessment of its risk profile. While the RM for a conglomerate is responsible for only that institution, the RM for a smaller institution may be responsible for a total of eight to ten institutions. The RM is supported by a supervisory team in performing the assessment, and by various specialist resources, as necessary.

Supervisory team members may vary from year to year as new issues develop and the institution's risk profile is affected. The RM assigns team members based on their knowledge of, and expertise within, particular business or functional areas.

### COMPOSITE RISK RATINGS (CRR)

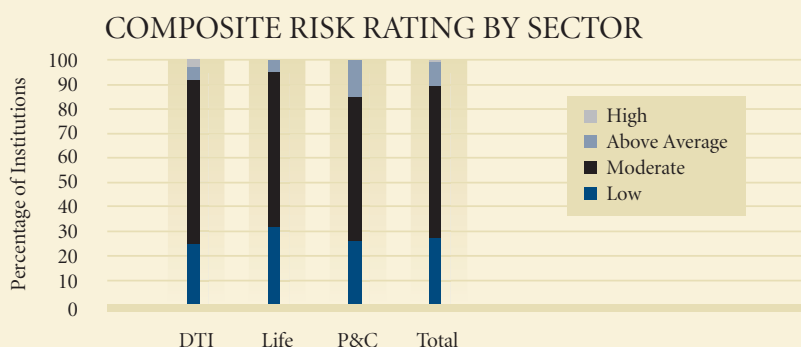
The Composite Risk Rating (CRR) represents OSFI's overall assessment of an institution's safety and soundness. The CRR is guided by a set of assessment criteria that were developed in consultation with the industry. There are four ratings for Composite Risk: "low", "moderate",

The number of staged institutions decreased in 2004-2005, mainly as a result of the improved health of the P&C industry. The number of staged P&C companies at the end of 2004-2005 was about half the number of the previous year, and the vast majority were in the early warning (stage 1) category.

“above average” and “high” risk. The CRR is reported to most institutions at least once a year (certain inactive or voluntary wind-up institutions may not be rated). The confidentiality of these ratings is protected by regulation.

At the end of March 2005, 90% of all rated institutions were assigned a low or moderate risk rating. This is an improvement over the previous year, when approximately 83% of all institutions were assigned a low

or moderate risk rating. The position ratings reflect the generally sound nature of risk management practices and policies at Canadian financial institutions, while the improvement is in part the continuation of favourable economic and financial conditions for financial institutions. Only one percent of institutions (four institutions) were assessed as high risk.

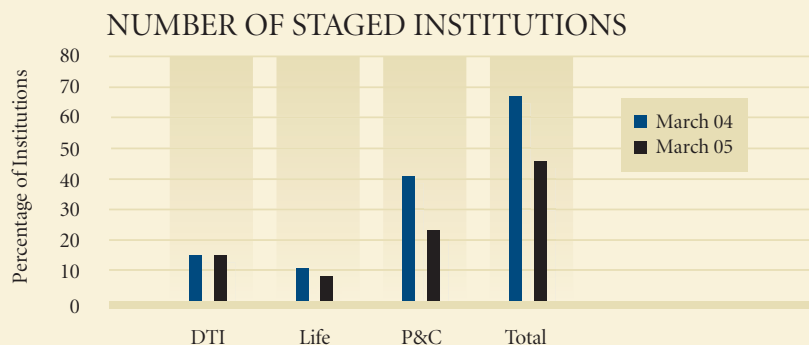


***As at March 31, 2005, 90% of rated financial institutions were assessed as low or moderate risk.***

#### INTERVENTION RATINGS

Financial institutions are also assigned an intervention rating, as described in OSFI’s Guide to Intervention for Federal Financial Institutions, which determines the degree of supervisory attention they receive. Broadly, these ratings are categorized as: normal (unstaged); early warning (stage 1); risk to financial viability or solvency (stage 2); future financial viability in serious doubt (stage 3); and non-viable/insolvency imminent (stage 4).

The number of staged institutions decreased in 2004-2005, mainly as a result of the improved health of the P&C industry. The number of staged P&C companies at the end of 2004-2005 was about half the number of the previous year. The vast majority of staged institutions were in the early warning (stage 1) category.



*The improved health of the P&C industry contributed to a sharp drop in the number of staged institutions in 2004-2005.*

## Rule Making

*Office of the Superintendent of Financial Institutions Act*

*“ . . . to promote the adoption by management and boards of directors of financial institutions of policies and procedures designed to control and manage risk.”*

Rule making, which includes contributing to legislative changes, drafting regulations and guidelines, and working with various standard-setting agencies (domestic and international), plays a key role in OSFI's ability to achieve its mandate. During 2004-2005, OSFI continued to promote institutional behaviours that support good risk management. OSFI also contributed, through international bodies, to the development of sound international rules for global financial institutions.

### *Domestic Rule Making*

#### **Collaboration with Standard Setters**

In 2004-2005, OSFI was involved with the Canadian Accounting Standards Board (AcSB) as it brought forward the Financial Instruments Standard, particularly with respect to the Fair Value Option. OSFI had worked actively with the International Accounting Standards Board (IASB) on a similar standard, which was led, in large part, by OSFI's participation on the Basel Committee on Banking Supervision (BCBS). Going forward, OSFI will be issuing guidance to promote sound risk management when financial institutions use the fair value option. For example, the guidance will note that the fair value option should be used only when fair values can be reliably estimated and that there must be rigorous valuation processes, given the impact fair value can have on financial statements and capital.

During the year, OSFI issued an Advisory addressing the long-term reporting implications for federally regulated financial institutions arising from Section 1100, *Generally Accepted Accounting Principles* (GAAP), in the Canadian Institute of Chartered Accountants' (CICA) Handbook. Section

1100 establishes standards for financial reporting in accordance with GAAP and describes what constitutes Canadian GAAP and its sources. The Advisory set out the capital adequacy reporting requirements that institutions must follow for certain instruments when reporting to OSFI. OSFI led discussions on a number of related issues internationally at the BCBS and domestically with financial institutions in arriving at its conclusions.

Together with securities regulators, OSFI was part of a review of the start-up phase of the Canadian Public Accountability Board (CPAB). The CPAB was created in 2003, with a mission to contribute to public confidence in the integrity of the financial reporting of Canadian public companies by promoting high-quality and independent auditing. While good progress has been made, future results will depend on individual audit firms rectifying the deficiencies in their processes identified by the CPAB.

OSFI works closely with the Canadian Institute of Actuaries (CIA) to ensure that its standards are appropriate and lead to acceptable valuations. OSFI sits on various CIA practice committees, and OSFI and CIA executive groups meet several times each year. During 2004-2005, OSFI began receiving the first set of external reviews of the work of company-appointed actuaries. These reviews are conducted under conditions and procedures described in OSFI Guideline E-15 and in the CIA standards.

#### Capital Guidance

During 2004-2005, OSFI issued revisions primarily to clarify those elements of the Minimum Continuing Capital and Surplus Requirements (MCCSR) guideline where there were frequent queries from the life insurance industry. These changes had no material impact on the methodology. OSFI did work with industry in one specific area, to derive improved risk measures that encourage better risk management for segregated funds and mortality requirements. These new requirements are expected to be in place for year-end 2005.

In February 2005, OSFI released a consultative paper summarizing its views on the future direction that life insurance capital rules could take. The study was initiated in light of domestic and international regulatory developments and issues that had been raised by the insurance industry.

The emerging theme for any new capital requirements is to encourage financial institutions to develop better risk management and control procedures, and to collect data in order to use company-specific risk components whenever possible.

The paper put forward conditions that should be met for future changes to the MCCSR calculation and proposed a collaborative effort with the industry. Going forward, OSFI will propose amendments, following review of the industry's comments.

OSFI released a consultative paper summarizing its views on the future direction that life insurance capital rules could take, and invited the industry to comment.

In February 2005, OSFI issued a draft guideline that sets out a framework for assessing the capital adequacy of insurance holding companies and non-operating life companies. The draft guideline took into account comments previously received from industry on a discussion paper.

The proposed capital regime is designed to ensure that in a consolidated group led by a holding company there is adequate capital to cover unexpected losses. In limited situations, instead of consolidating, OSFI is proposing to allow a deduction for investments in significant foreign life subsidiaries. This approach recognizes that a foreign regulator's rules sometimes better reflect the risks inherent in the local market. The proposed approach considers the adequacy of capital across the group, is more risk sensitive and promotes good disclosure practices. The capital regime was published in final form in June 2005.

### **Other Guidance**

#### SECURITIZATION

Increasingly, financial institutions are using risk transfer mechanisms, like securitization or credit derivatives, to reduce their risk exposures and enhance management of capital. Improper recognition of residual risks in such transactions, however, can create significant problems for institutions. In November 2004, OSFI finalized the Asset Securitization guideline (B-5) that had been issued in draft form the previous year. This guideline incorporates a more risk-sensitive capital approach that includes external ratings, makes improvements based on findings of cross-system reviews, and adds clarity to the rules.

#### ACCOUNTING DISCLOSURES

OSFI issued Guideline D-9 Source of Earnings Disclosure in December 2004 to improve disclosure of financial information by life insurance companies. This guideline provides that companies publish in their public annual financial statements an analysis of their income by source. OSFI cooperated with the Canadian Institute of Actuaries in developing guidance for company actuaries on the proper classification and reporting of statement items.

OSFI also re-issued Guideline E-12, which sets out expectations regarding how life insurance companies use inter-segment notes. Insurance companies generally partition their assets in various segments that support actuarial liabilities for particular lines of business, and inter-segment notes are used to share assets among various segments. Since the guideline was first issued in 2000, a number of suggestions had been received from the industry. The revised guideline reflects this feedback while continuing to uphold valuation standards.

#### INTEREST RATE RISK MANAGEMENT

OSFI issued guidance on Interest Rate Risk (IRR) management that reflects the broad principles set out by the Basel Committee on Banking Supervision (BCBS) in its July 2004 document Principles for the Management and Supervision of Interest Rate Risk. The objective of Guideline B-12 was to provide the industry with greater transparency and specificity about OSFI's expectations in certain areas of IRR management.





**SHEAU SOON**  
Analyst,  
Capital Division,  
Regulation Sector

### **Money Laundering and Terrorism Financing**

In November 2004, OSFI revised its guidance on Detering and Detecting Money Laundering and Terrorism Financing. Guideline B-8 was updated to provide clarification and more detail concerning practices in certain areas and to reflect some of the revised recommendations of the Financial Action Task Force (FATF). Canada is a member of the FATF, an inter-governmental body whose purpose is to develop and promote national and international policies to combat money laundering and terrorism financing.

OSFI increased its staff resources devoted to conducting anti-money laundering and anti-terrorism financing (AML/ATF) assessments. Through these assessments, OSFI reviews financial institutions' ability to deter and detect money laundering and terrorism financing. In 2004-2005, OSFI shifted its focus from the conglomerate banking and insurance groups to the smaller deposit-taking institution sector. Although OSFI will continue to review certain operations of conglomerate institutions on an ongoing basis, we believe that smaller institutions require more focused attention going forward.

In June 2004, OSFI moved ahead to establish a Memorandum of Understanding (MOU) with the Financial Transactions and Reports Analysis Centre of Canada (FINTRAC), after the passage of legislation allowing the sharing of information and analysis related to compliance with Part 1A of the *Proceeds of Crime (Money Laundering) and Terrorist Financing Act*. This has allowed OSFI to direct its assessment program to areas of concern to both agencies, making the work more targeted and effective and minimizing overlap and duplication

### ***International Activities***

The framework of rules for banks and life insurers is increasingly being set internationally, not in Canada. OSFI's role is to contribute to sound rules, make sure they respect Canadian realities, and implement them in a way that does not put Canadian institutions at a disadvantage with their foreign competitors.

OSFI worked during the year to build further informal, but effective, relationships with foreign supervisors. In 2005-2006, OSFI will explore information-sharing possibilities with selected host-country supervisory authorities that regulate significant foreign subsidiaries of Canadian banks. The aim is to lay the groundwork for closer coordination of supervisory work and sharing of results. Through International Association of Insurance Supervisors (IAIS) meetings, OSFI also worked to build relationships with foreign supervisors of life insurance companies.

### **Basel Committee on Banking Supervision**

The Basel Committee on Banking Supervision (BCBS) is the prime body bringing together supervisors and regulators of international banks from G-10 countries. It has taken a leadership role over a number of years in rule setting. As part of the process, OSFI has sought, and continues to seek, the input of Canadian banks, and to share Canada's expertise with BCBS members.

In June 2004, the BCBS released its revised capital framework entitled International Convergence of Capital Measurement and Capital Standards, commonly referred to as Basel II. This framework offers a new set of standards for minimum capital requirements for banking organizations. As a next step, in August 2004, OSFI released a series of policy papers for consultation with internationally active Canadian banks that covered areas of national discretion and OSFI's implementation of the new framework. The results of the consultations will be incorporated in OSFI's revised capital adequacy guidance. OSFI continues to consult with the Canadian Bankers Association on additional issues of interpretation as they arise to assist with implementation of the international framework.

OSFI maintains an active and influential role in the development of the Basel standards through its vice-chairmanship (Superintendent Nicholas Le Pan) and committee membership (Assistant Superintendent Julie Dickson) in the BCBS. The Superintendent also chairs the Accord Implementation Group (AIG), reporting to the BCBS. The AIG shares information on members' approaches to implementation in order to promote consistency of application across jurisdictions. A major focus of the AIG has been to consider issues relating to the interaction between home and host-country supervisors. OSFI participates in the work of technical sub-committees responsible for various aspects of the framework and continues to provide guidance or seek public comment on specific issues.

#### **International Association of Insurance Supervisors**

OSFI plays an important role in the work of the International Association of Insurance Supervisors (IAIS), which has been increasingly active in its role as a standard-setter for life and property and casualty insurance supervision. OSFI participates as a member of the Executive Committee, and the Budget and Technical sub-committees. The cornerstone of future guidance is being developed through a series of papers, and OSFI contributed to many of these, addressing the assessment of insurer solvency, as well as an asset liability management paper being prepared for the International Accounting Standards Board. As well, OSFI participated in proposals on international accounting for actuarial liabilities.

OSFI is also involved in a number of other international groups, including the Joint Forum, the Financial Stability Forum, the Integrated Financial Supervisors and the Association of Supervisors of Banks of the Americas (ASBA).

**OSFI released a series of policy papers for consultation with internationally active Canadian banks that covered areas of national discretion and OSFI's implementation of the revised Basel II capital framework.**

#### **ABHILASH BHACHECH**

*Managing Director,  
Operational Risk and  
Capital Assessment Services,  
Supervision Support Group*

#### **MEENU JOSHI**

*Senior Supervisor,  
Deposit Taking Institutions  
Cluster Conglomerate,  
Financial Conglomerates  
Group*

*Supervision Sector*





# Approvals

## Office of the Superintendent of Financial Institutions Act

*“The Superintendent has the powers, duties and functions assigned to the Superintendent by the Acts referred to in the schedule . . .”*

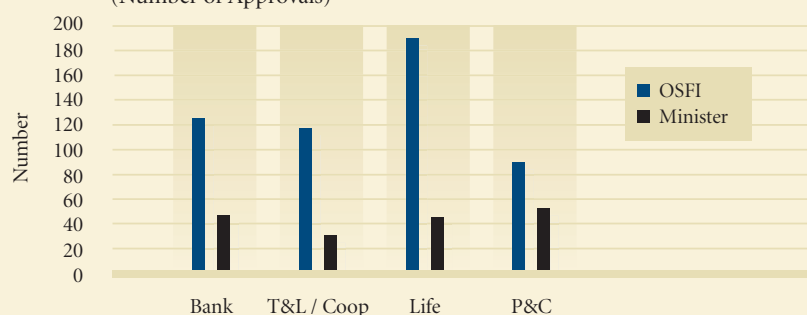
Federally regulated financial institutions and other applicants are required to seek regulatory consent for certain types of transactions, including incorporations, orders authorizing the carrying on of business activities in Canada, corporate restructurings and ownership changes.

### Applications and Opinions

OSFI processed 691 applications for approvals in 2004-2005, an increase of 3% over the previous year. Just over 52% of these applications were subject to the statutory “deemed approval” regime, where an application is automatically approved 30 days after receipt unless the Superintendent raises a concern. Approximately 59% of these approvals were in fact processed within 30 days; the majority of cases where “deemed approvals” extended beyond the prescribed period were due to incomplete applications.

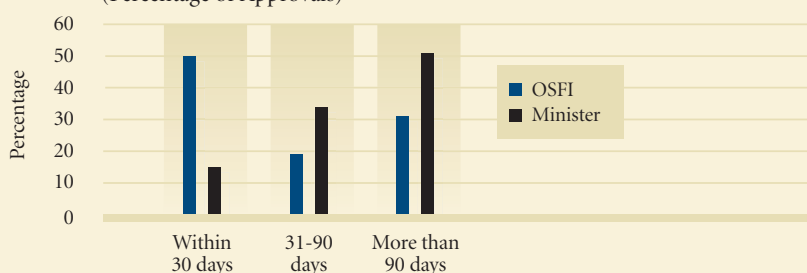
Ministerial approvals accounted for 25% of the approvals processed by OSFI during 2004-2005. Although there were fewer Ministerial approvals, these applications generally took longer to evaluate because they were more complex and often involved public policy issues.

APPROVALS BY INDUSTRY SECTOR 2004-2005  
(Number of Approvals)



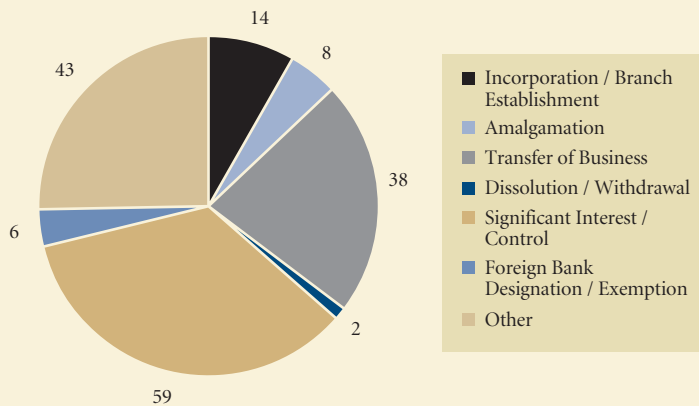
**OSFI processed 691 applications for approvals, an increase of 3% over the previous year.**

APPROVALS PROCESSING TIME 2004-2005  
(Percentage of Approvals)

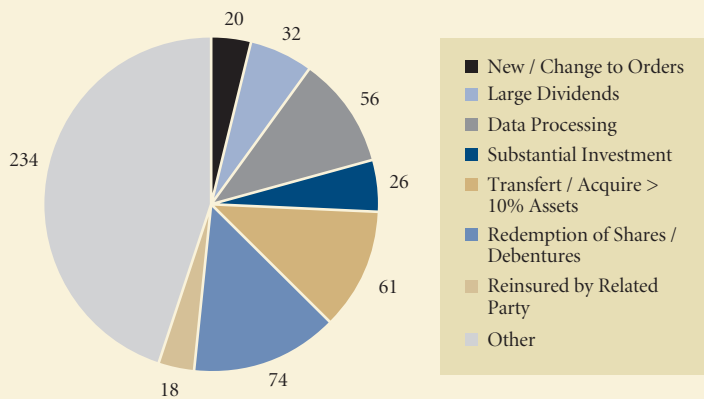


**Ministerial approvals accounted for 25% of all approvals.**

## MAJOR TYPES OF MINISTERIAL APPROVALS (Number of Approvals)



## MAJOR TYPES OF OSFI APPROVALS (Number of Approvals)

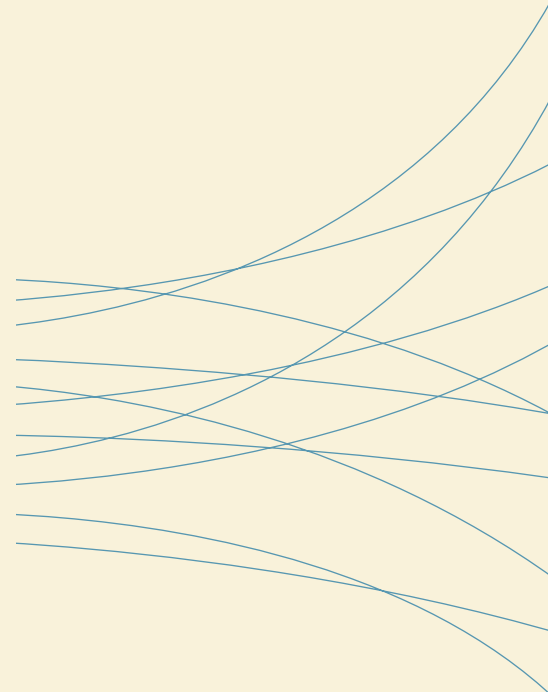


OSFI provides advance opinions on certain capital instruments and validates certain models used by institutions to ensure compliance with the regulatory capital regime. A total of 33 such opinions and validations were provided in 2004-2005.

As in previous years, several interested parties approached OSFI to discuss the incorporation of new closely held banks, as permitted pursuant to Bill C-8 passed in 2001. Some of these discussions led to formal applications, which are at various stages of review. One of these applications resulted in the establishment of a new closely held domestic bank, Dundee Wealth Bank.

### *Performance Standards*

During the year, OSFI developed performance standards establishing time frames for the processing of applications for regulatory approval and for other services that are subject to a user fee. This initiative is in keeping with OSFI's and the Government of Canada's commitment to enhance the accountability and improve the transparency relating to the services provided. In 2005-2006, OSFI will measure and report against these standards.



## *Guidance and Education*

In keeping with OSFI's objectives to enhance the transparency of its statutory approvals process and to promote better understanding of OSFI's interpretation of the federal financial institution statutes, OSFI develops Advisories and Rulings.

In 2004-2005, OSFI published eight revised Transaction Instructions providing additional guidance on factors that OSFI takes into account in its assessment of applications. OSFI published nine Rulings dealing with various issues such as aquaculture insurance, physically settled commodity trading, unauthorized use of the word "bank", and the concept of business in Canada under Part XII of the *Bank Act*. OSFI also developed new administrative practices designed to streamline two common types of approvals related to large dividends and data processing outside of Canada.

In October 2004, OSFI hosted a Legislation and Approvals Division Seminar, its third since 2002, for financial institutions and their advisors. Over 100 participants attended the seminar in Toronto. The seminar focused on issues related to OSFI's approvals process and provided greater insight into ongoing guidance initiatives and a few other current topics. The results of OSFI's 2004 Approvals Process Consultation, which is discussed earlier in this report, were presented at the seminar. As with previous seminars, most of those who attended expressed an interest in this initiative being repeated on a regular basis in the future.



### **MONIQUE CHAMPAGNE**

*Manager, Legislation  
and Policy Initiatives,  
Legislation and Approvals  
Division, Regulation Sector*

During 2004-2005, financial and economic conditions continued to create a stable but fragile environment for pension plans, with low interest rates contributing to solvency deficits.

*Office of the Superintendent of Financial Institutions Act*

*“ . . . to supervise pension plans in order to determine whether they meet the minimum funding requirements and are complying with the other requirements of the PBSA and its regulations and supervisory requirements under that legislation . . . and to promptly advise the administrator of a pension plan in the event that the plan is not meeting the minimum funding requirements or is not complying with other requirements . . . and to take, or require the administrator to take the necessary corrective measures . . . to deal with the situation in an expeditious manner.”*

**State of the Industry**

During 2004-2005, the state of the pension plan industry did not change significantly from the previous year. Financial and economic conditions continued to create a stable but fragile environment, with low interest rates contributing to solvency deficits. Every six months OSFI conducts a series of tests on the defined benefit plans it regulates to determine the solvency of these plans. Based on this exercise, as at December 2004, about half (55%) of all defined benefit plans supervised by OSFI had solvency funding deficits (compared to 53% in 2003).



**ANDREW PETERSON**  
Senior Supervisor, Private  
Pension Plans Division,  
Supervision Sector

PENSION PLANS

ASSESSMENTS

SOLUTIONS



The regulations governing federal pension plans do contemplate that plans may from time to time operate in a deficit position, and provision is made within the regulations to permit funding of these deficiencies over a five-year period. OSFI recognizes, however, that there will be circumstances where plans that do not have sufficient assets to cover all the liabilities will have to be restructured. Nonetheless, in general, OSFI sees the situation facing defined benefit plans as stable and manageable, provided there are no material adverse changes in asset markets or long-term interest rates.

As a result of the ongoing challenges facing pension plans and their sponsors, OSFI stepped up its efforts to identify proactively plans that pose a higher risk and to ensure that plan administrators take prompt corrective action where needed. OSFI increased its resources for monitoring and assessing the financial health of plan sponsors and conducted an increased number of on-site reviews. The Private Pension Plans Division increased its staff complement by 25%, mainly by recruiting individuals with supervisory experience from within OSFI.

Reflective of the challenges faced by private pension plans, as at March 31, 2005, OSFI had nine applications outstanding to reduce accrued plan benefits, and was aware of a number of pending transactions of the same nature. OSFI's review of these applications will consider, among a number of things, the process that was followed to advise members of the reduction in their benefits.

### ***Risk Assessment and Intervention***

OSFI supervises private pension plans covering employees in federally regulated areas of employment. These include banking, inter-provincial transportation, telecommunications, and undertakings outside the legislative authority of the provinces. The latter category includes businesses or undertakings in the Yukon, Northwest Territories and Nunavut.

Also falling under federal jurisdiction is any work, undertaking or business declared by the Parliament of Canada to be for the general advantage of Canada or for the advantage of two or more provinces. Uranium mining is an example of an undertaking that falls within this category. All other private pension plans are governed by the pension legislation of the provinces in which their members are employed (with the exception of Prince Edward Island, which does not have private pension plan legislation).

As at March 31, 2005, there were 1,284 pension plans registered under the *Pension Benefits Standards Act, 1985* (PBSA), covering over 570,000 employees. In 2004-2005, plan assets increased by 10.5%, to a value of approximately \$104 billion. The great majority of members and assets that OSFI regulates are held in defined benefit plans. Over the past five years, there has been a small but steady increase in the proportion of defined contribution plans relative to the total number of plans. Over the past year, a number of plan administrators have expressed concerns about the



As a result of the ongoing challenges facing pension plans and their sponsors, OSFI increased its resources for monitoring and assessing the financial health of plan sponsors and conducted an increased number of on-site reviews.

long-term viability of their defined benefit pension plans and a desire to move away from defined benefit toward defined contribution plans. While statistics at this time do not illustrate a significant shift in the number of defined benefit plans, OSFI anticipates that over time this trend may become more prevalent if current market conditions and challenges persist.

The most recent pension plan financial statements filed during the 12-month period ending March 31, 2005 report that 57% of pension assets are invested in equities, 38% in debt instruments and 5% in diversified and other assets. *Equities* include investments in pooled funds, stocks, and shares in real estate, resource and investment corporations. *Debt instruments* include government and corporate bonds, mortgage loans and deposits. *Diversified assets* cover balanced mutual and segregated funds and miscellaneous assets or other investments that are not included in the other two categories. Foreign investments were reported at approximately \$22 billion or 21% of total investments. Of the \$22 billion in foreign investments, 92% were in equities. Pension plans maintained essentially the same asset allocation as in the previous period.

Overall, the performance of equity markets in 2004 has improved the outlook for pension plans. Even though performance of broad equity indices was not as strong as in the previous year, 2004's increase was nonetheless quite strong by historical standards. Most domestic money managers enjoyed healthy returns in 2004, helped by a 12.5% increase in the S&P/TSX composite index. However, the continuing decline in long-term interest rates offset to some degree the improvement in asset returns.

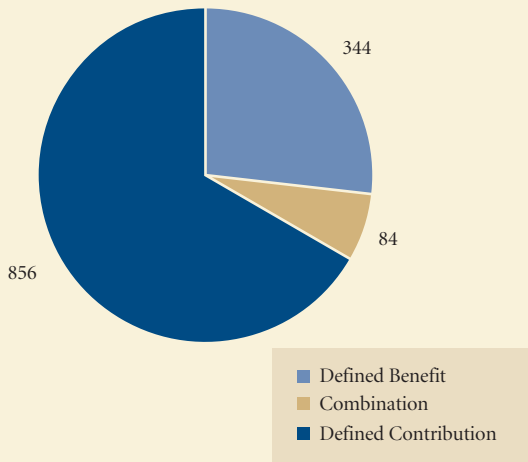
The average estimated solvency ratio for all defined benefit plans remained stable at 1.00 over the past year (compared to 1.02 the previous year). Estimated solvency ratios calculated by OSFI using year-end 2004 data showed that approximately half of all defined benefit plans supervised by OSFI were still underfunded, meaning their estimated liabilities exceeded assets, with 57% of these underfunded plans having liabilities that exceeded their assets by more than 10%. Given the current market environment and the impact of potential future adverse changes in economic conditions or financial markets, OSFI continued to carefully monitor both the condition of pension plans and, to the extent possible, that of their sponsors.

#### PENSION PLANS BY TYPE (last 4 years)

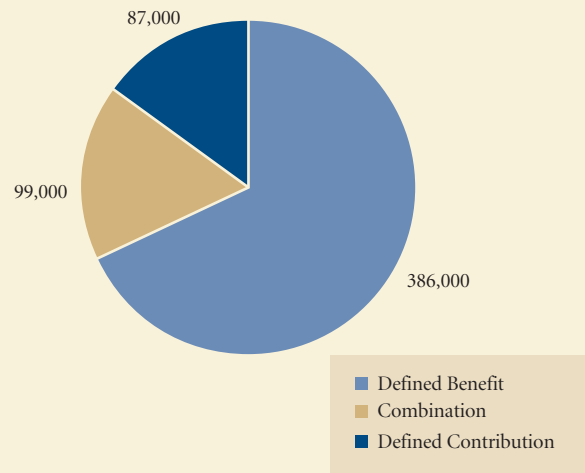
	Year-end 2004-2005	Year-end 2003-2004	Year-end 2002-2003	Year-end 2001-2002
<b>Total Plans</b>	1,284	1,256	1,205	1,195
<b>Defined Benefit</b>	344	336	346	352
<b>Combination</b>	84	84	70	70
<b>Defined Contribution</b>	856	836	789	773
<b>Total Membership</b>	572,000	547,000	579,000	557,000
<b>Defined Benefit</b>	386,000	367,000	397,000	389,000
<b>Combination</b>	99,000	96,000	88,000	88,000
<b>Defined Contribution</b>	87,000	84,000	94,000	80,000
<b>Total Assets</b>	\$104 billion	\$95 billion*	\$85 billion	\$91 billion
<b>Defined Benefit</b>	\$85 billion	\$78 billion	\$70 billion	\$75 billion
<b>Combination</b>	\$16 billion	\$15 billion*	\$13 billion	\$14 billion
<b>Defined Contribution</b>	\$3 billion	\$2 billion	\$2 billion	\$2 billion

\* Restated

PENSION PLANS BY TYPE 2004-2005  
(Number of Plans)



MEMBERSHIP BY PLAN TYPE 2004-2005  
(Number of Members)



*Of the more than 1,200 plans regulated by OSFI, only a third are defined benefit or combination plans, yet these plans account for 85% of membership.*

## ADJUSTMENTS TO PENSIONS

As required by the *Pension Benefits Standards Act, 1985*, plan sponsors report the extent to which they have provided inflation protection and the source of funds for the adjustments.

### Inflation Protection

In 2004-2005, nearly 28% of the plans that offer defined benefits reported increases in pensions being paid out, i.e. retirees' pensions (compared to 25% the previous year). Of these plans, 29% also increased deferred pensions.

Increases were based on full Consumer Price Index (CPI) in 34% of cases, 29% on partial CPI and 37% using other formulae, such as excess interest, a flat dollar amount, or a percentage of pension payment. In 80% of cases (77% in 2003-2004), adjustments were made as a result of collective agreements or were required by the plan text. In the remaining cases, employers made voluntary adjustments.

### Source of Funds for Adjustments

During 2004-2005, 34% of the plans that made adjustments to pensions did so using surplus funds or gains (compared to 38% the previous year). The remainder used sources outside the pension fund, created unfunded liabilities, or used some combination of options to improve pensions.

In 30% of cases, plans used surplus/gains to improve benefits, while in 70% of the cases the employer reduced contributions through the use of surplus/gains. This is a change from 2003-2004, when 61% used surplus/gains to improve benefits and 59% reduced contributions. The remaining defined benefit plans either did not have surplus/gains or chose to let their surplus/gains accumulate.



## Supervisory Policies

OSFI's approach to pension plan supervision is a balanced one that recognizes that plan administrators need to take reasonable risks in their investment and funding strategies, and that plans or their sponsors can sometimes experience difficulties that lead to loss of benefits.

The main pillars of OSFI's approach are early warning tests, solvency testing, on-site examinations and the watch list.

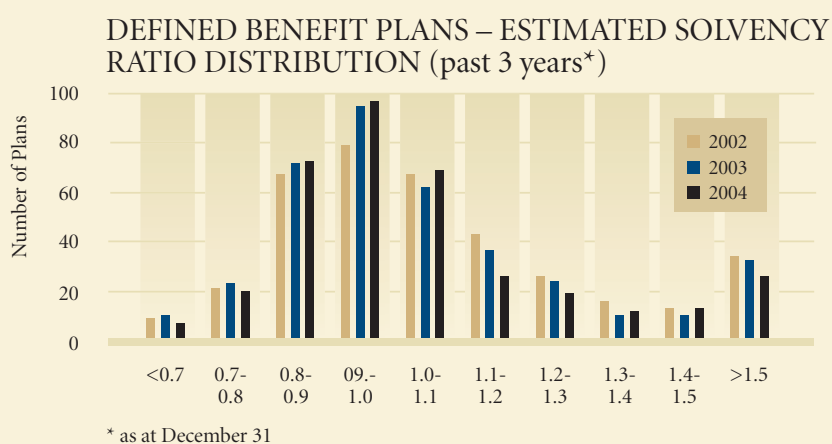
### Early Warning Tests

OSFI has developed a series of early warning tests to detect risks based on information submitted in pension plans' filings. A first series of automated tests is run to identify higher-risk plans. These plans are then subjected to a more detailed analysis by OSFI's pension plan supervisors in an effort to assess whether further action should be taken. In 2004-2005, 25% of plans that remitted filings were subjected to a more detailed review.

### Solvency Testing

Early detection of solvency and funding problems is a key element in safeguarding members' benefits. In 2002, OSFI developed a model to estimate the solvency of a plan between its actuarial valuation reporting periods.

This test is now run on a semi-annual basis and is used to estimate solvency ratios for all defined benefit pension plans. Depending on the results, plan administrators are contacted and asked to validate these results and/or to provide additional information on their pension plans. If the estimated solvency ratio is close to or less than one, or if the plan's risk profile is in the high range, various interventions are considered, including, but not limited to, requests for early filing of valuation reports, which in turn triggers the need for additional payments to fund deficits. This test has provided OSFI with important information, which has allowed it to intervene earlier in at-risk pension plans.



**Over the past three years, the estimated solvency ratios calculated by OSFI show a movement towards the bandwidth of between 0.8 and 1.1.**

In addition, OSFI continued to identify underfunded pension plans that were taking contribution holidays in 2004-2005. In OSFI's view, such contribution holidays were not prudent in some circumstances. These situations were all dealt with to OSFI's satisfaction. OSFI took action, ranging from strongly encouraging plan sponsors to cease contribution holidays, to requiring enhanced notification to members and/or requesting early valuation reports.

### On-Site Examinations

OSFI's risk-based supervision approach includes on-site examinations of selected pension plans. The selection of plans for on-site examination is based on a number of factors including, but not limited to, plan size and the assessed risk to beneficiaries. On-site examinations enable OSFI to enhance its assessment of the financial situation and quality of the administration of plans. They also provide OSFI with the opportunity to meet the individuals involved in plan administration, thereby improving communications between these administrators and the Office. In addition to completing detailed desk reviews of some 70% of defined benefit plans, OSFI also performed a number of on-site examinations during the year with a continued focus on governance and disclosure to members. OSFI expects to increase the number of on-site reviews in 2005-2006.

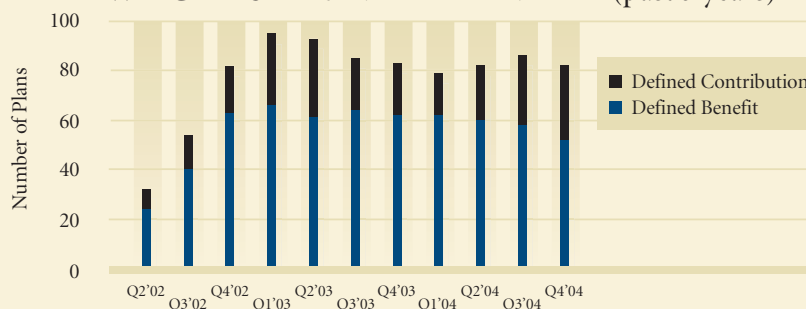
### Watch List

In deciding whether and how to intervene, OSFI takes into account the size of the plan's deficit and the sponsor's capacity to fund it. Pension plans that give rise to serious concern, due to their financial condition or for other reasons, are placed on a watch list and are actively monitored. The number of pension plans on OSFI's watch list declined slightly during 2004-2005 from a high of 86 to 82. Of these, 52 were defined benefit plans (62 in 2003-2004) and 30 were defined contribution plans (21 in 2003-2004). During the course of 2004-2005, 31 new plans were added to the watch list and 32 were removed, in part due to OSFI's intervention.



**DENIS LEROUX**  
 Director,  
 Office Management  
 and Technical  
 Services Division,  
 Corporate Services Sector

WATCH LIST TREND BY PLAN TYPE (past 3 years)



Note: Data for Q1'02 is not shown as the current methodology defining watch list plans was not introduced until Q2'02. The quarters are based on fiscal years.

***During 2004-2005, the state of the pension plan industry did not change significantly from the previous year.***

### Intervention

In 2004-2005, OSFI dealt with a number of late remittance issues in respect to pension plans. OSFI worked actively with plan sponsors, administrators, custodians and other officials trying to find reasonable solutions that ultimately resulted in the protection of members' benefits.

### Rule Making

In August 2004, the Government of Canada approved regulations allowing Air Canada to amortize existing pension funding deficiencies over a ten-year period instead of the usual five-year period. Conditions attached to the funding relief included appropriate disclosure of information to plan beneficiaries, and certain restrictions regarding actuarial methods used to plan improvements. OSFI implemented the Air Canada Pension Plan Solvency Deficiency Funding Regulations and related portability rules. This was the final chapter in a series of steps that included the active involvement of OSFI to protect the rights and interests of the 55,000 members of Air Canada's pension plans.

In the summer of 2004, the Supreme Court of Canada issued a decision in the Monsanto case (*Monsanto Canada Inc. versus Ontario [Superintendent of Financial Services]*). The case involved a pension plan registered under the *Ontario Pension Benefits Act* and the interpretation of provisions in Ontario's pension legislation dealing with the handling of pension plan surplus amounts on a partial plan wind-up. OSFI assessed the potential relevance of this decision for federal pension legislation.

Federal rules governing partial plan termination are among the issues addressed in a consultation about the future of defined benefit plans launched in May 2005 by the Department of Finance. The Department also released a discussion paper entitled "Strengthening the Legislative and Regulatory Framework for Defined Benefit Pension Plans Registered under the *Pension Benefits Standards Act, 1985*." The paper seeks stakeholders' views on a number of matters ranging from partial plan terminations under the *Pension Benefits Standards Act, 1985*, to funding of defined benefit plans, with the aim of maintaining a balance between the interests and incentives of private sector plan sponsors and plan members. The results of this consultation will be used to develop recommendations for regulatory or legislative changes affecting defined benefit pension plans. Accordingly, OSFI has put implementation plans with respect to the Monsanto decision on hold pending the outcome of the government's review.

OSFI is a member of the Canadian Association of Pension Supervisory Authorities (CAPSA), a forum for discussing common issues faced by federal and provincial pension plan supervisory authorities. During 2004-2005, CAPSA issued guidelines on pension plan governance that are partly based on OSFI's previous work in the area. CAPSA also adopted guidelines for Capital Accumulation Plans. OSFI strongly supported both these guidelines and believes that they will have an important effect on plan governance.

## *Approvals*

Federally regulated pension plans are required to seek approval from the Superintendent of Financial Institutions for different types of transactions affecting pension plans, including plan registration, asset transfer, full and partial plan termination, plan merger, refund of surplus, or reduction of benefits. A dedicated approvals unit was formed during 2004-2005 to focus on these transactions. Over time, it is expected that this change will result in improved processing time for various applications.

During 2004-2005, all asset transfers between defined benefit plans were put on hold as a result of the need to assess the impact of recent court rulings. OSFI is working on the development of instructions to guide this process, and it is expected that through 2005-2006 the backlog of transactions resulting from the hold on approvals will be eliminated.

During the year, 47 new plans were registered with OSFI. Of these, 13 were defined benefit plans. A further 19 registered plans, affecting some 762 members, informed OSFI that they were terminating or consolidating with other plans. In addition, one new application for a refund of surplus to an employer was received. No refunds were approved during 2004-2005.

OSFI formed a dedicated pension plans approvals unit to focus on transactions requiring approval.

Canada and other G-8 governments have recognized that upgrading the supervisory capacity of emerging market regulatory bodies can help to enhance the stability of the global financial system.

TECHNICAL ASSISTANCE

SUPERVISORY CAPACITY

ENHANCED STABILITY

Globalization of the financial system continues unabated. Canadian financial institutions, many of which are increasingly expanding their physical presence and exploring business opportunities outside of Canada, play a key role in the global financial system. Canada and other G-8 governments have recognized that upgrading the supervisory capacity of emerging market regulatory bodies can help to enhance the stability of the global financial system. Canada has chosen to play an important role in this regard both directly and indirectly, through OSFI's technical assistance program, which is designed to help emerging market economies improve their financial institution supervisory systems.

Since its inception in 2001, OSFI's International Advisory Group (IAG), which receives the bulk of its funding from the Canadian International Development Agency (CIDA), has administered and operated its technical assistance program by conducting needs assessments and providing hands-on technical advice, training, workshops and seminars, primarily to supervisors in the Caribbean, Asia, Latin America, Eastern Europe and, to a lesser extent, in Africa. Technical assistance by IAG is, for the most part, provided at no cost to qualifying jurisdictions.

OSFI offers unique "in-house" programs that allow foreign bank and insurance company supervisors the opportunity to visit and learn at OSFI. During 2004-2005, OSFI hosted some 100 supervisors representing every continent. IAG also hosted many delegations to OSFI for periods ranging from several hours to a week.

IAG continues to offer a variety of bilateral and multilateral (regional) training programs and to provide technical assistance, with or without technical assistance partners, in various locations outside of Canada. This training often extends beyond the typical classroom setting and is developed according to the needs of the specific jurisdiction. It includes the provision of hands-on technical advice, consulting services and follow-up as necessary.

IAG has had success by working alongside foreign supervisors "in the field", helping them to apply various theoretical training elements. IAG staff, for example, was particularly involved during the year with insurance supervisors from Trinidad and Tobago and from Barbados where it worked alongside those countries' supervisors assisting in the implementation of "on-site" examination programs. In 2004-2005, IAG continued to provide legislative and regulatory drafting expertise, played a key role in the selection process for senior-level supervisory staff and addressed industry participants and regulators on important subjects such as corporate governance and risk management.

During 2004-2005, IAG continued to be particularly involved with the International Monetary Fund (IMF) / World Bank Financial Sector Assessment Program (FSAP). In addition to having served as "experts" in the assessment of compliance with the Basel Core Principles and the International Association of Insurance Supervisors (IAIS) Core Principles, IAG worked with several jurisdictions that are attempting to correct deficiencies identified during their FSAP assessment. During 2004-2005, IAG was selected by the Financial Sector Reform and Strengthening Initiative (FIRST) to assist Thailand's Department of Insurance in preparing for the



OSFI's Jean Sarazin, Leo Querel, Ralph Lewars and Kim Norris, Managing Director, International Advisory Group, with Prof. Jan Monkiewicz, Chairman of Poland's Insurance and Pension Funds Supervisory Commission, and his staff during the Risk-based Supervisory Workshop held in Warsaw, Poland.



OSFI's technical assistance program is designed to help emerging market economies improve their financial institution supervisory systems.

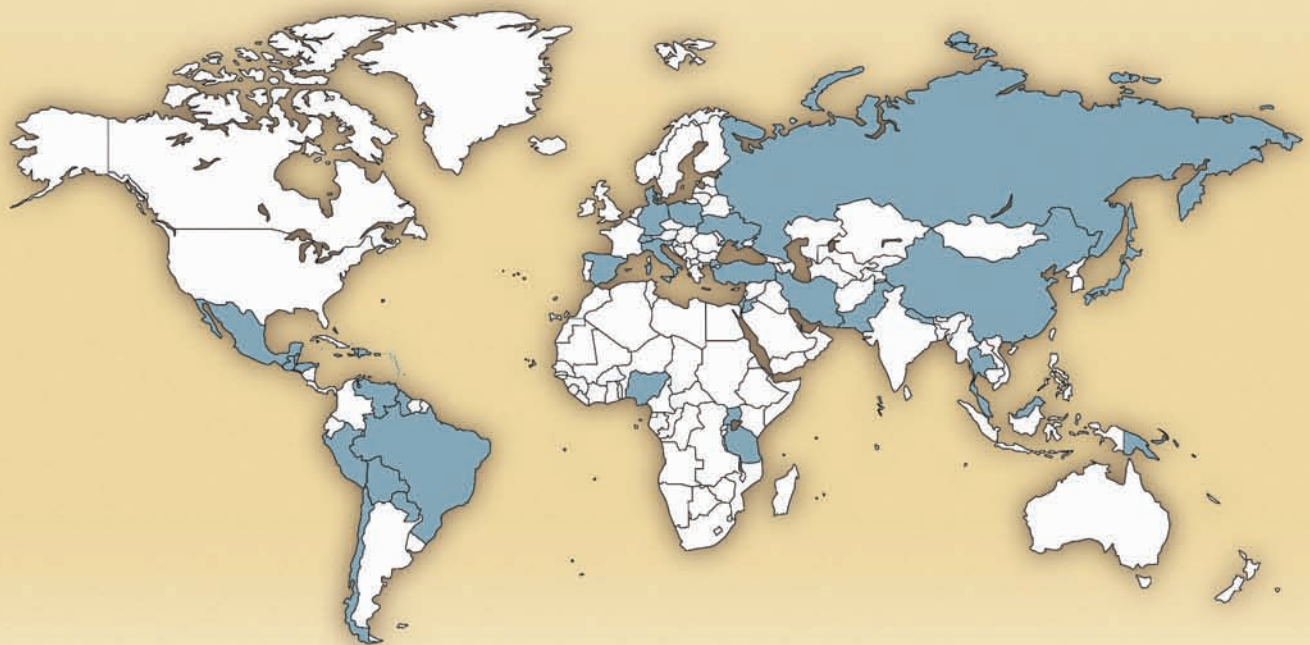
country's FSAP assessment in 2006. This "self-assessment" exercise in Thailand is a significant project for IAG and will continue in 2005-2006.

IAG is involved in a number of other longer-term, ongoing projects. Of particular note is the Dominican Republic, where IAG, with the assistance and support of the Canadian Ambassador to that country, entered into an Agreement of Technical Assistance with the Superintendente de Bancos in September 2004. This agreement, which covers a number of regulatory and supervisory issues, came about as a direct result of the collapse of the country's largest commercial bank and the difficulties of two medium-sized banks, which severely undermined public confidence in the banking system.

Another example of an ongoing project is in Malaysia, where IAG continues to work closely with Bank Negara to implement a system of risk-based supervision for insurance companies registered in Malaysia.

IAG attempts to "partner" with other technical assistance providers around the world, where feasible, in order to achieve efficiencies and economies. IAG is staffed by individuals with significant financial institution regulatory and supervisory experience, primarily gained at OSFI, and who are knowledgeable in "today's" supervisory techniques and principles.

During 2004-2005, OSFI's International Advisory Group provided technical assistance or training to financial supervisors from numerous countries.



Anguilla – Antigua & Barbuda – Bahamas – Bahrain – Barbados – Belize – Bermuda – Bolivia –  
Brazil – British Virgin Islands – Cayman Islands – Chile – China – Denmark – Dominica – Dominican  
Republic – El Salvador – Germany – Grenada – Guatemala – Guernsey – Guyana – Haiti – Honduras –  
Italy – Jamaica – Japan – Jordan – Lebanon – Malaysia – Mexico – Montserrat – Nepal –  
Netherlands Antilles – Nevis – Nigeria – Pakistan – Papua New Guinea – Paraguay – Peru – Poland –  
Russia – Singapore – Spain – St. Kitts – St. Lucia – St. Vincent – Switzerland – Tanzania – Thailand –  
Trinidad & Tobago – Turkey – Turks & Caicos Islands – Uganda – Ukraine – Venezuela

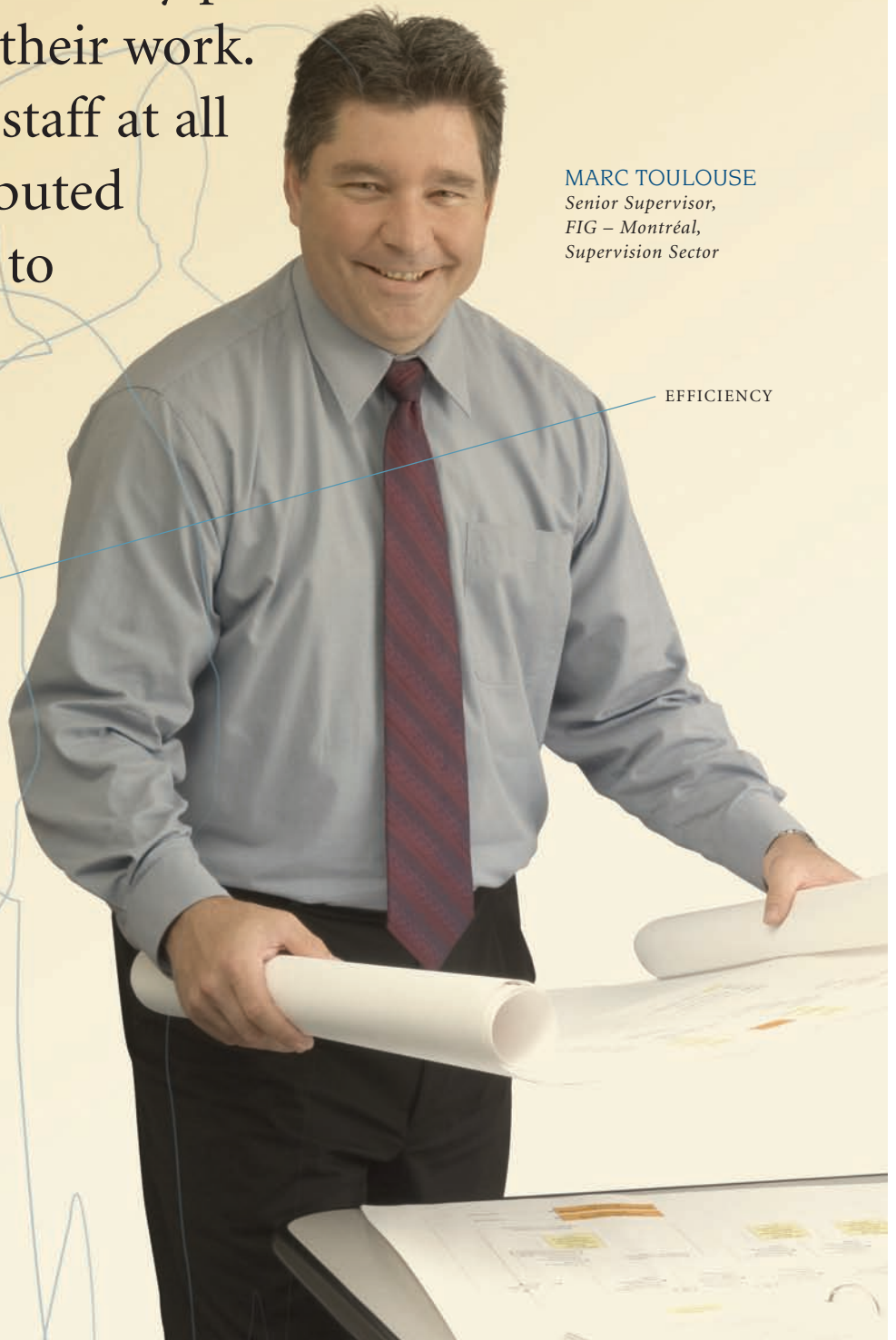


During 2004-2005, OSFI staff reviewed a number of supervisory processes and introduced technology-enabled changes in how they plan and execute their work. Supervision staff at all levels contributed significantly to this effort.

MARC TOULOUSE  
*Senior Supervisor,  
FIG – Montréal,  
Supervision Sector*

CONTRIBUTION

EFFICIENCY



## *Streamlining Data Collection*

OSFI, the Bank of Canada, the Canada Deposit Insurance Corporation, the Department of Finance and Statistics Canada are working together to assess the relevance and usefulness of financial data currently filed by deposit-taking institutions. To date, considerable progress has been made on this joint initiative to streamline and rationalize the collection of data from these institutions.

Work completed this year will result in a net reduction of approximately 30 per cent in the data that is currently collected in OSFI Financial Returns. Discussions with institutions will continue in 2005-2006 to determine the additional data requirements needed for Basel II implementation.

Going forward, there will be greater sharing and leveraging of the data amongst these government agencies. The agencies are also working towards a more formalized common framework for data collection, which will result in greater efficiencies and transparency in future data requests, aimed at easing the regulatory burden on institutions.

OSFI is also working towards incorporating diskette filing for federally regulated pension plan returns. This change will benefit both OSFI and the pension industry by speeding up input and improving data integrity.

## *Improving Work Processes*

OSFI made major progress in the development and implementation of its multi-year Business Systems Integration Initiative (BSII). The project is designed to reengineer core supervision processes and allow OSFI to better allocate its resources to high-risk areas.

During 2004-2005, OSFI staff reviewed a number of supervisory processes and introduced technology-enabled changes in how they plan and execute their work. Supervision staff at all levels contributed significantly to this effort. These changes resulted in staff reductions in certain areas, and redeployment of some of the affected resources to other areas. This technology has already started to deliver benefits and further enhancements are planned.

The majority of the development work related to BSII is now behind OSFI. With the continued support of the supervision team, in 2005-2006 OSFI expects to complete the implementation of these new processes and systems, including the Core Supervisory Workflow System (CSWS). These changes will allow OSFI to continue to be well positioned to respond to changes and challenges in the financial services industry.

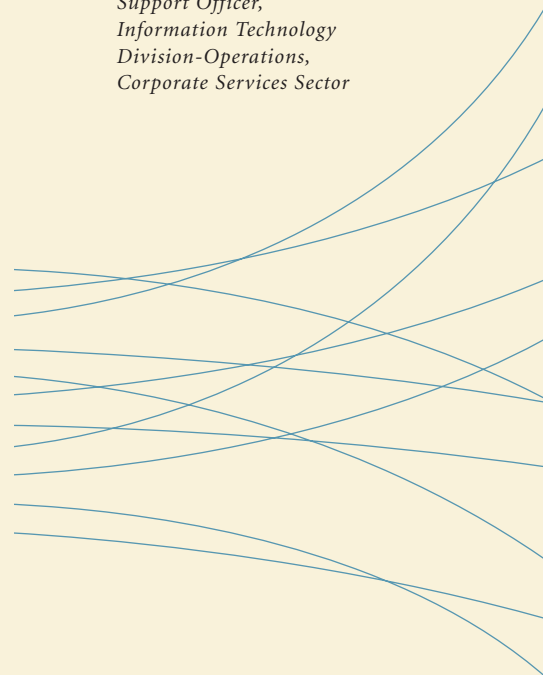
## *Enabling Information Management*

OSFI completed Phase 2 of its implementation of a corporate Electronic Document Management System (EDMS). EDMS will allow OSFI employees to manage electronic documents better and to share information. In 2004-2005, all the financial institution supervisory



**PENNY LEE**  
*Director, Monitoring and  
Analytics Support Division,  
Supervision Support Group,  
Supervision Sector*

**SHAHID SAYA**  
*Information Technology  
Support Officer,  
Information Technology  
Division-Operations,  
Corporate Services Sector*





records were organized, and a monitoring and audit procedure was implemented to monitor and validate the system and its contents.

Over the year, OSFI finalized plans for the design and implementation of technology-enabled reporting and analytics capabilities, supported by industry-leading business intelligence tools, for action in 2005-2006. This will provide OSFI employees with easier access to existing data as well as supporting broader utilization.

### *Enhancing Management Practices*

OSFI formally established its internal audit function in 2002. The Audit & Consulting Services group uses a risk-based approach to support OSFI in understanding the effectiveness of OSFI's governance and control frameworks. In 2004-2005, OSFI's audit committee had the same membership as the Executive Committee, specifically, the Superintendent and the three Assistant Superintendents. OSFI has begun recruiting external members to its audit committee, with the objective of having an independent audit committee to enhance OSFI's governance structure. OSFI expects to have the newly constituted audit committee in place by early 2006.

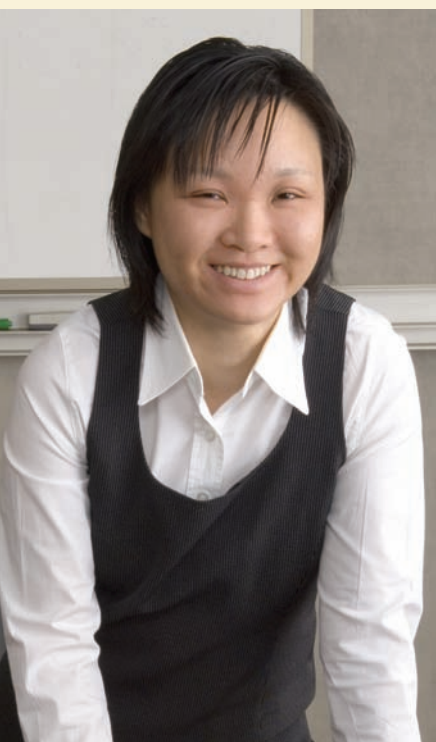
OSFI made further progress in implementing Enterprise-wide Risk Management (ERM), a contemporary management tool that provides a comprehensive and integrated approach to identifying risks and assessing the quality of risk mitigants. As a result of a series of risk assessments facilitated by the Audit & Consulting Services group in 2004-2005, operational groups can draw clearer linkages between OSFI's priorities, their actions and associated risks. It is expected that ERM will be fully established within OSFI in 2005-2006, with responsibility for ERM transferring to managers.

OSFI created a Project Management Group to provide overall governance for priority information management and technology projects. This group coordinates the design and implementation of major corporate projects that span several internal divisions, leading to improved delivery times and avoiding duplication of effort among OSFI staff.

OSFI began work on upgrading its Security Framework, which will address all aspects of security within OSFI including governance, policies, procedures, security risk management, compliance and monitoring. The framework will build upon existing security policies and components, and will span all security functions such as physical security, information technology, human resources, information, contracting, and business continuity.

The timing of this initiative coincides with the release of the Office of the Auditor General's (OAG) audit of IT Security within the federal government (February 2005 – Chapter 1). OSFI's security framework, targeted for completion in 2005-2006, will take into account the findings and recommendations contained in the OAG Report, while ensuring compliance with the Government Security Policy and associated standards, and consistency with overall industry best practices.

WING YIN MA  
Web Master,  
Communications  
and Public Affairs,  
Corporate Services Sector



OSFI implemented the Program Activity Architecture (PAA), as recommended by the Treasury Board Secretariat, as part of the federal government's commitment to strengthen oversight and accountability. OSFI updated its accountability framework, detailing its program and sub-program activities, to ensure that reporting will accurately reflect the work that OSFI does. OSFI also developed a performance measurement framework and a suite of measures corresponding to the PAA, which will be implemented in 2005-2006. More details can be found on OSFI's web site in the "[Report on Plans and Priorities for 2005-2006](#)".

### *Developing OSFI's Human Resources*

OSFI's executive team participated in a targeted succession planning process to identify and implement plans to mitigate the risk of potential turnover within critical executive-level positions across OSFI. Not only did this initiative produce some targeted action plans, it also uncovered the need to ensure that leadership and official language development continues to be an ongoing commitment in OSFI's business planning process. In response, OSFI introduced a modularized management development curriculum that all management staff will be required to complete within a two- to three-year period. This program is designed to enhance the skills of OSFI's leaders to better motivate and develop staff, and to better understand and consistently deliver on their accountabilities within key management processes.

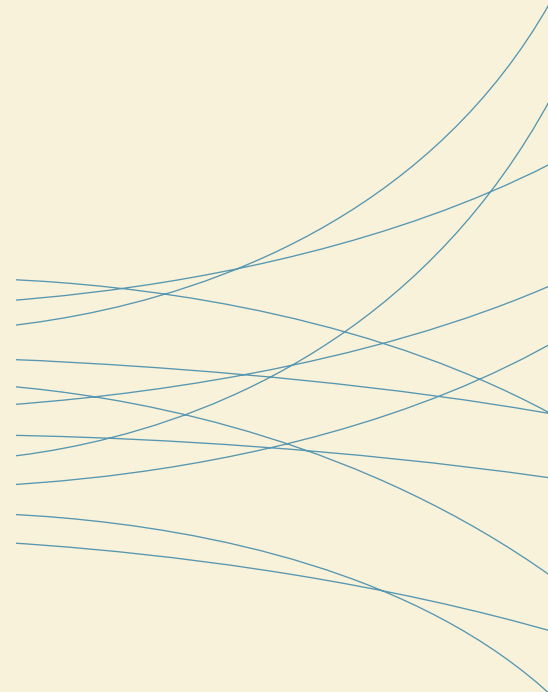
OSFI continued to refine the performance management process introduced in 2003-2004. After completing one full cycle of the new program, employees and management were asked how OSFI might improve the process. Based on their input, changes were made to clarify performance ratings and to expedite the process. Competency definitions were also customized in many parts of the organization to reflect specific work processes. These changes will help employees better understand what is expected of them and will help managers better assess their staff relative to expectations.

Training continued to be a high priority at OSFI. A significant portion of OSFI's training efforts were focused on supporting the reengineering of several key business processes and the implementation of enabling technology such as workflow and information management systems. As implementation continues into early 2006, this training trend will continue and ultimately the courses developed will be added to OSFI's core curriculum.

### A QUALIFIED WORKFORCE

In 2004-2005, OSFI continued to attract, retain and train a qualified workforce:

- 90% of external employment offers were accepted
- 6.4% is the voluntary turnover rate
- 4.8 days were spent per employee on training
- 52% of new hires were women
- 24% of new hires were visible minorities





Superintendent Nicholas Le Pan spoke at the Fourth National Conference on Financial Regulation in Toronto on May 14, 2004. The photo, taken by Zoran Bozicevic, appeared in the *National Post*.



## Informing Canadians

OSFI continued to inform Canadians about our activities and plans, and to contribute to a dialogue on key issues facing the financial sector.

During 2004-2005, the Superintendent and other OSFI subject experts delivered over 30 presentations to industry and regulatory forums, both nationally and internationally, to such audiences as the Institute of International Bankers, the Global Association of Risk Professionals, the Economic Club of Toronto, the International Conference of Banking Supervisors, and the C.D. Howe Institute.

To provide all interested parties with easier access to our information on-line, in 2004-2005 OSFI redesigned its external web site: [www.osfi-bsif.gc.ca](http://www.osfi-bsif.gc.ca). Users from the public and from industry were consulted about their needs, and improvements were made to the web site to present information in a more client-centric and intuitive way. Some of the information on the new web site is grouped by industry segment, while another section highlights information of interest to the general public. The web site also provides a “Look and Feel” more consistent with Treasury Board guidelines, allowing Canadians to access information more easily due to the familiar layout and navigation.

As part of OSFI’s commitment to transparency, for the first time, OSFI made public its *Plan and Priorities 2005-2008* (formerly known as the Strategic Plan). OSFI also made public the findings of both the 2004 *Industry Consultation* and the *Approvals Process Consultation*. The full text can be found on OSFI’s web site.

In accordance with federal government policies introduced in 2004, OSFI published [information on travel and hospitality expenses](#) incurred within OSFI by the Superintendent, Assistant Superintendents and Chief Actuary, as well as [information on contracts over \\$10,000](#) issued by or on behalf of OSFI. The information is updated every three months on OSFI’s web site.

## SHARING OSFI’S EXPERTISE

Throughout 2004-2005, OSFI shared its expertise with interested Canadians, including members of the general public, industry, regulators and legislators:

- Served over 860,000 visitors to OSFI’s web site
- Handled 13,272 public enquiries
- Responded to 154 enquiries from Members of Parliament
- Delivered over 30 speeches and presentations to industry and regulatory forums

The Chief Actuary asked the United Kingdom Government Actuary's Department to select a panel of independent Canadian actuaries to perform a peer review of the 21<sup>st</sup> Actuarial Report on the Canada Pension Plan. This improved process establishes a precedent and provides Canadians with the utmost confidence that the highest standards of practice, including international standards, are being applied.

REVIEW

CONFIDENCE

JEAN-CLAUDE MÉNARD  
*Chief Actuary*



The Office of the Chief Actuary (OCA) has different responsibilities from other sectors within OSFI. Rather than fulfilling a regulatory or supervisory function, the OCA was created to provide actuarial and other services to the Government of Canada and provincial governments who are Canada Pension Plan (CPP) stakeholders. It was established within OSFI as a separate unit and, while the Chief Actuary reports to the Superintendent, he or she is solely responsible for the content and actuarial opinions in reports prepared by the OCA.

The current environment for the retirement income system puts an additional onus on the Office of the Chief Actuary to be, and be seen to be, fully accountable and professionally independent. The Chief Actuary and all Fellows and Associates are members of the Canadian Institute of Actuaries (CIA) and are subject to the CIA Rules of Professional Conduct, which identify the professional rules and ethical standards with which a member must comply and thereby serve the public interest. The OCA maintains its credibility and the quality of its work by adhering strictly to professional actuarial standards. The statutory actuarial reports are prepared by OCA Fellows of the CIA and co-signed with the Chief Actuary to enhance the internal quality control process.

### *Role and Responsibilities*

The federal government and the provinces, through the Canada Pension Plan (CPP), public sector pension arrangements and other social programs, have made commitments to Canadians and are responsible for the funding of these commitments. Some are long-term, and it is important that decision-makers, Parliamentarians and the public understand these commitments and the inherent risks they present. The Office of the Chief Actuary has a vital and independent role to play in this process. We provide appropriate checks and balances on the future costs of the different pension plans and social programs that fall under our responsibilities.

The Office of the Chief Actuary conducts statutory actuarial valuations of the CPP, Old Age Security (OAS) program, and pension and benefit plans covering the federal Public Service, the Canadian Forces, the Royal Canadian Mounted Police (RCMP), the federally appointed judges, and Members of Parliament. Since 2001, the OCA has also been responsible for undertaking the actuarial review of the Canada Student Loans Program.

Whenever a bill is introduced before Parliament that has significant impact on the financial status of a public pension plan or social program falling under the statutory responsibilities of the Chief Actuary, the OCA must submit an actuarial report valuing this impact to the appropriate minister. The Chief Actuary submits these reports to the ministers of Finance, Social Development, Human Resources and Skills Development and to the President of the Treasury Board.



The OCA also provides the relevant government departments with actuarial advice on the design, funding and administration of these plans. OCA clients include Social Development, Finance, Treasury Board Secretariat, Human Resources and Skills Development, Public Works and Government Services, National Defense, Veterans Affairs, the RCMP and Justice Canada.

## *Developments*

The Office of the Chief Actuary is required by law to produce an actuarial report on the Canada Pension Plan (CPP) every three years. The report is one item considered by federal and provincial finance ministers when reviewing and making recommendations on the CPP every three years.

The 21<sup>st</sup> Actuarial Report on the Canada Pension Plan was completed this year and tabled in Parliament in December 2004. The report confirms the long-term viability and financial sustainability of the CPP. The report also confirms that the legislated 9.9% combined employer-employee contribution rate for 2004 and thereafter is expected to be sufficient to pay for future expenditures and to accumulate assets of more than \$140 billion by 2010 as larger numbers of Canadians reach retirement age.

In a past Federal-Provincial Review of the Canada Pension Plan, the ministers of Finance endorsed regular peer reviews of future actuarial reports and consultations by the Chief Actuary with experts on the assumptions to be used in actuarial reports. The Office of the Chief Actuary held seminars to get opinions from a wide range of experts in the fields of demography, economics and investments. These seminars as well as feedback from periodic independent reviews of the actuarial reports on the CPP provide the Office of the Chief Actuary with valuable input. These activities are part of the ongoing operation of the Office of the Chief Actuary.

As part of OSFI's policy of ensuring that Canadians and their Parliamentarians are provided with sound and relevant actuarial advice, a panel of three well-respected independent actuaries reviewed the 21<sup>st</sup> Actuarial Report on the Canada Pension Plan and their conclusions were made public in May 2005. The independent panel confirmed that the report was competently prepared, the assumptions used are reasonable and, as a result, the conclusions of the Chief Actuary that the CPP is financially stable are well supported. The independent review confirms that the work of the Chief Actuary meets professional standards of actuarial practice and fairly communicates the results. The quality of the reports and the timeliness of other actuarial reports and advice would not have been possible without the continual support, collaboration and commitment of all the staff of the OCA.

The Office of the Chief Actuary provides appropriate checks and balances on the future costs of the different pension plans that fall under its responsibilities.

The independent review also confirms that the OCA has adequate resources and access to data and other information required to fulfill its mandate. The review resulted in twelve recommendations dealing with various aspects of the report including data, methodology, communication of results and other actuarial issues. As it has done in the past, the OCA will study the recommendations and give them due consideration for future implementation.

To further enhance the credibility of the review process, the Chief Actuary agreed with a suggestion by the Auditor General to seek input from a foreign actuarial organization outside the federal government. Therefore, the OCA entered into an agreement with the United Kingdom Government Actuary's Department (GAD). GAD was asked to select the independent Canadian actuaries who would perform the peer review and to provide an opinion on the work done by the reviewers once the peer review was completed. In May 2004, a call for volunteers was issued, and the final panel of three was selected from ten applicants and announced in September 2004. The opinion of GAD, released in May 2005, considers the terms of reference of the independent peer review to be appropriate so that it addressed all the relevant issues necessary to perform an in-depth review of the actuarial work underlying the 21<sup>st</sup> Actuarial Report on the Canada Pension Plan.

This improved process establishes a precedent and provides Canadians with the utmost confidence that the highest standards of practice, including existing international standards, are being applied. The 21<sup>st</sup> Actuarial Report on the Canada Pension Plan, tabled in December 2004, as well as the independent peer review report released in May 2005, will both serve as the basis for the federal and provincial finance ministers' statutory three-year review of the Canada Pension Plan in 2005.

## RECOGNITION OF THE EXPERTISE AND DEDICATION OF OCA STAFF

The quality and timeliness of the OCA's reports and advice, as confirmed by the peer review panel for the CPP report, would not have been humanly possible without the continual support, collaboration and commitment of all the staff of the OCA. The peer review panel said "the professional experience of the staff was adequate for carrying the work required," and "the work was completed in compliance with the relevant professional standards of practice." These high standards are impossible to achieve without dedicated, expert staff.

The peer review panel also said "we are pleased to observe that there appears to be a program of staff recruiting and succession planning in place, and there is a mix of more experienced and newer personnel on the staff of the OCA." Recruitment in the OCA is working well; OSFI is seen as a good place to work.

*Source: The "Review of the Twenty-First Actuarial Report on the Canada Pension Plan conducted by the CPP Actuarial Review Panel" can be found on OSFI's web site.*

The OCA completed a number of other reports in 2004-2005, including actuarial reports on the pension plan for federally appointed judges, on the benefit plan financed through the RCMP (dependants) Pension Fund and on the Old Age Security program. These reports were subsequently tabled before Parliament. The OCA also completed its third actuarial review of the Canada Student Loans Program. The OCA completed its fourth actuarial study, "National Population Projections", which provides an estimate of the future size and composition of the population of Canada. This study was subsequently released in May 2005.

Other services provided by the OCA during the year included:

- Various expert witness reports before the CPP Review Tribunal and the Pension Appeals Board;
- Ongoing advice and support to the federal-provincial CPP committee;
- Public Accounts actuarial reports on the major public sector pension plans sponsored by the government including information used in the financial statements of the Public Service, Canadian Forces and RCMP pension plans;
- Public Accounts actuarial reports for the Public Service Health Care Plan and Pensioners' Dental Service Plan and assessment of the workers' compensation actuarial liability for the accounting of retirement and post-employment benefits under the government accrual accounting policies;
- Public Accounts actuarial report on Pension Act-related post-employment benefits for the Canadian Forces including war veterans;
- Ongoing advice to Veterans Affairs Canada on programs covering members of the Canadian Forces and war veterans;
- Ongoing advice to the Judicial Compensation and Benefits Commission;
- Ongoing advice to the Treasury Board Secretariat on group insurance plans covering federal government employees, Canadian Forces and members of the RCMP; and
- Ongoing advice and support given to the Canada Pension Plan Investment Board, the Public Sector Pension Investment Board and the Pension Advisory Committees of the Public Service, the Canadian Forces and the RCMP.

In 2005-2006, the OCA will continue its program of inter-disciplinary seminars with presentations from appropriate experts on relevant subjects to the preparation of future actuarial reports. The OCA will also maintain the tradition of continual improvements to the actuarial methods by applying more extensive and sophisticated stochastic analysis. The OCA will move forward with a new section in the actuarial report named "Uncertainty of Results". It is important that Canadians not only understand the Chief Actuary's best estimate of the future contribution rates to the CPP, but also appreciate the uncertainty necessarily involved in such estimates.

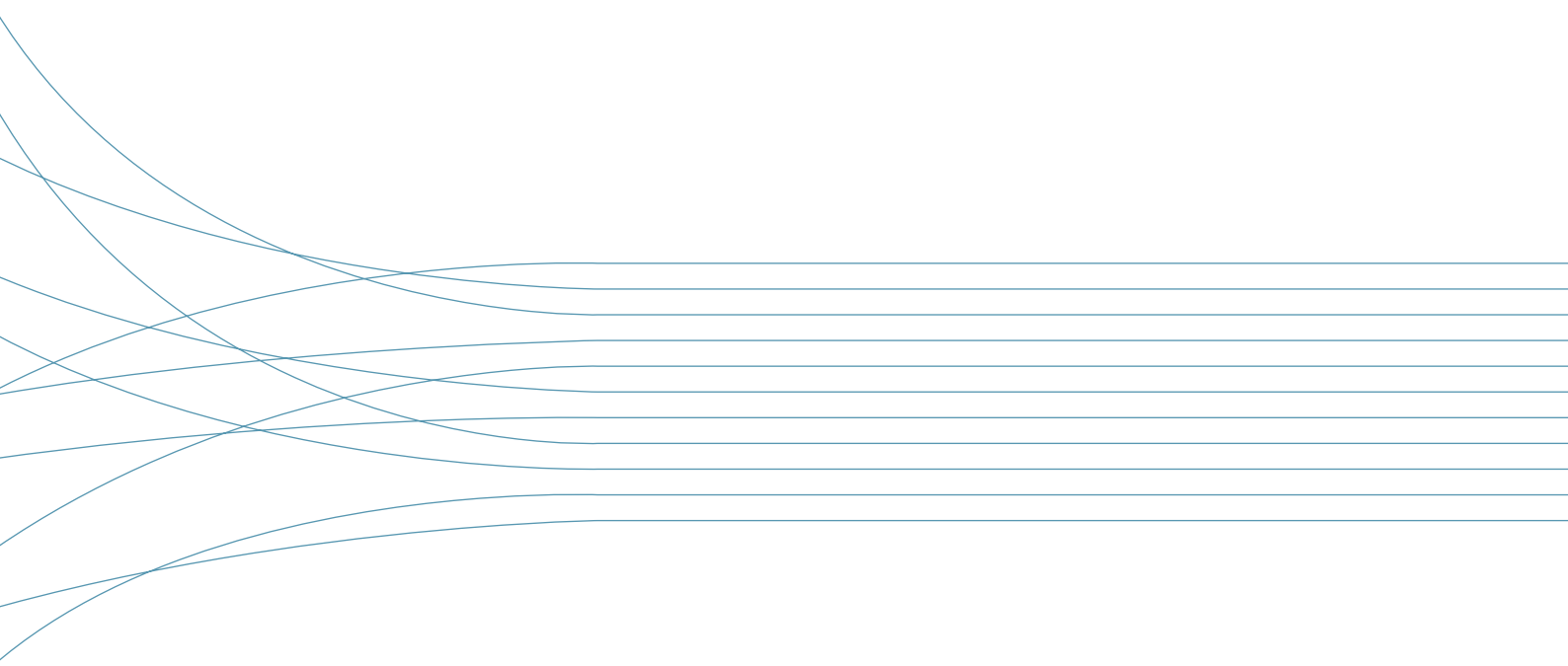
## KEEPING WATCH OVER THE INTERESTS OF CANADIANS

The Canada Pension Plan (CPP) provides protection to millions of Canadian workers and their families against the loss of income due to retirement, disability and death. In 2004, 4 million Canadians received CPP benefits, with a total value of approximately \$23.5 billion. These benefits included pensions, survivors and orphans benefits, and disability benefits. A further 11.7 million Canadian workers made contributions to the plan.

Canadians want to feel confident that the CPP will be able to meet their needs in future years. A key role of the Office of the Chief Actuary is to provide an independent opinion on the viability of the CPP. In 2004-2005, the OCA completed the [21<sup>st</sup> Actuarial Report on the Canada Pension Plan](#). The report confirms the long-term viability and financial sustainability of the CPP.

The costs of the CPP are covered by the financial contributions of employees, their employers and self-employed people, and by revenue from investments. In its report, the OCA confirmed that the legislated 9.9% combined employer-employee contribution rate for 2004 and thereafter is expected to be sufficient to pay for future expenditures and to accumulate assets of more than \$140 billion by 2010 as larger numbers of Canadians reach retirement age.

The approach and the conclusions of the Chief Actuary were validated by an independent peer review panel. The 21<sup>st</sup> Actuarial Report on the Canada Pension Plan and the peer review report will serve as the basis for the federal and provincial finance ministers' statutory three-year review of the CPP in 2005.





**FINANCIAL STATEMENTS**



## BUDGET AND ASSESSMENT HIGHLIGHTS

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OSFI recovers its costs from several revenue sources. The vast majority of OSFI's costs, which are for risk assessments and intervention (supervision), approvals and rule making, including related overhead costs, are charged to the financial institutions and private pension plans that OSFI regulates and supervises.

Highlights for the 2004-2005 budget, as compared to estimates, include:

- OSFI met its target, as communicated to financial industry associations, of keeping the overall increase in assessment fees under 7%. Total base assessments to financial institutions were in fact 2.5% lower than the estimates that had been communicated to industry, and represented a growth of 3.4% over the prior year.
- Assessments are differentiated to reflect the costs incurred by OSFI's activities related to each industry group. Base assessments on the P&C insurance sector increased by 6.5% from the prior year due to OSFI's increased monitoring of this sector's current recovery. Base assessments in the deposit-taking sector rose by 6.6% to reflect OSFI's increased activity in that sector due to more, and more complex, transactions and increased efforts on the New Capital Adequacy Framework (Basel II) implementation. Base assessments on the life insurance sector decreased by 4.2%.
- Surcharges to problem institutions were approximately 29% higher than estimates for the year due to a greater than planned number of staged institutions and longer periods of staging.
- A 30% increase in fees for applications for approval, to better reflect the actual cost of providing approvals, was implemented effective August 2004 (the second of a two-year phase-in).
- Actual expenses were 0.9% below budget estimates and up 2.7% over the prior year. The achievement of ongoing benefits from a technology/process reengineering initiative, shifts in the timing of capital projects, and a drop in the employee benefits rate set by Treasury Board contributed to lower than planned expenses. These reductions were partially offset by one-time restructuring costs.
- As a result of the business process reengineering initiative, OSFI reduced its maximum head count to 475 full-time equivalents in 2004 from 495 set in 2002. OSFI ended the year with a head count of 426.
- OSFI completed its Ottawa accommodation plan on time and on budget. Several business process reviews were completed in the Corporate Services sector, resulting in streamlined operations and head count reductions.





## FINANCIAL HIGHLIGHTS

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### *Background*

OSFI recovers its costs from several revenue sources.

The majority of costs related to risk assessment and intervention, approvals and rule making are recovered through base assessments and pension plan fees according to various formulas set out in regulations. The system is designed to allocate costs to industries based on the approximate amount of time spent supervising and regulating the industry. Costs are then assessed to individual institutions within an industry based on the applicable formula, with a minimum assessment for smaller institutions.

Specific user fees cover costs for certain approvals. Problem (staged) institutions are assessed a surcharge on their base assessment, approximating the extra supervision resources required. As a result, well-managed, lower-risk institutions and those with fewer approvals bear a smaller share of OSFI's costs.

OSFI also receives revenues for cost recovered services. These include revenues from the Canadian International Development Agency (CIDA) for international assistance, revenues from provinces for whom OSFI does supervision of their institutions on contract, and revenues from other federal agencies for whom OSFI provides administrative support. Starting in 2002-2003, cost recovered services revenue also included amounts charged separately to major banks for the implementation of the internal ratings-based approach of the New Capital Adequacy Framework – “Basel II”.

Overall, OSFI fully recovered all its expenses for the fiscal year 2004-2005.

Effective 2004-2005, OSFI modified its financial statement presentation and notes to align these with its Program Activity Architecture (PAA). The activity of international assistance is now presented separately from that of regulation and supervision of federally regulated financial institutions.

Effective 2002-2003, OSFI began collecting late and erroneous filing penalties from financial institutions that submit late and/or erroneous financial and non-financial returns. These penalties are billed quarterly, collected and remitted to the Consolidated Revenue Fund. By regulation, OSFI cannot use these funds to reduce the amount that it assesses the industry in respect of its operating costs.

The Office of the Chief Actuary is funded by fees charged for actuarial services and by a parliamentary appropriation.

### *Federally Regulated Financial Institutions*

#### **Revenues**

Base assessments to industry rose \$2.0 million, or 3.4%, for the year ended March 31, 2005. Revenue from user fees and charges decreased by \$0.8 million, or 11%, from the previous year, mainly due to lower surcharges as a result of a reduction in the number of problem institutions during the year.

User fees from approvals were slightly higher than the previous year. The coming into force, in August 2004, of the second of a two-year fee increase of 30% per year was partially offset by a decline in the number of approvals required. The phased-in increase in user fees was implemented to better reflect the actual cost of providing approvals and to apply a more equitable method of recovering costs.

Cost recovered services revenue from major banks related to implementing the internal ratings-based approach of the New Basel Capital Accord was \$2.5 million, consistent with the prior year.

### Expenses

Total expenses were \$68.7 million, a 1.3% increase from the previous year.<sup>1</sup>

The increase in human resources costs, the main driver of OSFI expenses, was the result of non-recurring restructuring costs and planned growth in employee compensation. During the year OSFI also increased its performance-related pay, which is available to employees at all levels within the organization. These increases were offset by a decrease in the employee benefits rate set by Treasury Board from 27.6% to 26.5%, and a reduction in the actual average number of full-time equivalent employees as a result of a hiring freeze during 2004-2005 in anticipation of the restructuring.

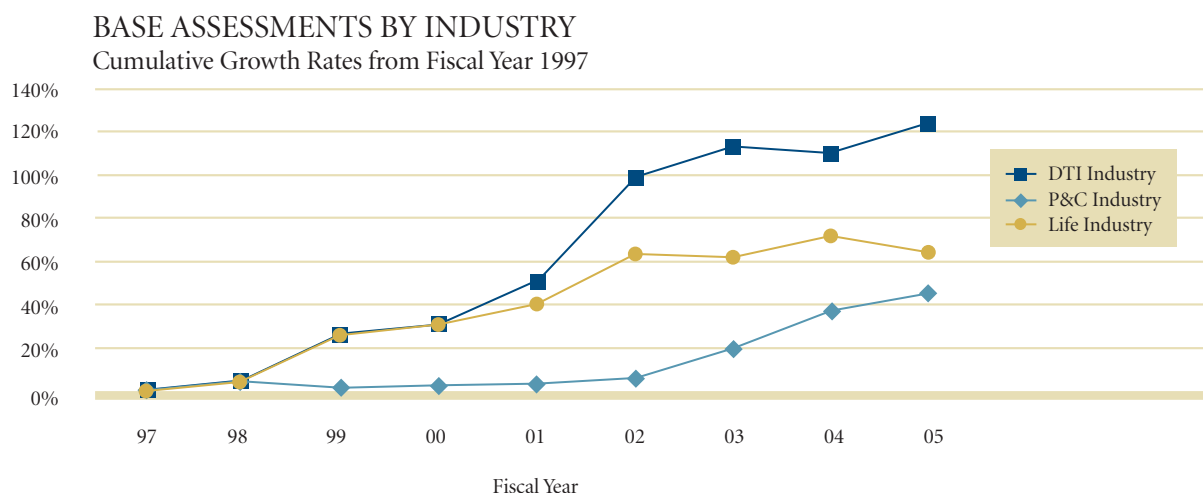
Benefits from a technology/process reengineering resulted in \$1.4 million of ongoing annual savings from the elimination of certain positions and vacancies that were no longer needed.

OSFI continued to implement its information management/technology plan and make related improvements to its business processes.

### Financial Institution Assessments by Industry

OSFI assessments are differentiated to reflect the costs incurred by each industry group. The chart below shows the growth of base assessments by industry group over the past eight years. Base assessments are the costs allocated to an industry, less specific fees for approvals and surcharges for problem institutions. Assessments for the P&C sector over this eight-year period rose less than for other industry sectors. Since 2002-2003, however, assessments on the P&C industry grew faster reflecting an increase in OSFI's time due to economic conditions and a greater number of staged institutions in this industry.

The increase in 2004-2005 base assessments to the deposit-taking industry reflects increased activity due to an increase in the number and complexity of transactions and increased efforts on parts of the New Capital Adequacy Framework – “Basel II”. The reduction in assessments to the life industry in 2004-2005 reflects the impact of consolidation among the major companies in this industry.



<sup>1</sup> Certain 2004 comparative figures have been reclassified to conform to the presentation adopted in 2005.

## Federally Regulated Private Pension Plans

### Fees Assessed

OSFI's costs for regulating and supervising pension plans are recovered from an annual fee charged to plans, based on the number of plan members. Plans are assessed a fee when applying for registration under the PBSA and when filing the Annual Information Return. Total fees assessed during the fiscal year ending March 31, 2005, were \$3.4 million, down from \$3.5 million a year earlier.

The fee rate is established based on OSFI's estimate of current year costs to supervise pension plans, adjusted for any excess or shortfall of fees in the preceding years. The estimate is then divided by the anticipated assessable membership to arrive at a per member fee. The rate established for fiscal year 2004-2005 was \$11 per assessable member, unchanged from the prior year.

The aforementioned excess or shortfall of fees in any particular year is amortized over five years in accordance with the fee formula set out in regulations. Past years' surpluses have historically kept fee rates down; in 2003-2004 and 2004-2005, however, OSFI incurred unplanned expenses related to problem pension plans that depleted the surplus position.

### Expenses

The cost of administering the PBSA for fiscal year 2004-2005 was \$4.9 million, up from \$4.3 million the previous year. This increase is largely driven by an increased focus on pension plan issues due to the higher number of "at-risk" pension plans. OSFI also staffed vacant positions during the period to enhance its supervision activities.

#### Fees Assessed and Expenses for Fiscal Years 1998-1999 to 2004-2005

(\$000, except Basic Fee Rate)

Year	1998-1999	1999-2000	2000-2001	2001-2002	2002-2003	2003-2004	2004-2005
Fees Assessed	2,347	3,875	3,765	3,332 <sup>1</sup>	3,270	3,549	3,444
Expenses	3,190	3,589	3,239	3,439	3,163	4,322	4,919
Basic Fee Rate <sup>2</sup> per Member	8.00	12.00	12.00	11.00	10.00	11.00	11.00

## International Assistance

Expenses for International Assistance increased by 34% in 2004-2005. The increase from the prior year is mainly attributed to the allocation of indirect costs to this activity to reflect its fully loaded cost. Revenues from the Canadian International Development Agency for this activity cover approximately two-thirds of its costs; the difference is funded by base assessments from federally regulated financial institutions.

## Office of the Chief Actuary

The Office of the Chief Actuary (OCA) is funded by fees charged for actuarial services and by an annual parliamentary appropriation. The increase from the prior year in the expenses of the OCA is mainly attributed to planned growth in employee compensation.

<sup>1</sup> Restated from \$3,439 to report fees assessed on a cash basis.

<sup>2</sup> The minimum and maximum annual assessment per plan is derived by multiplying the annual assessment by 20 and 10,000 respectively. With an annual assessment of \$11.00 per member, the minimum annual assessment is \$220 and the maximum is \$110,000.



## MANAGEMENT'S RESPONSIBILITY FOR THE FINANCIAL STATEMENTS

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Responsibility for the integrity and objectivity of the accompanying financial statements and the consistency with all other information contained in this annual report rests with OSFI management.

These financial statements, which include amounts based on management's best estimates as determined through experience and judgement, have been prepared in accordance with Canadian generally accepted accounting principles. Management has developed and maintained books of accounts, records, internal controls, management practices, and information systems designed to provide reasonable assurance that assets are safeguarded and controlled, resources are managed economically and efficiently in the attainment of corporate objectives, and transactions are in accordance with the *Financial Administration Act* and regulations and with OSFI policies and statutory requirements.

The Auditor General of Canada, the independent auditor for the Government of Canada, has audited the transactions and financial statements of OSFI and reports on her audit to the Minister of Finance.



**Nicholas Le Pan**  
Superintendent



**Donna Pasteris**  
Assistant Superintendent  
Corporate Services

Ottawa, Canada  
May 27, 2005



## AUDITOR'S REPORT

To the Minister of Finance

I have audited the statement of financial position of the Office of the Superintendent of Financial Institutions as at March 31, 2005 and the statements of operations and equity of Canada and cash flows for the year then ended. These financial statements are the responsibility of the management of the Office of the Superintendent of Financial Institutions. My responsibility is to express an opinion on these financial statements based on my audit.

I conducted my audit in accordance with Canadian generally accepted auditing standards. Those standards require that I plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In my opinion, these financial statements present fairly, in all material respects, the financial position of the Office of the Superintendent of Financial Institutions as at March 31, 2005 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

Douglas G. Timmins, CA  
Assistant Auditor General  
for the Auditor General of Canada

Ottawa, Canada  
May 27, 2005

## STATEMENT OF FINANCIAL POSITION

As at March 31, 2005 with comparative figures for the year ended March 31, 2004  
(in thousands of dollars)

<b>ASSETS</b>			
	<b>Note</b>	<b>2005</b>	<b>2004</b>
<b>Assets</b>			
Cash Entitlement		\$ 30,969	\$ 40,031
Accounts Receivable	5	11,567	5,745
Accrued Pension Plan Fees		1,155	–
Accrued Base Assessments		846	1,388
Capital Assets	4	9,819	5,072
<b>TOTAL ASSETS</b>		<b>\$ 54,356</b>	<b>\$ 52,236</b>
<b>LIABILITIES AND EQUITY OF CANADA</b>			
	<b>Note</b>	<b>2005</b>	<b>2004</b>
<b>Liabilities</b>			
Accrued Salaries and Benefits		\$ 11,305	\$ 10,316
Accounts Payable and Accrued Liabilities	5	5,857	4,225
Unearned Base Assessments		2,420	2,914
Unearned Private Pension Plan Revenue		–	267
Other Unearned Revenue		542	452
Employee Future Benefits other than Pension	6	6,694	6,524
		<b>\$ 26,818</b>	<b>\$ 24,698</b>
<b>Equity of Canada</b>		<b>27,538</b>	<b>27,538</b>
<b>TOTAL LIABILITIES &amp; EQUITY OF CANADA</b>		<b>\$ 54,356</b>	<b>\$ 52,236</b>

Commitments and Contingencies 12



**NICHOLAS LE PAN**  
Superintendent of Financial Institutions

The accompanying notes are an integral part of the financial statements.



# STATEMENT OF OPERATIONS AND EQUITY OF CANADA

For the year ended March 31, 2005 with comparative figures for the year ended March 31, 2004  
(in thousands of dollars)

	Note	2005	2004
<b>Regulation and Supervision of Federally Regulated Financial Institutions</b>			
Revenue	10	\$ 69,227	\$ 67,957
Expenses	10,11	68,657	67,795
Net Results before Filing Penalties		570	162
Filing Penalties	8	365	211
Net Results		935	373
<b>Regulation and Supervision of Federally Regulated Private Pension Plans</b>			
Revenue	10	4,919	4,322
Expenses	10,11	4,919	4,322
Net Results		–	–
<b>International Assistance</b>			
Revenue	10	1,211	992
Expenses	10,11	1,781	1,332
Net Results		(570)	(340)
<b>Office of the Chief Actuary of Canada</b>			
Revenue	10	3,253	3,119
Expenses	10,11	3,977	3,831
Net Results		(724)	(712)
<b>NET RESULTS OF OPERATIONS BEFORE GOVERNMENT FUNDING</b>		<b>(359)</b>	<b>(679)</b>
Government Funding	7	724	890
<b>NET RESULTS OF OPERATIONS FOR THE YEAR</b>		<b>365</b>	<b>211</b>
<b>EQUITY OF CANADA, BEGINNING OF YEAR</b>		<b>27,538</b>	<b>27,538</b>
Filing Penalties Earned on Behalf of the Government	8	(365)	(211)
<b>EQUITY OF CANADA, END OF YEAR</b>		<b>\$ 27,538</b>	<b>\$ 27,538</b>

The accompanying notes are an integral part of the financial statements.

## STATEMENT OF CASH FLOWS

For the year ended March 31, 2005 with comparative figures for the year ended March 31, 2004  
(in thousands of dollars)

	Note	2005	2004
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>			
Cash Receipts from Financial Institutions, Pension Plans and Other Government Departments		\$ 76,252	\$ 87,546
Cash Paid to Suppliers and Employees		(77,626)	(99,840)
Payments and Receipts in respect of Insurance Company Liquidations (Net)	9	59	19,519
Filing Penalties Remitted to the Consolidated Revenue Fund	8	(365)	(567)
<b>Net Cash Provided by (Used in) Operating Activities</b>		<b>(1,680)</b>	<b>6,658</b>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>			
Acquisition of Capital Assets	4	(7,382)	(2,142)
<b>Net Cash Used in Investing Activities</b>		<b>(7,382)</b>	<b>(2,142)</b>
<b>NET INCREASE (DECREASE) IN CASH ENTITLEMENT</b>		<b>(9,062)</b>	<b>4,516</b>
<b>CASH ENTITLEMENT AT BEGINNING OF YEAR</b>		<b>40,031</b>	<b>35,515</b>
<b>CASH ENTITLEMENT AT END OF YEAR</b>		<b>\$ 30,969</b>	<b>\$ 40,031</b>

The accompanying notes are an integral part of the financial statements.



# NOTES TO THE FINANCIAL STATEMENTS

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For the year ended March 31, 2005

## 1. *Authority and objectives*

### ***Mandate***

The Office of the Superintendent of Financial Institutions (OSFI) was established by the *Office of the Superintendent of Financial Institutions Act* (OSFI Act) in 1987. Pursuant to the *Financial Administration Act* (FAA), OSFI is a department of the Government of Canada for the purposes of that Act and is listed in schedule I.1 of the Act.

In 1996, OSFI subsequently received a legislated mandate that clarified its objectives in the regulation and supervision of federal financial institutions and private pension plans. Under the legislation, OSFI's mandate is to:

- Supervise federally regulated financial institutions<sup>1</sup> (FRFIs) and private pension plans to determine whether they are in sound financial condition and meeting minimum plan funding requirements respectively, and are complying with their governing law and supervisory requirements;
- Promptly advise institutions and plans in the event there are material deficiencies and take, or require management, boards or plan administrators to take, necessary corrective measures expeditiously;
- Advance and administer a regulatory framework that promotes the adoption of policies and procedures designed to control and manage risk;
- Monitor and evaluate system-wide or sectoral issues that may impact institutions negatively.

In meeting this mandate, OSFI contributes to public confidence in the financial system.

### ***Strategic outcomes and activities***

Primary to OSFI's mission and central to its contribution to Canada's financial system are two strategic outcomes:

1. *To regulate and supervise to contribute to public confidence in Canada's financial system and safeguard from undue loss.* OSFI safeguards depositors, policyholders and private pension plan members by enhancing the safety and soundness of federally regulated financial institutions and private pension plans.
2. *To contribute to public confidence in Canada's public retirement income system.* This is achieved through the activities of the Office of the Chief Actuary, which provides accurate, timely advice on the state of various public pension plans and on the financial implications of options being considered by policy makers.

<sup>1</sup> A federally regulated financial institution is any entity that has been created or is allowed to offer financial services pursuant to one of the financial institution statutes promulgated by the federal government and includes banks, trust and loan companies, federally registered insurance companies, fraternal benefit societies, cooperative credit associations, and pension plans.

Three *business activities* support OSFI's first strategic outcome to regulate and supervise financial institutions and pension plans so as to contribute to public confidence.

1. *Regulation and supervision of federally regulated financial institutions*

This program activity is central to the achievement of OSFI's mandate to protect the rights and interests of depositors and policyholders and advance a regulatory framework that contributes to public confidence in the Canadian financial system. The three basic elements of this program are:

- *Risk assessment and intervention* includes activities to monitor and supervise financial institutions, monitor the financial and economic environment to identify emerging issues and intervene in a timely way to protect depositors and policyholders, while recognizing that all failures cannot be prevented.
- *Rule making* encompasses the issuance of guidance and regulations, input into federal legislation affecting financial institutions, contributions to accounting, auditing and actuarial standards, and involvement in a number of international rule-making activities.
- *Approvals* of certain types of actions or transactions undertaken by regulated financial institutions. This covers two distinct types of approvals: those required under the legislation applying to financial institutions and approvals for supervisory purposes.

2. *Regulation and supervision of federally regulated private pension plans*

This program activity incorporates risk assessment, intervention, rule making and approvals related to federally regulated private pension plans under the *Pension Benefits Standards Act, 1985*.

3. *International assistance*

OSFI supports initiatives of the Canadian Government to assist emerging market economies to strengthen their regulatory and supervisory systems. This program incorporates activities related to providing help to other selected countries that are building their supervisory and regulatory capacity. This program is largely funded by the Canadian International Development Agency, and is carried out directly by OSFI and through its participation in the Toronto International Leadership Centre for Financial Sector Supervision. This involvement is of benefit to financial institutions to the extent that it strengthens the financial-system regulatory and supervisory regimes in those jurisdictions where Canadian institutions operate, leads to similar oversight of companies that are competing in the marketplace, and strengthens bonds between Canada and jurisdictions in which Canadian institutions wish to expand.

OSFI's second strategic outcome – to contribute to public confidence in Canada's public retirement income system – is achieved through the activities of the Office of the Chief Actuary (OCA).

The OCA provides a range of actuarial services, under the *Canada Pension Plan Act* and the *Public Pensions Reporting Act* to the Canada Pension Plan (CPP) and some federal government departments, including the provision of expert and timely advice in the form of reports tabled in Parliament. The basic elements of this program are:

1. *Canada Pension Plan and Old Age Security*

The OCA estimates long-term expenditures, revenues and current liabilities of the CPP and federal public-sector pension and insurance plans, long-term future expenditures for Old Age Security programs, and prepares statutory triennial actuarial reports on the financial status of these programs.

2. *Other Public Pension Plans*

The OCA prepares statutory triennial actuarial reports on the financial status of federal public sector employee pension and insurance plans covering the federal Public Service, the Canadian Armed Forces, the Royal Canadian Mounted Police, federally appointed judges and Members of Parliament.

3. *Canada Student Loans*

Since 2001, the OCA undertakes the actuarial review of the Canada Student Loans Program by evaluating the portfolio of loans and the long-term costs of the program.

## ***Additional legislative references***

In addition to the Acts referred to above, OSFI has responsibilities under the following legislation:

- *Bank Act*;
- *Cooperative Credit Associations Act*;
- *Green Shield Canada Act*;
- *Insurance Companies Act*;
- *Trust and Loan Companies Act*; and
- *Pension Benefits Standards Act, 1985*.

## ***2. Revenue and spending authority***

Pursuant to section 17 of the OSFI Act, the Minister of Finance may spend any revenues collected under sections 23 and 23.1 of the OSFI Act to defray the expenses associated with the operation of OSFI. The Act also establishes a ceiling for expenses at \$40 million above the amount of revenue collected.

OSFI's revenues are comprised of assessments, service charges, and fees. The expenses against which assessments may be charged include those in connection with the administration of the *Bank Act*, the *Cooperative Credit Associations Act*, the *Green Shield Canada Act*, the *Insurance Companies Act*, and the *Trust and Loan Companies Act*. The formula for the calculation of assessments is included in regulations.

The *Pension Benefits Standards Act, 1985* (PBSA, 1985) provides that fees may be charged for the registration and supervision of private pension plans and for the supervision, including inspection, of registered pension plans. The amount of the fees is set annually by regulation pursuant to Section 39 of the PBSA, 1985.

Section 23.1 of the OSFI Act provides that the Superintendent may assess against a person a prescribed charge ("service charge") and applicable disbursements for any service provided by or on behalf of the Superintendent for the person's benefit or the benefit of a group of persons of which the person is a member. "Person" includes individuals, corporations, funds, unincorporated associations, Her Majesty in Right of Canada or of a province, and a foreign government. The service charges are detailed in the regulations.

Pursuant to section 16 of the OSFI Act, Parliament annually provides appropriations to support the operations of the Office of the Chief Actuary.

## ***3. Significant accounting policies***

### ***a) Basis of presentation***

The financial statements of OSFI have been prepared in accordance with Canadian generally accepted accounting principles.

### ***b) Revenue recognition***

OSFI matches its revenue to its operating costs. Any amounts that have been billed and for which costs have not been incurred are classified as unearned revenue on the statement of financial position. Revenue is recorded in the accounting period in which it is earned whether or not it has been billed or collected. At March 31 of each year, amounts may have been collected in advance of the incurrence of costs or, alternatively, amounts may be owed to OSFI.

Base assessments are billed annually based on an estimate of the current fiscal year's operating costs (an interim assessment) together with a final accounting of the previous year's assessment for actual costs incurred. Assessments are calculated prior to December 31 of each year, in accordance with Section 23(1) of the *OSFI Act* and the *Assessment of Financial Institutions Regulations, 2001*.

Cost recovered services represent revenue earned from services provided in accordance with the terms and conditions set out in specific Memoranda of Understanding.

Pension plan fees are earned from registered pension plans. Fee rates are set annually by regulation based on budgeted expenses, forecast pension plan membership and actual results from the previous year. Pension plan fees are charged in accordance with the *Pension Benefits Standards Regulations, 1985*.

User fees and charges include revenue earned pursuant to the *Charges for Services Provided by the Office of the Superintendent of Financial Institutions Regulations 2002* – as amended from time to time – in respect of legislative approvals and approvals for supervisory purposes, and surcharges assessed to federally regulated financial institutions assigned a “stage” rating pursuant to the Guide to Intervention for Federal Financial Institutions. Assessment surcharges are charged in accordance with the *Assessment of Financial Institutions Regulations, 2001*.

Filing penalties are penalties levied against financial institutions when they submit late and/or erroneous financial and corporate returns due to OSFI. Penalties levied are not available to reduce the net costs that OSFI assesses the industry (are non-respensible) and are remitted to the Consolidated Revenue Fund. Filing penalties are charged in accordance with the *Filing Penalties (Office of the Superintendent of Financial Institutions) Regulations*.

### ***c) Cash entitlement***

OSFI does not have its own bank account. The financial transactions of OSFI are processed through the Consolidated Revenue Fund (CRF) of Canada. OSFI's cash entitlement represents the amount OSFI is entitled to withdraw from the CRF without further authority. This amount does not earn interest.

### ***d) Capital assets***

Capital assets are recorded at historical cost less accumulated amortization. Amortization is recorded using the straight-line method over the estimated useful lives of the assets as follows:

<b>Assets</b>	<b>Useful Life</b>
Leasehold Improvements	Remaining life of the lease
Furniture and Fixtures	7 years
Office Equipment	4 years
Informatics Hardware	3 years
Informatics Infrastructure (Networks)	3 years
Informatics Software	5 years

### ***e) Employee future benefits***

#### **(i) Pension benefits**

OSFI's eligible employees participate in the Public Service Pension Plan administered by the Government of Canada. Both the employees and OSFI contribute to the cost of the Plan. OSFI's contribution amount is currently based on a multiple of the employee's required contributions, and may change over time



depending on the experience of the Plan. These contributions represent the total pension obligations of OSFI and are charged to operations on a current basis. OSFI is not required under present legislation to make contributions with respect to any actuarial deficiencies of the Public Service Pension Plan.

**(ii) Severance benefits**

On termination of employment, employees are entitled to certain benefits provided for under their conditions of employment through a severance benefits plan. The cost of these benefits is accrued as the employees render their services necessary to earn severance benefits. These benefits represent the only obligation of OSFI that entails settlement by future payment.

The cost of benefits is actuarially determined as at March 31 of each year using the projected benefit method prorated on services. The valuation of the liability is based upon a current market discount rate and other actuarial assumptions, which represent management's best long-term estimates of factors such as future wage increases and employee resignation rates. The excess of any net actuarial gain (loss) over 10% of the benefit obligation is amortized over the average remaining service period of active employees.

***f) Specified purpose account for insurance company liquidations***

OSFI has an interest-bearing, specified purpose account (note 9) within the Consolidated Revenue Fund for insurance company liquidations. Prior to amendments to the *Winding-up and Restructuring Act*, OSFI acted as liquidator of failed insurance companies when appointed by Court Order. Under these circumstances, the Superintendent hired agents to carry out the liquidation work in each case. Section 23.3 of the *Winding-Up and Restructuring Act*, which came into force in 1996, established that the Superintendent can no longer be appointed as liquidator of a failed institution.

In its capacity as liquidator, OSFI pays, on behalf of the remaining active institutions, all expenses related to the liquidation, and then recovers these costs from active institutions pursuant to the *Insurance Companies Act*. Where liquidated companies distribute assets to the Superintendent, these assets are distributed back to the remaining active institutions that paid the costs of liquidation. Accordingly, the revenues and expenses, recoveries and distributions related to this account are not included in the Statement of Operations and Equity of Canada.

***g) Use of estimates***

These financial statements are prepared in conformity with Canadian generally accepted accounting principles, which require that OSFI management makes estimates and assumptions that affect the amounts reported in these financial statements. Liabilities related to human resources and the useful lives of capital assets are the most significant items for which estimates are used. Actual results could differ from those estimates.

**4. Capital assets**

Category	Gross Book Values			Accumulated Amortization			Net Book Values	
	Opening Balance	Additions (net)	Closing Balance	Opening Balance	Amortization Expense (net)	Closing Balance	2005	2004
Leasehold Improvements	\$ 1,970	\$ 3,721	\$ 5,691	\$ 1,384	\$ 436	\$ 1,820	\$ 3,871	\$ 586
Furniture and Fixtures	1,586	1,488	3,074	1,053	268	1,321	1,753	533
Office Equipment	351	152	503	273	71	344	159	78
Informatics Hardware	2,127	517	2,644	1,616	339	1,955	689	511
Informatics Infrastructure	2,960	153	3,113	2,114	556	2,670	443	846
Informatics Software	6,845	1,351	8,196	4,327	965	5,292	2,904	2,518
<b>Total</b>	<b>\$ 15,839</b>	<b>\$ 7,382</b>	<b>\$ 23,221</b>	<b>\$ 10,767</b>	<b>\$ 2,635</b>	<b>\$ 13,402</b>	<b>\$ 9,819</b>	<b>\$ 5,072</b>

## 5. *Related party transactions*

OSFI is related in terms of common ownership to all Government of Canada departments, agencies and crown corporations. OSFI enters into transactions with these entities in the normal course of business and on normal trade terms.

OSFI recorded expenses of \$19,702 thousand (2004: \$16,061 thousand) and revenue of \$4,752 thousand (2004: \$4,661 thousand) from transactions in the normal course of business with other government departments during the year.

As at March 31, accounts receivable and payable with other government entities and unrelated external parties were as follows:

(\$ thousands)		Related Parties	External Parties	Total
2005	Accounts Receivable	577	10,990	11,567
	Accounts Payable and Accrued Liabilities	1,922	3,935	5,857
2004	Accounts Receivable	59	5,686	5,745
	Accounts Payable and Accrued Liabilities	1,353	2,872	4,225

## 6. *Employee future benefits*

### a) *Pension benefits*

OSFI and all eligible employees contribute to the Public Service Pension Plan. This pension plan provides benefits based on years of service and average earnings at retirement. The benefits are fully indexed to the increase in the Consumer Price Index. The estimated employer contributions to the Public Service Pension Plan during the year were \$5,798 thousand (2004: \$5,696 thousand).

### b) *Severance benefits*

Information about OSFI's severance benefit plan is presented in the table below.

(\$ thousands)	2005	2004
Accrued benefit obligation, beginning of year	\$ 6,497	\$ 5,903
Current service cost	555	506
Interest cost	386	368
Benefits paid	(772)	(297)
Actuarial loss	350	17
Accrued benefit obligation, end of year (1)	7,016	6,497
Unamortized net actuarial loss (gain)	(322)	27
<b>Accrued Benefit Liability</b>	<b>\$ 6,694</b>	<b>\$ 6,524</b>
Net benefit plan expense		
Current service cost	555	506
Interest cost	386	368
Amortization of net actuarial loss (2)	—	—
<b>Benefit Expense</b>	<b>\$ 941</b>	<b>\$ 874</b>

1. The accrued benefit obligation is not funded as funding is provided when benefits are paid. Accordingly, there are no plan assets.
2. The amortization period is the remaining average service period of active employees.

The significant actuarial assumption adopted in measuring OSFI's accrued benefit obligation is a discount rate of 5.13% (2004 – 6.05%).

For measurement purposes, management's best estimate for the general salary increases to estimate the current service cost and the accrued benefit obligation as at March 31, 2005 is an annual economic increase of 2.5% for the plan year 2006 (2004 – 2.5% for the plan year 2005). Thereafter, an annual economic increase of 2.9% is assumed (2004 – 3%). The average remaining service period of active employees covered by the benefit plan is 11 years (2004 – 11 years).

## 7. *Government funding*

OSFI receives an annual parliamentary appropriation pursuant to section 16 of the OSFI Act to support its mandate relating to the Office of the Chief Actuary. In this fiscal year, OSFI was granted \$724 thousand (2004: \$890 thousand). The parliamentary appropriation for the prior year was composed of a \$712 thousand appropriation to defray the expenses associated with the provision of services by the Office of the Chief Actuary and a non-recurring appropriation of \$178 thousand to be applied to activities consistent with the government Modern Comptrollership initiative.

## 8. *Filing penalties*

On April 1, 2002, OSFI's filing penalty regulations came into force in accordance with the OSFI Act. Penalties are levied quarterly to financial institutions when they submit late and/or erroneous financial and corporate returns due to OSFI during the preceding calendar quarter. Penalties levied by OSFI are non-responsible and are to be remitted to the Consolidated Revenue Fund. The funds are not available to OSFI and are not included in the balance of the Cash Entitlement. As a result, the penalties do not reduce the amount that OSFI assesses the industry in respect of its operating costs.

During 2004-2005, OSFI levied \$365 thousand (2004: \$211 thousand) in late and erroneous filing penalties.

## 9. *Specified purpose account for insurance company liquidations*

During the year, the following activity occurred in this account:

(\$ thousands)	2005	2004
Opening Balance	\$ 59	\$19,578
Recoveries deposited	37	–
Interest earned	–	480
Distribution of assets from liquidated estates	(416)	(20,595)
Other transactions in respect of liquidation expenses	320	596
<b>Closing Balance</b>	<b>\$ –</b>	<b>\$ 59</b>
Remaining insurance company liquidations under control of the Superintendent	<b>8</b>	<b>8</b>

## 10. Segmented information

### Revenue by Business Activity

	2005					2004				
	Base Assessments	Cost Recovered Services	Pension Plan Fees	User Fees and Charges	Total	Base Assessments	Cost Recovered Services	Pension Plan Fees	User Fees and Charges	Total
Regulation and Supervision of Federally Regulated Financial Institutions	\$ 60,171	\$ 3,157	\$ –	\$ 5,899	\$ 69,227	\$ 58,166	\$ 3,136	\$ –	\$ 6,655	\$ 67,957
Regulation and Supervision of Federally Regulated Private Pension Plans		52	4,867		4,919			4,322		4,322
International Assistance		1,211			1,211		972		20	992
Office of the Chief Actuary		3,209		44	3,253		3,032		87	3,119
<b>TOTAL REVENUE</b>	<b>\$ 60,171</b>	<b>\$ 7,629</b>	<b>\$ 4,867</b>	<b>\$ 5,943</b>	<b>\$ 78,610</b>	<b>\$ 58,166</b>	<b>\$ 7,140</b>	<b>\$ 4,322</b>	<b>\$ 6,762</b>	<b>\$ 76,390</b>

### Expenses by Business Activity

	2005	2004
<b>Regulation and Supervision of Federally Regulated Financial Institutions</b>		
Risk Assessment and Intervention	\$ 48,659	\$ 48,304
Rule Making	13,829	13,290
Approvals	6,169	6,201
<b>Total</b>	<b>68,657</b>	<b>67,795</b>
<b>Regulation and Supervision of Federally Regulated Private Pension Plans</b>	<b>4,919</b>	<b>4,322</b>
<b>International Assistance</b>	<b>1,781</b>	<b>1,332</b>
<b>Office of the Chief Actuary</b>		
Canada Pension Plan and Old Age Security	1,360	1,141
Public Pension Plans	2,059	2,146
Canada Student Loans Program	558	544
<b>Total</b>	<b>3,977</b>	<b>3,831</b>
<b>TOTAL EXPENSES</b>	<b>\$ 79,334</b>	<b>\$ 77,280</b>

## 11. Revenue and expenses by major classification

(\$ thousands)	For the year ended March 31				
	2005	2004	2003	2002	2001
<b>Revenue</b>					
Base Assessments	\$ 60,171	\$ 58,166	\$ 56,460	\$ 53,497	\$ 43,175
Cost Recovered Services	7,629	7,140	6,266	3,405	1,733
Pension Plan Fees	4,867	4,322	3,155	3,434	3,765
User Fees and Charges	5,943	6,762	4,221	3,089	3,629
<b>Total Revenue Earned from Respendable Sources</b>	<b>78,610</b>	<b>76,390</b>	<b>70,101</b>	<b>63,425</b>	<b>52,302</b>
Non-Respendable Filing Penalties Revenue	365	211	710	–	–
<b>Total Revenue</b>	<b>78,975</b>	<b>76,601</b>	<b>70,811</b>	<b>63,425</b>	<b>52,302</b>
<b>Expenses</b>					
Human Resources	57,488	55,801	52,215	48,853	40,185
Information Management / Technology	7,972	8,129	5,519	3,144	3,149
Facilities	5,789	5,109	5,098	4,878	4,392
Travel	2,998	2,860	2,953	2,281	2,152
Administration	2,512	2,444	2,059	2,402	2,407
Professional Services	1,553	1,683	1,237	1,298	1,001
Professional Development	1,062	1,254	1,727	1,537	1,387
<b>Total Expenses</b>	<b>79,334</b>	<b>77,280</b>	<b>70,808</b>	<b>64,393</b>	<b>54,673</b>
<b>Net Results of Operations before Government Funding</b>	<b>(359)</b>	<b>(679)</b>	<b>3</b>	<b>(968)</b>	<b>(2,371)</b>
Government Funding	724	890	707	917	2,173
<b>Net Results of Operations Including Non-Respendable Filing Penalties Revenue</b>	<b>365</b>	<b>211</b>	<b>710</b>	<b>(51)</b>	<b>(197)</b>
Non-Respendable Filing Penalties Revenue Earned on Behalf of the Government	(365)	(211)	(710)	–	–
<b>NET RESULTS OF OPERATIONS</b>	<b>\$ –</b>	<b>\$ –</b>	<b>\$ –</b>	<b>\$ (51)</b>	<b>\$ (197)</b>
<b>AVERAGE NUMBER OF EMPLOYEES</b>	<b>453</b>	<b>466</b>	<b>454</b>	<b>419</b>	<b>398</b>

## 12. *Commitments and contingencies*

### *a) Commitments*

OSFI has entered into lease agreements for office space and office equipment in four locations across Canada. The minimum aggregate annual payments for future fiscal years are as follows:

(\$ thousands)

2005-2006	\$	4,610
2006-2007		4,503
2007-2008		4,480
2008-2009		4,285
2009-2010		2,106
	\$	<b>19,984</b>

### *b) Contingencies*

OSFI is involved in claims and litigation for which provisions have been made to the extent determinable.

## 13. *Comparative figures*

Certain 2004 comparative figures have been reclassified to conform to the presentation adopted in 2005.



## Appendix 1

### *Disclosure of Information*

Under the *Office of the Superintendent of Financial Institutions Act*, the Superintendent is required to report to Parliament each year on the disclosure of information by financial institutions and the state of progress made in enhancing the disclosure of information in the financial services industry.

OSFI contributes to and promotes effective disclosure by publishing selected financial information on OSFI's web site and through Beyond 20/20 Inc.; by providing guidance to institutions on their disclosure practices; and by participating in international supervisory groups with similar objectives.

In the past few years, OSFI issued separate disclosure guidelines for deposit-taking institutions, life insurance companies and P&C insurance companies, setting out minimum requirements for information disclosure on financial, risk management and control practices. These requirements supplement disclosures required by the Canadian Institute of Chartered Accountants' (CICA) Handbook under generally accepted accounting principles and other OSFI guidelines. OSFI intends to revisit its disclosure guidelines over the next year due to the new Financial Instruments Accounting Standards which will become effective for the 2007 fiscal year.

OSFI is currently involved in developing the Life-1 reporting forms and accompanying instructions which will enhance financial statement disclosures by life insurers. Other domestic efforts in insurance include OSFI's work with the Canadian Institute of Actuaries (CIA) in developing a model for annual disclosure of gains and losses by source, and participation in the development of guidance issued by the CIA on the methodology of these calculations. In 2004, OSFI issued a new guideline which requires public disclosure of the source of earnings by Canadian life insurance companies for their 2004 fiscal year. Embedded value disclosure is already a reporting feature of several large Canadian life insurers.

Internationally, OSFI has been active on several fronts in enhancing disclosures:

- OSFI continues to participate as a leading member country in issues related to the New Capital Adequacy Framework (Basel II) of which Pillar III – Market Discipline will require enhanced disclosures by banks of capital and risk management practices. During the past year OSFI has been working with industry to implement these changes.
- Through its participation in the Basel Committee on Banking Supervision, OSFI has been active in the work of the International Accounting Standards Board (IASB) on the Fair Value Option of the Financial Instruments Standard and related disclosure requirements on financial instruments. The Canadian Accounting Standards Board has noted the benefit of the IASB's additional disclosure and is looking at possibly including the Fair Value Option.

OSFI actively monitors and provides input on the work of the Enhanced Disclosure Subcommittee of the International Association of Insurance Supervisors (IAIS). The Enhanced Disclosure Subcommittee is charged with drafting standards and guidance papers aimed at enhancing the standards of disclosure by insurance enterprises.

In October 2004, the IAIS issued a final standard entitled "Standard on Disclosures Concerning Technical Performance and Risks for Non-life Insurers and Reinsurers". Throughout the year the subcommittee was developing a new standard entitled "Standard on Disclosures Concerning Investment Performance and Risks for Insurers and Reinsurers". This standard is expected to be final in October 2005.

## Appendix 2

### Financial Institutions and Pension Plans Regulated by OSFI

	Number <sup>1</sup>	Assets <sup>2,3</sup> (\$ Millions)
<b>Banks</b>		
Domestic	19	1,796,712
Foreign Bank Subsidiaries	27	102,686
Foreign Bank Branches	22	36,240
<b>Trust and Loan Companies</b>		
Bank-owned	32	194,805
Other	34	14,383
<b>Cooperative Credit Associations</b>	7	12,035
<b>Life Insurance Companies</b>		
Canadian-incorporated	42	347,511
Foreign Branches	53	19,396
<b>Fraternal Benefit Societies</b>		
Canadian-incorporated	12	5,891
Foreign Branches	9	1,401
<b>Property and Casualty Insurance Companies</b>		
Canadian-incorporated	90	60,870
Foreign Branches	97	23,987
<b>Pension Plans</b>	1,284	104,190

<sup>1</sup> Number of regulated companies as at 31 March 2005. Includes institutions in the process of liquidation or termination and institutions limited to servicing existing business. A list of institutions regulated by OSFI can be found on OSFI's web site at [www.osfi-bsif.gc.ca](http://www.osfi-bsif.gc.ca) under "Who We Regulate".

<sup>2</sup> As at 31 March 2005 where available, otherwise 31 December 2004.

<sup>3</sup> Total assets of the industries regulated by OSFI are not the simple sum of the above-noted figures. The figures for entities that report on a consolidated basis include subsidiaries whose assets may also be included in a different category.

## Appendix 3

### Summary of Asset Breakdown of Pension Plans Regulated by OSFI<sup>1</sup>

As at March 31, 2005 with comparative figures for the year ended March 31, 2004  
(in millions of dollars)

	2005		2004 <sup>2</sup>	
<b>Cash</b>	\$ 324	0.4%	\$ 312	0.3%
<b>Debt Securities</b>				
Short-term Notes, Other Term Deposits	\$ 3,273	3.1%	\$ 3,052	3.2%
Government Bonds	22,098	21.2%	20,082	21.2%
Corporate Bonds	6,702	6.4%	6,551	6.9%
Mutual Funds – Bonds, Cash Equivalents & Mortgage	6,010	5.8%	5,538	5.9%
Mortgage Loans	1,234	1.2%	1,307	1.4%
General Fund of an Insurer	96	0.1%	99	0.1%
<b>Total Debt Securities</b>	<b>\$ 39,413</b>	<b>37.8%</b>	<b>\$ 36,629</b>	<b>38.7%</b>
<b>Equity</b>				
Shares in Investment, Real Estate or Resource Corporation	\$ 4,920	4.7%	\$ 5,162	5.5%
Common and Preferred Shares	40,989	39.4%	35,392	37.4%
Mutual Funds – Stocks	11,501	11.0%	10,533	11.1%
Mutual Funds – Real Estate	573	0.6%	209	0.2%
Real Estate	1,279	1.2%	1,456	1.5%
<b>Total Equity</b>	<b>\$ 59,262</b>	<b>56.9%</b>	<b>\$ 52,752</b>	<b>55.7%</b>
<b>Diversified and Other Investments</b>				
Mutual Funds – Balanced	\$ 2,500	2.4%	\$ 1,849	2.0%
Segregated Funds	1,469	1.4%	1,190	1.3%
Other	1,071	1.0%	1,560	1.7%
<b>Total Diversified and Other Investments</b>	<b>\$ 5,040</b>	<b>4.8%</b>	<b>\$ 4,599</b>	<b>5.0%</b>
<b>Other Accounts Receivable (Net of Liabilities)</b>				
	\$ 151	0.1%	\$ 277	0.3%
<b>Total Net Assets</b>	<b>\$ 104,190</b>	<b>100.0%</b>	<b>\$ 94,569</b>	<b>100.0%</b>

<sup>1</sup> Represents asset distribution as reported in the financial statements of pension plans whose year-end falls between January 1 and December 31 of respective years.

<sup>2</sup> Restated.

## *How to Reach OSFI*

OSFI welcomes questions about its role and responsibilities as well as enquiries related to federally regulated pension plans. Several methods are available to communicate with us:

### **Toll-free Information Service**

OSFI operates a toll-free information service from 8:30 a.m. to 5:00 p.m. Eastern Time, Monday through Friday. It can be reached by calling **1 800 385-8647** or (613) 990-6011 for local (Ottawa-Gatineau) calls. E-mail: **extcomm@osfi-bsif.gc.ca**

### **Internet**

OSFI's web site address is **www.osfi-bsif.gc.ca**. The site provides timely access to a wide variety of OSFI information and documents, including speeches, news releases, guidelines, legislation, policy statements, bulletins, financial information and a listing of all financial institutions and pension plans regulated by OSFI.

### **Publications**

OSFI publications are generally available on our web site ([www.osfi-bsif.gc.ca](http://www.osfi-bsif.gc.ca)) or by contacting:

Publications Distribution  
Office of the Superintendent of Financial Institutions  
13<sup>th</sup> Floor, 255 Albert Street  
Ottawa ON K1A 0H2  
Telephone: (613) 990-7655  
Facsimile: (613) 952-8219  
E-mail: [pub@osfi-bsif.gc.ca](mailto:pub@osfi-bsif.gc.ca)

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