OSFI Annual Report 1999-2000

ACCOUNTABILITY





Office of the Superintendent of Financial Institutions

Bureau du surintendant des institutions financières

Canada

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OSFI's Mission

To better focus on its legislated mandate and to provide a framework for accountability, OSFI has developed the following mission statement:

Our mission is to safeguard policyholders, depositors and pension plan members from undue loss. We advance and administer a framework that contributes to public confidence in a competitive financial system. We also provide actuarial services and advice to the Government of Canada.

We are committed to providing a professional, high-quality and cost-effective service.

The Honourable Paul Martin, P.C., M.P.

Minister of Finance

Ottawa, Canada K1A 0A6

Dear Minister:

Pursuant to section 25 of the *Office of the Superintendent of Financial Institutions Act*, I am pleased to submit to you and the Secretary of State (International Financial Institutions) the Annual Report of the Office of the Superintendent of Financial Institutions for the period April 1, 1999 to March 31, 2000.

Yours very truly,

John R.V. Palmer

Superintendent

Ottawa, September 2000

FINANCIAL INSTITUTIONS AND PENSION PLANS REGULATED BY OSFI

	Number[1]	Assets[2,4] (in millions)
Banks		
Domestic	11	$1,385,658
Foreign bank subsidiaries	40	$89,767
Foreign bank branches	2	not available[3]
Trust and Loan Companies		
Bank-owned	39	$195,500
Other	26	$7,178
Cooperative Credit Associations	7	$8,076
Life Insurance Companies		
Canadian incorporated	54	$255,788
Foreign branches	67	$21,719
Fraternal Benefit Societies		
Canadian-owned	13	$6,584
Foreign branches	14	$855
Property and Casualty Insurance Companies		
Canadian incorporated	95	$37,479
Foreign branches	113	$16,877
Pension Plans	1,170	$79,500

Notes

1 Number of regulated companies as at 31 March 2000. 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.

2 As at 31 March 2000 where available, otherwise 31 December 1999.

3 Orders to establish a branch in Canada were provided to two authorized foreign banks effective 31 March 2000.

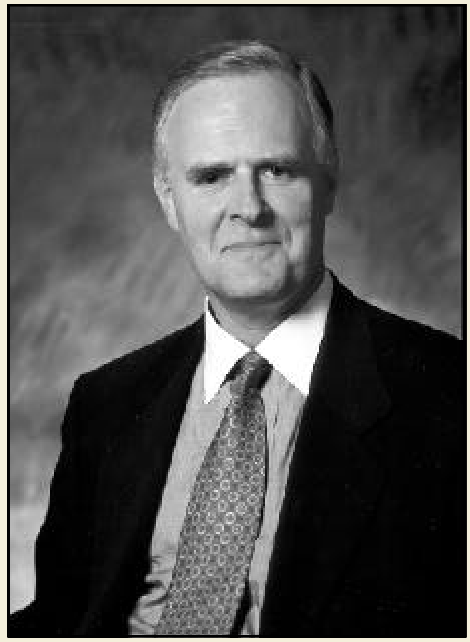
4 Total assets of the industries regulated by OSFI are not the simple sum of the above-noted figures. The figures for entities that report on a consolidated basis include subsidiaries whose assets may also be included in a different category.

FEDERALLY REGULATED FINANCIAL INSTITUTIONS

For OSFI, a federally regulated financial institution is any entity (public or private corporation,subsidiary, or branch) that has been created or allowed to offer financial services pursuant to one of the financial institution statutes promulgated by the federal government. Banks, for example, are incorporated or registered under the *Bank Act*, while insurance companies – both life companies as well as property and casualty insurers – are incorporated or registered under the *Insurance Companies Act*. Both Acts specify a number of "dos and don'ts" that govern the activities of these institutions in the public interest.

Towards Greater Accountability

The 1999-2000 fiscal year was the sixth falling in my term as Superintendent and certainly the busiest that I can recall at OSFI. The financial institutions and pension plans supervised by OSFI were more active than ever in anticipating and responding to some formidable strategic challenges. At the same time, governments and regulators, in Canada and elsewhere, intensified their efforts to ensure that regulatory frameworks were keeping pace.



John R.V. Palmer

Amid the ever-more-rapid pace of change in the Canadian and global financial services industries, it is important for regulators and those to whom they are accountable to assess how well they are keeping pace. One of OSFI's most important long-term undertakings in this regard has been to develop processes by which its performance in carrying out the legislative mandate given to it by Parliament can be evaluated.

In previous annual reports, we have talked about our efforts to construct, on the foundation of our legislative mandate, an accountability framework consisting of strategic objectives, a mission statement, corporate values, performance standards and mechanisms for measuring performance against those standards. Improvements to OSFI's accountability framework figured prominently in our activities again this year. This has been a challenging undertaking because so few precedents exist within the public sector and virtually none has been available within the regulatory community. Nevertheless, OSFI has been making steady progress, and to highlight this essential aspect of our work, we have chosen the theme of "accountability" for this year's annual report.

Initiatives over the past year to enhance OSFI's accountability included the second editions of three stakeholder surveys that gave us important indications of areas in which we have made progress toward our objectives and areas that still require work. During the year, we established a new Quality Assurance and Performance Standards Division to help us evaluate our performance and to assist us in the continuing development of our performance standards. We also carried out preparatory work for the creation of a board of external advisors, which will help OSFI assess its performance and report the results to its various stakeholders. The board of advisors was assembled after the year-end and will hold its first meeting in October 2000.

As OSFI moves forward and the international financial sector continues to evolve, a strong accountability framework will help OSFI to fulfil its role effectively as the principal regulator and supervisor of federal financial institutions and pension plans.

The strategic challenges faced by Canada's financial sector over the last year may never have been greater. They included (and still include):

- Growing competition from foreign financial institutions, not only internationally, but increasingly in the Canadian market.
- Growing competition from non-financial institutions, such as technology companies, and unregulated entities, such as leasing companies, offering overlapping services.
- Mergers between foreign competitors, giving them greater scale in certain areas compared to Canadian institutions.
- The growth of specialist institutions offering a single product or a narrow range of products worldwide, with even greater scale advantages compared with multi-product Canadian institutions.
- Diminishing returns on fixed-income investments due to the current relatively low inflation, low interest rate environment.
- Downward pressure on operating margins due to interest rate levels and intense competition in certain market segments.
- Rapid advances in technology in the financial sector, creating opportunities but also significant competitive challenges.
- A dramatic increase in the speed of business decision-making, forcing institutions to anticipate and respond to competitive threats more quickly.
- Better informed but more demanding and impatient capital markets, looking for rapid growth, higher returns, and with a growing preference for market leaders and a good technology "story."

Faced with these challenges, entities supervised by OSFI responded in a variety of ways:

- Efforts continued, and in many cases intensified, to reduce operating costs through more effective use of technology and the closure of branches and offices.
- Higher yield assets were sought, including lower rated investments and loans.
- Business lines were carefully reviewed to consider profitability and future potential. In a number of cases, business lines lacking sufficient scale or competitiveness were sold.
- There were more strategic partnerships between financial institutions and non-financial institutions, particularly in the

field of technology.

- Although any mergers between Canada's largest financial institutions were deferred pending passage of new financial sector legislation, other smaller but still significant mergers and acquisitions took place, including the acquisition of Canada Trust by The Toronto-Dominion Bank.
- With limitations on growth prospects in Canada, some Canadian institutions expanded in the United States and other countries, largely through acquisition. The relatively low value of the Canadian dollar and the high values of financial assets in other countries, particularly the United States, tended to limit the size of these foreign purchases.
- Reflecting the growing size of many global businesses, the scale of transactions increased, with implications for transactions financed by Canadian financial institutions.

Many of these initiatives have implications for the risk profiles of the entities undertaking them, requiring increased vigilance on the part of the regulator. Another area requiring increased vigilance is the level and composition of regulatory capital maintained by financial institutions.

Given the pressure to enhance returns on equity, OSFI-supervised institutions have been seeking to reduce or improve the efficiency of their capital. We saw an increasing trend on the part of foreign-owned property and casualty insurance companies to repatriate capital in excess of regulatory minimums. Most life insurance companies have been maintaining capital levels well in excess of minimum requirements, but these capital levels began to fall for the first time since the failure of Confederation Life.

Pressure from deposit-taking institutions to reduce capital levels toward regulatory minimums became evident several years ago. This caused OSFI to introduce target levels, in excess of minimum requirements, for well-capitalized institutions, consisting of Tier 1 capital at seven per cent of risk-weighted assets and total capital at 10 per cent of risk-weighted assets. Deposit-taking institutions supervised by OSFI now meet or exceed these levels, but institutions are seeking other ways to improve the efficiency of capital and enhance returns.

We have seen an unprecedented wave of securitization over the past two years, as Canadian banks sought to reduce risk-weighted assets by transferring ownership of pools of assets to groups of investors. Increasingly, credit derivatives are being used for a similar purpose. Banks have also been seeking to change the composition of capital, creating "innovative instruments," which can mimic the behaviour of common equity in times of crisis but otherwise resemble debt instruments. The objective of such instruments, from the point of view of the issuing institution, is to qualify them as Tier 1 capital for regulatory purposes while obtaining the benefits of interest deductibility for tax purposes.

The efforts of Canadian institutions to

undertake important strategic initiatives, improve operating profitability and enhance the efficiency of capital placed unprecedented demands on OSFI. Not only was it important to allocate resources to follow these activities in the course of our on-going monitoring, but many of the transactions also required approvals from either OSFI or the Minister of Finance. The complexity of some of the transactions and the sophistication of many of the new capital instruments tested OSFI's resources as never before.

In addition to being faced with more complex transactions, institutions, with our encouragement, increasingly consulted with us in advance of undertaking transactions. This provided an opportunity to obtain a better understanding of how we would interpret the legislation and our potential administrative policies in what were often ground-breaking areas. We are organizing ourselves to provide more advance guidance in the future to assist our institutions in planning their strategic initiatives.

Of the many strategic initiatives in Canada's financial sector over the past year, perhaps none was as important as the demutualization of four of Canada's largest life insurance companies. The conversion from policyholder ownership to shareholder ownership was an enormous undertaking for each of the companies and for OSFI. We have favoured the availability of demutualization because it offered the opportunity to improve the companies' access to capital markets and enhance market discipline, both of which are important in a prudential context. All four companies have now completed their demutualizations and the related initial public offerings.

While we were kept busy supervising and serving some 480 financial institutions and 1,100 pension plans, there were other initiatives and projects that occupied our attention.

Chief among these activities was providing support to the Department of Finance in the development of the government's financial sector policy paper released in June 1999 and in preparing the legislative package that was tabled a year later. OSFI provided advice on many aspects of the package and was deeply involved in the design of the new holding company regime and the expanded "permitted investment" rules, which are intended to give federal financial institutions more structural and operating flexibility.

In August 1999, OSFI formally released its new Supervisory Framework, setting out in a public document how it will direct its supervisory efforts to areas of highest risk in the financial institutions that it supervises, while placing increased reliance wherever possible on controls and other risk mitigants put in place by the institutions themselves. Reactions from financial institutions, industry associations and other stakeholders to this new approach were quite positive.

OSFI played an active role in international regulatory and supervisory bodies, recognizing that as financial institutions become more international and as national financial sectors become more interdependent, regulators need to harmonize their approaches and co-ordinate their efforts more effectively. OSFI was particularly active in the Basel Committee on Banking Supervision and the International Association of Insurance Supervisors, and helped form a new body, the Integrated Financial Supervisors, which held its first meeting in May 1999. OSFI also agreed to join the newly formed *Association of Supervisors of Banks of the Americas (ASBA)*, recognizing the growing importance to Canada of financial sectors in Latin America and the Caribbean. OSFI served as a member of the Financial Stability Forum, and participated in a Forum working group on Offshore Financial Centres, which submitted its final report to the Forum in March 2000. OSFI also continued its support for The Toronto International Leadership Centre for Financial Sector Supervision.

One of the most important initiatives undertaken at the international level has been the revision to the 1988 Basel Committee Capital Accord, which currently defines regulatory capital for deposit-taking institutions around the world. A major project is underway to make the Basel Capital rules more risk-sensitive and align them more closely with the risk-management practices of deposit-taking institutions to better reward good risk-management practices and reduce the scope for regulatory arbitrage. By the end of the fiscal year, OSFI's aggregate commitment to this project was running at about seven person-years, supported by work under way at a number of Canadian banks.

The trade-off between risk and reward is a common thread that runs throughout the various strategic initiatives of financial institutions both nationally and internationally, and influences government/regulatory responses. Institutions have been seeking to enhance their financial returns by taking additional risks, while attempting to ensure that those risks are carefully controlled. Governments and regulators have accepted the need for a somewhat higher level of risk in the system to achieve the economic benefits of greater competitiveness and innovation, driven, to some extent, by steps taken in other countries to lighten regulatory requirements.

As institutions move up the risk curve to enhance returns to shareholders, and as governments find it necessary to accommodate these changes, often with a view to assuring a level playing field with foreign institutions, we need to recognize that these changes are occurring at what may prove to be a late stage in the longest period of economic recovery in recorded history. A review of past economic cycles shows that when periods of economic recovery are well advanced, there tends to be pressure for lighter regulation and more flexibility for financial institutions to innovate, diversify and compete more successfully. When economic recoveries end, as they always do, and financial institutions fail, as they occasionally do, attitudes change and there is pressure for more vigorous regulation and supervision.

We are making some important and far-reaching changes in the rules governing our financial sector at a time when economic prospects have rarely looked better and memories of past financial institution failures are quickly receding. As we allow more risk into the financial system to obtain important benefits for consumers and investors, we need to recognize that the financial world may look somewhat different once the laws of economic gravity reassert themselves.

Looking back at the year's events, memories of the challenge posed by the Year 2000 date conversion are also beginning to recede because the transition took place so smoothly in most countries around the world. Nevertheless, before the fact, the challenge appeared to be serious, and the potential consequences of not being ready could have been devastating for most financial institutions. As a result, OSFI, like financial institution regulators in many other countries, initiated an active program in 1996 to warn financial institutions of the potential risks and to encourage them to develop satisfactory conversion plans. OSFI continued its efforts up to and immediately after the conversion date, monitoring conversion programs and bringing potential problems to the attention of senior management and boards of directors. We were pleased to see that, for Canada's financial institutions, the conversion took place with scarcely a hiccup.

Once again this year, it was vividly demonstrated to me that people are the key to the success of any organization and this is nowhere more true than in organizations like OSFI, which are in the knowledge business. As in past years, many of OSFI's efforts were directed at improving training and career opportunities for its employees and recruiting individuals from the financial sector with some of the specialized skills and knowledge needed by OSFI to carry out its responsibilities.

Many new recruits joined OSFI during the year, including senior personnel in OSFI's still-new Specialist Support Sector, established in the previous year. At the most senior level, we welcomed Michael Hafeman, a senior member of Canada's actuarial community, who became Assistant Superintendent of the Specialist Support Sector. Michael was joined shortly after the year-end by John Doran, a senior bank executive, who became Assistant Superintendent, Supervision.

Earlier in the year, John Thompson, the Deputy Superintendent responsible for OSFI's Regulation Sector, decided to retire after a seven-year term with OSFI. I am personally grateful to John for his many contributions to OSFI over this period. Among these contributions, John played a seminal role in strengthening the International Association of Insurance Supervisors, including the establishment of its first head office in Basel and the recruitment of a Secretary General. Julie Dickson, who was appointed Assistant Superintendent, Regulation Sector, on January 1, 2000, has replaced John.

During the year, Nick Le Pan served as Deputy Superintendent responsible for the Supervision Sector, but, following the addition of John Doran, assumed the broader role of Deputy Superintendent of Financial Institutions. Edna MacKenzie continued to serve as Assistant Superintendent, Corporate Services, rounding out the executive team.

Despite unprecedented demands on their time, energy and expertise, OSFI employees responded well to the challenges they faced, with hard work, dedication and an extraordinarily high level of commitment to OSFI's mission. All this dedication and commitment will be needed as we move forward into even more challenging times in Canada's financial sector.

Sincerely,

John R.V. Palmer

Superintendent

OSFI and its Responsibilities

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. It was established in 1987 by an Act of Parliament, the *Office of the Superintendent of Financial Institutions Act*.

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 powers from and is responsible for administering the following legislation:

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

Each of these Acts sets out the rules for the structure and operation of a federally regulated financial institution and 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 organized into four sectors: Supervision, Regulation, Specialist Support and Corporate Services. The organization employs some 400 people in offices located in Ottawa, Montreal, Toronto and Vancouver.

OSFI is funded mainly through asset-based or membership-based assessments on the industry and a modified user-pay program for selected services. A small portion of OSFI's revenue is derived from the Government of Canada for actuarial services relating to the Canada Pension Plan.

Milestones in OSFI's History

Late 1800s – establishment of the Office of the Superintendent of Insurance (OSI), which subsequently became the Department of Insurance (DOI).

1925 – the Office of the Inspector General of Banks (OIGB) was established.

Early 1930s – MacMillan Royal Commission reviewed banking and currency issues in the Canadian financial system.

Early 1960s – Porter Royal Commission reviewed structural and operational issues affecting the financial system and financial institutions in Canada.

1967 – the Minister of Finance introduced legislation to establish the Canada Deposit Insurance Corporation (CDIC).

Mandate and Objectives

OSFI is committed to providing professional, high quality and cost-effective service. To accomplish its mission of safeguarding policyholders, depositors and pension plan members from undue loss, OSFI advances and administers a regulatory framework that contributes to public confidence in the financial system. At the same time, OSFI ensures the regulatory system does not unduly impede institutions from competing effectively.

OSFI has five objectives that are critical to achieving its mission:

Public confidence - contribute to public confidence by enhancing the safety and soundness of the Canadian financial system through the evaluation of system-wide risks and promotion of sound business and financial practices.

Safeguard from undue loss - identify institution-specific risks and trends, and intervene in a timely manner to minimize losses to policyholders, depositors and pension plan members.

Cost-effectiveness - maintain a full and open dialogue with our stakeholders on the costs and benefits of our work.

Competition - fulfil our regulatory mandate having due regard for the need to allow institutions to compete effectively.

Quality - provide a high quality service by giving employees the tools and professional development needed to meet the challenges of a rapidly changing environment.

Mid-1980s – increased international competition, the failure of two Canadian banks and the subsequent enquiry into these failures by the Honourable Willard Z. Estey highlighted the need for changes in Canada's approach to handling the risks associated with the financial marketplace.

July 1987 – the Government of Canada proclaimed the *Financial Institutions and Deposit Insurance Amendment Act* and the *Office of the Superintendent of Financial Institutions Act.* The latter Act joined the DOI and the OIGB to form OSFI, which was given the powers to supervise and regulate all federally regulated financial institutions and pension plans.

May 1996 – Bill C-15 received Royal Assent. This new legislation clarifies OSFI's prime responsibilities as helping to minimize losses to depositors, policyholders and pension plan members, and contributing to public confidence in the Canadian financial system.

measuring up

MEASURING UP

ONE OF OSFI'S STRATEGIC OBJECTIVES IS TO MINIMIZE UNDUE LOSSES TO DEPOSITORS, POLICYHOLDERS AND PENSION PLAN MEMBERS. THIS SECTION HIGHLIGHTS OSFI'S WORK IN DEVELOPING A NUMBER OF PERFORMANCE INDICATORS RELATED TO MINIMIZING UNDUE LOSS.

Performance Measures – Undue Loss

One of OSFI's strategic objectives is to minimize undue losses to depositors, policyholders and pension plan members. Key OSFI activities that help achieve this goal are its contributions to the development of legislation that establishes a prudential framework, and the setting of rules, policies and guidelines related to such matters as required capital and risk management. However, OSFI's Supervisory Program is the main activity directly related to achieving this objective.

Realizing that no single measure can yield clear and definitive results, OSFI has developed a number of performance indicators related to minimizing undue loss. Most of these indicators are influenced by more than just OSFI's actions. For example, there has been no failure of a federal deposit-taking institution or an insurer since 1996. This situation may be partly attributable to the overall quality of management of Canadian financial institutions and to OSFI's activities, however, it no doubt also reflects the lengthy period of good economic and financial conditions.

OSFI could try to design a system that is virtually failure-proof, but such a system would not offer Canadians the full benefits of a competitive and efficient financial sector. In fact, OSFI's legislated mandate makes it clear that failures are not evidence of poor performance on OSFI's part. OSFI's mandate states, in part: "Notwithstanding that the regulation and supervision of financial institutions can reduce the risk that financial institutions will fail, financial institutions carry on business in a competitive environment that necessitates the management of risk and financial institutions can experience financial difficulties that can lead to their failure."

OSFI classifies institutions by various stages of intervention. Stage 0 is normal or acceptable results, stage 1 is early warning, stage 2 is risk to financial viability or solvency, stage 3 is financial viability in serious doubt, and stage 4 is non-viability/ insolvency imminent.

OSFI monitors several indicators to help track its own performance. The first indicator is simply the number and proportion of institutions that are "staged" (that is above stage 0) and the proportion of assets in the sector held by these institutions. Generally, the proportion of staged institutions and the proportion of assets in such institutions has been declining over the past few years, but the decline is less than might be expected during these sound economic times. This situation probably reflects OSFI's actions under its early intervention mandate, which now result in institutions being placed in staged categories earlier as problems develop.

OSFI also completes a self-assessment of the effectiveness of its intervention activity for each staged institution or pension plan. Aggregate patterns in the results of this self-assessment are considered at regular intervals as part of management's review, and any issues arising are dealt with. The progress achieved as a result of OSFI's recommendations or requirements is rated as either strong, acceptable or weak.

At any one time over the past few years, there have been between 60 and 70 staged entities from among the approximately 480 institutions that OSFI supervises. For the staged institutions, in the vast majority of cases, OSFI's intervention activity is rated as having acceptable results, with a number showing strong results in response to supervisory recommendations or requirements. When staged institutions demonstrate weak results, they are the focus of additional supervisory attention.

Performance indicators also consider movement into and out of various stages. Under its early intervention program, OSFI is seeing an expected movement in and out of the early warning stage as it identifies concerns and the institutions in question respond. In any year, the majority of staged entities are in the early warning category and many of them improve and are upgraded.

OSFI has also stepped up the analysis of its activities to identify patterns that cut across institutions in intervention categories. One pattern that appears to be growing more prevalent among staged institutions is weakness in control and governance. These weaknesses seem to be the most difficult for staged entities to improve upon. To assist institutions, OSFI will issue a guideline on governance in 2000 to clarify its expectations in this area.

OSFI's performance indicators are being expanded to monitor the time financial institutions spend in stages, and OSFI is examining "triggers" to help identify cases that need more active intervention. Although there are currently very few such cases, OSFI is examining them to determine potential patterns of unexpected results in risk assessments that should have been detected earlier.

The usefulness of these indicators and processes will be enhanced in the near future as OSFI's Quality Assurance Program comes into operation. In addition, OSFI's new board of advisors will review performance indicators and help enhance OSFI's accountability.

As another indicator, OSFI considers the losses that have occurred in cases where financial institutions or pension plans have had to be wound up. If the percentage recovery rate on a failure is low, it may indicate that OSFI did not act quickly enough to seek an order to close the institution. At the same time, recovery rates are also dependent on economic conditions that exist when an institution is being liquidated. In general, this measure helps indicate whether OSFI acted in a timely fashion when the most serious problems exist.

The overall recovery rate on these cases since OSFI was formed in 1987 is 91% (taking account of the time value of money and neglecting any amounts paid by deposit insurers or compensation funds). For many wind-ups, the recovery was 100% for policyholders and depositors.

OSFI also performs an internal post-mortem after a failure has occurred. While such reviews provide useful insights, they have limited usefulness as performance indicators because they lag considerably behind actual OSFI actions.

The checks and balances in the current federal regulatory system also enhance OSFI's accountability. In particular, OSFI regularly discusses actual or potential problems involving member institutions with Canada Deposit Insurance Corporation (CDIC) and the Canadian Life and Health Insurance Compensation Corporation (CompCorp), which fulfil independent risk assessment roles. These discussions help to identify issues and ensure that our actions are coordinated and appropriate. In some cases, OSFI and these organizations prepare joint responses to identified problems.

Future steps in the development of performance indicators include expanding the intervention self-assessment to include all institutions, not just staged companies. As well, the effectiveness of OSFI's performance indicators will be tested by comparing them with other internal and external ratings of institutions, and assessing results with improved OSFI data on time spent supervising various institutions.

THE EVALUATION OF OSFI'S PERFORMANCE BY EXTERNAL ORGANIZATIONS IS IMPORTANT TO HELP GAUGE HOW EFFECTIVELY OSFI IS FULFILLING ITS LEGISLATED MANDATE. THIS SECTION REVIEWS MAJOR ACTIVITIES UNDERTAKEN OVER THE PAST YEAR TO DETERMINE THE OPINIONS OF STAKEHOLDER GROUPS AND OTHER IMPORTANT ORGANIZATIONS CONCERNING OSFI'S EFFECTIVENESS AND ACCOUNTABILITY.

FEEDBACK

feedback

IMF Peer Review

In May 1999, the International Monetary Fund, in conjunction with the World Bank, implemented a pilot Financial Sector Assessment Program (FSAP) designed to strengthen surveillance of IMF members' financial systems. Canada agreed to be the first major industrialized country to undergo such an assessment. A prominent feature of the FSAP was a peer review of Canada's observance and implementation of the Basel Core Principles, carried out by experienced bank supervisors from the Board of Governors of the Federal Reserve System (United States), the Central Bank of Brazil and the Deutsche Bundesbank (Germany). In support of the Minister of Finance, OSFI played a major role in developing the supervisory peer review concept and working with the IMF and World Bank to incorporate it into the FSAP process.

The IMF peer review of Canada concluded there is a high degree of compliance with applicable standards, which has contributed to Canada's stable financial system. The report noted minor deviations from the Basel principles. These were already being addressed in proposed legislative changes that were announced in June 1999 and subsequently introduced by the Government of Canada in June 2000.

As part of the IMF review, an assessment was conducted of OSFI's performance against a set of principles published in 1997 by the International Association of Insurance Supervisors (IAIS). The IAIS assessment methodology was still under development at that time and the IMF, for operational reasons, did not use peer review for this part of its work. However, the IMF report on OSFI noted that there was broad compliance with all IAIS principles.

In the context of the FSAP and based on the self-assessments provided by Canadian authorities, the IMF produced the *Report on the Observance of Standards and Codes*, which reviews Canada's observance of international standards. This IMF report can be found on the IMF Web site at www.imf.org/external/np/rosc/can/index.htm.

Public Opinion Survey

An important element in tracking OSFI's performance and helping promote accountability is the commissioning of independent surveys of selected external audiences to determine their views on OSFI's performance.

In 1997, OSFI commissioned a national public opinion poll of Canadian adults to determine their level of confidence in the safety of money placed with Canadian financial institutions. This survey, to be conducted periodically, was performed for the second time in late 1999. Similar questions were asked during surveys conducted in 1986 and 1993.

In the 1999 survey, 84 per cent of respondents said they were confident about Canada's financial system. This figure is slightly below the 88 per cent reported in the 1997 survey, but the decline is not significant in statistical terms. Indeed, confidence remains at a high level and within the range observed by the polling agency in similar surveys dating back to the mid-1980s.

Other government agencies, in addition to OSFI, have the capacity to contribute to public confidence in Canada's financial system. Public confidence is also influenced by domestic and international factors beyond the direct control of government agencies. Although it is not possible to determine the specific contribution of government agencies to maintaining public confidence, recent events in other countries have demonstrated that such confidence likely suffers when regulatory agencies are not performing at a satisfactory level. OSFI will continue to monitor the levels of public confidence in the Canadian financial system to help assess how effective it is in achieving its objectives.

Effectiveness Survey

In 1998 OSFI commissioned a leading market research firm to conduct OSFI's first Effectiveness Survey. The survey consisted of interviews of senior executives in institutions regulated by OSFI and in professional firms that serve the financial sector to determine their views on OSFI's effectiveness. This survey, which will be conducted periodically, was performed a second time in the spring of 2000.

The 1998 survey found that OSFI's performance was well regarded by respondents. They viewed OSFI as a serious, consultative regulator that is perhaps the best in Canada. However, they expressed concern about OSFI's high staff turnover and its ability to adapt to the rapidly changing financial sector.

The 2000 survey indicates that OSFI's performance as a regulator is now even more highly regarded by respondents than in 1998. This is a good indication that the many organizational and procedural changes made over the last five years have been effective. These changes have also contributed to a significant reduction in employee turnover.

However, in the spring 2000 survey, executives expressed concerns similar to those noted in the 1998 survey. Although a significant number of respondents indicate they believe OSFI employees are knowledgeable about the areas for which they are responsible and that OSFI's risk-based examinations are effective, they continue to believe OSFI must improve its staff training and its ability to hire, develop and retain qualified employees. Two-thirds of respondents also expressed concerns about OSFI's ability to keep pace with changes in the financial sector.

OSFI shares the concerns expressed by respondents to this survey and has addressed them through a number of initiatives. Two such activities are the creation of the Specialist Support Sector and improvements to OSFI's training programs. The eight divisions of the Specialist Support Sector (Accounting, Actuarial, Capital, Capital Markets, Compliance, Credit Risk, Financial Analysis and Data Management, and Financial Services Technology) provide specialized technical assistance to supervision teams and focus on the identification of emerging risks. OSFI's new and more comprehensive training programs provide in-depth training in supervisory areas where there has been significant change.

Employee Survey

OSFI developed and completed its second employee survey this year to assess employee satisfaction. The specific objectives of the survey were to determine the "climate" of the organization, compare the findings with a similar 1997 survey to identify further areas where improvements could be made, and provide additional data to track human resource programs over the next year.

Responses this year were generally more positive than in 1997. Of the 22 comparable issues on which respondents were questioned, the responses to 19 were more positive and only one was more negative. The responses to the remaining issues did not change.

OSFI's strengths indicated by this year's survey included: permitting employees to take personal responsibility for training and career development; employee benefits; supervisory effectiveness; making it possible for employees to contribute to corporate objectives because of an understanding of OSFI's mission and values; the ability of employees to communicate in the official language of their choice; and general satisfaction.

In addition to comparing this year's results to those obtained in 1997, some survey items were also compared to an external Canadian database of representative private sector and public sector employers. Of the 32 survey items compared, OSFI employees rated six items significantly more positively than did Canadians in the general working population. Four survey items were more negative than in the general population; there were no significant differences between the remaining items.

Although OSFI demonstrated several areas of strength, the survey results indicated that the following issues remain a challenge for OSFI: performance pay; fair pay;

performance management; leadership effectiveness; and effective staffing. A comprehensive plan, including the on-going use of an Employee Advisory Group, will be developed by OSFI's executive to make further progress on these important issues.

OSFI Advisory Board

For private sector corporations, as well as financial regulatory agencies in many other jurisdictions, governance provided by a Board of Directors is a cornerstone of their accountability framework as it instills a heightened level of corporate discipline and rigour.

As a means of further enhancing its accountability, OSFI is establishing an Advisory Board that will provide counsel to the Superintendent on a wide range of issues related to OSFI's internal operations and overall areas of responsibilities.

During 1999-2000, OSFI laid the groundwork for the creation of an Advisory Board. Seven board members, representing a wide range of financial sector expertise and senior management and operational experience, were selected in mid-2000. The Superintendent will initially chair this advisory body, and it is expected that the inaugural meeting of the Board will be held in October 2000.

The Board will not be privy to any institution-specific information, and individual Board members will be subject to conflict of interest and confidentiality rules. The Board will not involve itself in financial sector policy issues or in other matters that are ministerial responsibilities.

Although OSFI's Board will be advisory in nature, its scrutiny of OSFI's plans and priorities will help to ensure OSFI is well positioned to meet its mandate and strategic objectives.

The new Board will provide the Superintendent with a valuable industry perspective on the changing realities of the financial services sector. This input will be important in assisting OSFI to maintain its effectiveness and to find the right balance in its supervisory policies between safety and soundness, on the one hand, and competitiveness and flexibility on the other.

OSFI Advisory Board - Role and Mandate

The OSFI Advisory Board has been established to advise the Superintendent on a wide range of issues related to OSFI's internal operations and general accountabilities.

A primary objective of the Board is to provide the Superintendent with advice on appropriate plans and priorities to ensure OSFI is well positioned to meet its broad organizational objectives.

The Board will also provide the Superintendent with an industry perspective on the changing realities of the financial services sector. This input will be instrumental in assisting OSFI to maintain its effectiveness and ability to be forward thinking.

Guidance from the Board is likely to be sought in several areas:

- material issues relating to OSFI's internal operations, including finance or administrative policies that affect regulated institutions (e.g., cost recovery systems) and substantive human resource matters (e.g., processes for attracting, evaluating and retaining qualified staff);
- OSFI's business plans, strategic plans and related matters such as performance measures or internal streamlining initiatives;
- new supervisory or regulatory policy directions and strategic priorities (e.g., changes to the supervisory framework, selected regulatory policies);
- OSFI's participation in international groups or forums;
- communications-related issues, including OSFI's relationships with external stakeholders and its overall communications plan;
- trends and emerging risks in the financial services sector and their impact on OSFI's research initiatives.

The OSFI Advisory Board currently consists of seven members, and will meet three to four times per year. The Superintendent is acting as Chairperson; however, in time, a Board member could be requested to assume the role of Chair. Directors have been appointed for a three-year term and are being paid competitive stipends for their work.

The composition of the Board reflects a range of experience and backgrounds — including members with financial sector expertise, as well as individuals with senior management or operating experience in a related field, a professional designation or other relevant skill-set. Conflict of interest and confidentiality rules will apply. As the Board is advisory and will not make decisions concerning individual institutions or groups of institutions, directors may own shares of regulated financial institutions and are not precluded from involvement in the management or oversight of a regulated financial institution.

raising the bar

RAISING THE BAR

OSFI IS CONTINUALLY REVIEWING ITS OPERATIONS AND PROCEDURES TO DETERMINE HOW THEY CAN BE MADE MORE TRANSPARENT AND EFFICIENT. THIS SECTION HIGHLIGHTS SOME OF OSFI'S MAJOR EFFORTS OVER THE PAST YEAR TO IMPROVE ITS PERFORMANCE AND ACCOUNTABILITY.

Streamlining

OSFI worked closely with the Department of Finance on legislative changes to streamline the approval process for many transactions currently requiring the approval of the Superintendent. The results of this work are contained in Bill C-38, introduced in the House of Commons on June 13, 2000. The Bill sets out a deemed approval process.

Under the proposed deemed approval process, when institutions file an application with OSFI, the Superintendent will have a maximum 30-day period to raise concerns, seek further information or indicate that there will be a delay. If none of these actions is taken, the transaction will be deemed to have been approved. The Superintendent can also explicitly approve the transaction before the end of the 30-day period.

OSFI will publish information requirements for each approval under the Act to increase transparency and help ensure there are no delays due to inadequate information.

Processing applications against time frames is a significant step forward and will create the basis for measuring OSFI's performance in this area. Performance measures will be developed using data collected from a new system designed to track the status of applications, including any reasons for delay. For the first time, OSFI will be able to assess how efficiently it deals with applications and will have information that will form the basis for developing solutions to any problems in the application process.

Although legislative changes are required to implement fully the deemed approval concept, OSFI will be adjusting its internal procedures to reflect the 30-day time frames in advance of the passage of legislation.

Cost-Benefit Analysis

Sound regulation is fundamental to the maintenance of a stable and competitive financial system. On a theoretical level, the optimal amount of regulation is straightforward. It is that level at which the costs of more regulation will exceed the benefits of the added regulation or, in other words, when added regulation is no longer cost-effective.

Unfortunately, there is no easy way to assign numerical values to the costs and benefits of regulation. Work is ongoing in many economies, most notably in the United States and the United Kingdom, to measure the impact of regulation on the economy. In fact, recent legislation establishing the Financial Services Authority (FSA) in the United Kingdom requires the FSA to conduct cost-benefit analysis in discharging its functions. The FSA is required to publish an estimate of the costs and an analysis of the benefits of its proposals whenever their impact is likely to be more than a minimal increase in the costs of those affected.

OSFI recognizes that regulatory measures impose costs on the economy, costs that are incurred in anticipation of benefits to be generated by the regulatory measures. OSFI is committed to operating in a cost-effective way and intends to add cost-benefit analyses to its decision-making "toolkit."

Cost-benefit analysis is a well established discipline of applied economics and has long been used by government agencies in Canada as an appraisal tool for policy evaluation. Use of cost-benefit analysis, even when numerical estimates cannot be made with precision, provides a valuable framework to identify, target and check the impacts of regulatory measures that OSFI proposes. It also provides a useful format to focus consultation with stakeholders and contributes to the accountability of OSFI.

OSFI is currently working with sister agencies in Australia and the United Kingdom to develop a practical approach to cost-benefit analysis in the financial services sector, and will involve stakeholders and other sister agencies in those efforts.

Web Site Re-design

OSFI opened its Internet Web site in October 1996, and was one of the first regulators to do so.

In the autumn of 1999, OSFI embarked on a project to re-design its Web site. This project will enhance the transparency of OSFI's activities and take better advantage of this medium's ability to make information readily accessible in a cost-effective manner.

In addition to planning several changes based on experience with the site and best practices used by other Web sites, OSFI conducted a survey of its stakeholders to obtain their opinions and determine their information requirements. Work is well under way and the launch of the re-designed site is expected during the summer of 2000.

USER-PAY ASSESSMENT FOR SELECTED SERVICES

Following extensive consultation with financial institutions and their industry associates, OSFI introduced a program of charging individual financial institutions for selected services. In Phase One of this program, which went into effect on January 1st, 1999, OSFI began charging fees for certain corporate approvals.

OSFI commenced Phase Two of its user-pay program in 1999. During this phase, OSFI is evaluating the fairness of its current methodology for assessing costs to financial institutions and is considering the introduction of assessment surcharges to recover directly from problem institutions additional costs associated with enhanced supervision. OSFI is also currently evaluating penalty fees for late or erroneous filings of financial and non-financial returns.

In the summer of 1999, OSFI established an Industry Advisory Committee, composed primarily of representatives of the industry associations. The committee was established to provide an effective vehicle for the associations and their members to offer constructive comments and suggestions on the various issues being dealt with in Phase Two. The goal is to implement any changes to the current assessment methodology commencing on April 1st, 2001.

In April 2000, OSFI added user fees for selected new activities and increased certain Phase One user fees. These user fees also cover charges paid to the Chief Actuary for actuarial services.

TWO IMPORTANT AREAS IN WHICH OSFI NOT ONLY MAKES THE GRADE, BUT ALSO STRIVES TO EXCEL, ARE OFFICIAL LANGUAGES AND EMPLOYMENT EQUITY. THIS SECTION PRESENTS HIGHLIGHTS OF HOW WE SCORED ON THESE ISSUES IN 1999-2000.

MAKING THE GRADE

making the grade

Official Languages Report

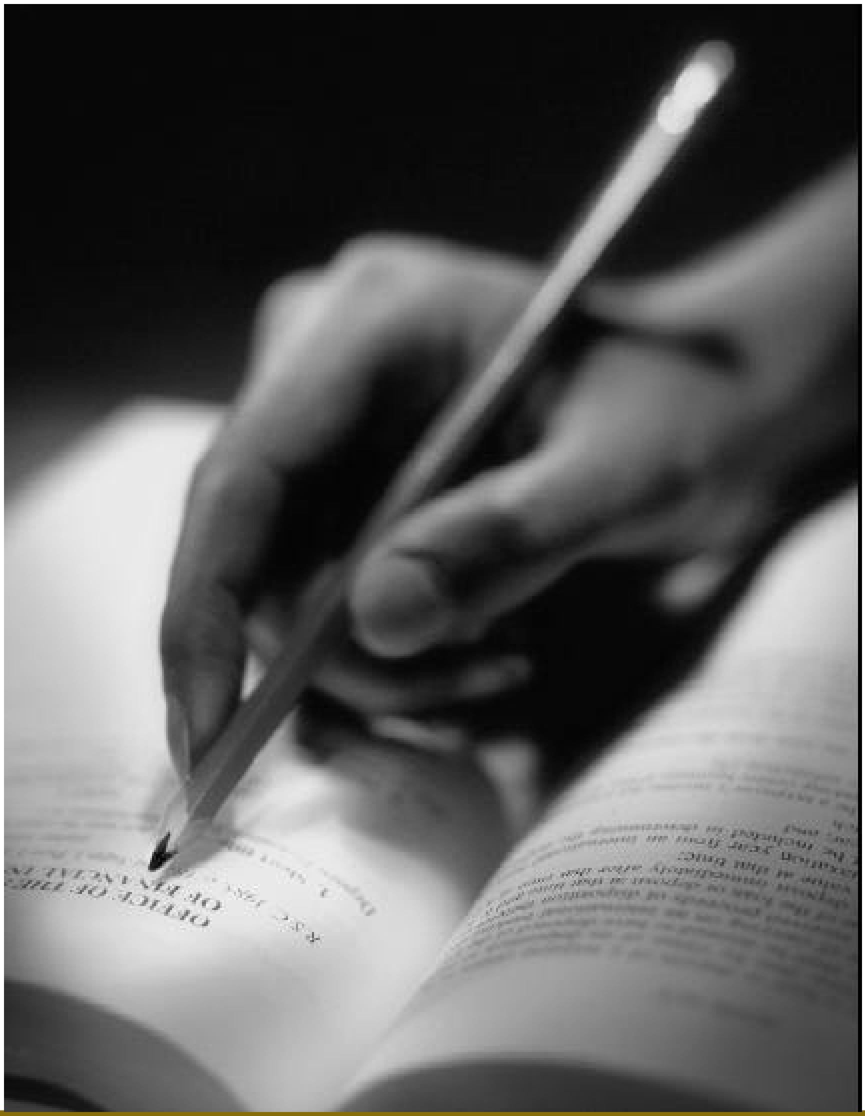
The following are among the accomplishments noted in OSFI's last Annual Report on Official Languages:

- OSFI has met the 100 per cent capability to serve the public in both official languages through the implementation of 1-800 telephone information service for public inquiries. This service automatically connects callers to the Ottawa office where bilingual, informed staff are available to answer their questions.

- Although OSFI meets the average representation of francophones in all categories, its representation of francophones in the administrative support category exceeds the Public Service average for this group.

Employment Equity

OSFI is proud of the diversity of its work force and understands the importance of promoting employment equity. The Human Resources initiatives implemented at OSFI are consistent with employment equity practices. The four target groups for employment equity policies and programs are women, aboriginal peoples, persons with disabilities and visible minorities. All these groups are well represented at OSFI. The total percentage of women at OSFI exceeds the national rate, and OSFI has increased the hiring of women into the Management category by 15 per cent. As for the other target groups, their representation at OSFI either meets or exceeds the overall national or availability rate.



THE FOLLOWING SECTIONS HIGHLIGHT OSFI'S MAJOR ACTIVITIES AND ACHIEVEMENTS OVER THE 1999-2000 FISCAL YEAR.

TAKING STOCK

taking stock

New Legislation

On June 13, 2000, the Government of Canada introduced legislation reforming the policy framework for the financial services sector. This legislation follows the government's June 1999 policy paper, *Reforming Canada's Financial Services Sector: A Framework for the Future*.

Among other matters, the legislation provides greater structural flexibility for federally regulated financial institutions through the introduction of an expanded permitted investment regime and a regulated holding company option for large banks and large demutualized insurance companies. In addition, it lowers the entry requirements for new financial institutions, removes some of the barriers to closely held ownership of small banks, and allows larger share participations in large banks, which increases the scope for strategic alliances.

The legislation also provides OSFI with more powers that will enhance its ability to deal with problem situations.

Demutualization

In March 1999, the Government of Canada passed legislation and made regulations allowing Canada's large mutual life insurance companies to convert into companies with publicly traded common stock – a process called demutualization. In the conversion to a stock company, eligible policyholders in the mutual companies could either become shareholders or elect a cash payment in lieu of shares.

The four largest mutual insurance companies converted to stock companies in 1999 and early 2000. OSFI played an active role to help ensure policyholders were protected during this process. Specifically, OSFI worked with the relevant companies to ensure policyholder information was prepared in a plain-language format and approved the material that was sent to policyholders to help them form a reasoned judgement on demutualization. OSFI also required the companies to provide expert opinions on the value of the company and whether the method of allocating that value to policyholders was fair and equitable.

Finally, OSFI established a toll-free telephone information service to assist in responding to policyholder questions on demutualization. During the fiscal year, a total of 8,368 consumer enquiries were received by OSFI regarding demutualization.

New Supervisory Framework

During the year, OSFI continued to implement its revised supervisory methodology, with full implementation occurring in stages as OSFI personnel gain experience with the new approach.

The Supervisory Framework, which provides an outline of OSFI's revised supervisory methodology, was distributed to relevant financial institutions in August 1999, for information and to invite comments. In addition, meetings were held with various industry groups to discuss the Framework and respond to questions about the revised methodology and its impact on OSFI and on institutions.

An important feature of the Framework will be increased transparency through supervisory ratings. Once evaluation criteria and definitions have been developed in consultation with the industry, individual institutions will be provided with their composite ratings and ratings for each of the applicable risk management control functions.

MCCSR Guideline Review for Life Insurance Companies

In 1999, in collaboration with the Canadian Life and Health Insurance Association (CLHIA), OSFI undertook a review of the Minimum Continuing Capital and Surplus Requirements (MCCSR) Guideline. As a result of this process, OSFI issued a discussion paper in January 2000 on capital adequacy requirements for life insurance companies.

The discussion paper concluded that fundamental changes to capital adequacy requirements for life insurance companies are not necessary at this time and that the existing formula provides the flexibility required to address emerging issues. However, the review highlighted a number of priority issues to be addressed and work is underway to develop appropriate requirements for those risks. OSFI also advised the industry that a capital requirement for segregated fund guarantees will be finalized for application at the end of 2000.

IM/IT Strategic Plan

During the year, OSFI continued to build the Information Management/Information Technology (IM/IT) environment called for in OSFI's Strategic Plan. The objective of this work is to put in place a set of integrated technologies, readily adaptable to the work processes and information needs of employees.

Ultimately, OSFI's IM/IT environment will feature a standard "tool set" on all desktop computers or notebooks, which will allow users to create, store, manipulate, search for, retrieve, distribute/share and re-use information seamlessly and productively wherever they are working. When advancements in firewall and other security mechanisms permit, this will be accomplished through the linkage of "OSFINet", OSFI's Intranet site, to the Internet.

Once in place, the new environment will facilitate electronic collection, distribution and sharing of information with all of OSFI's stakeholders. New technologies will be used to consolidate OSFI's information holdings into an integrated knowledge base, with tools that allow users to easily search, find, retrieve, manipulate and store data. OSFINet will be used as the standard or common window to access information in the knowledge base.

Minimum Capital Test for P&C Insurers

Under the aegis of the Canadian Council of Insurance Regulators (CCIR), OSFI worked with supervisors in Alberta, Ontario and Quebec during the year to develop a harmonized, risk-based capital adequacy test for Canadian property and casualty insurers. The proposed Minimum Capital Test (MCT) will replace the four separate solvency tests that currently exist under federal and provincial legislation, and is scheduled to take effect by year-end 2001.

This proposal was issued to the industry for comment on February 28, 2000. The industry will have further opportunities to comment following the collection of data on a trial basis for both the 1999 and 2000 year-ends. The CCIR Task Force will review the comments received and the data, and intends to issue a final guideline before the end of 2001.

International Activities

OSFI is an active member of the Basel Committee on Banking Supervision, which for a number of years has been the acknowledged standard-setter for international banking supervision. The Basel Committee's current focus is on improving the 1988 Basel Capital Accord. The Capital Accord is an international minimum standard agreed to by G-10 bank supervisors and implemented in most countries around the world. OSFI is a member of seven of the Committee's technical groups and task forces. Most of these working groups and task forces are developing the components of the new Capital Accord that the Committee expects to conclude over the next two years.

Throughout 1999-2000, OSFI also participated in International Association of Insurance Supervisors (IAIS) training seminars and committees. In particular, OSFI helped draft the paper on insurance for the Financial Stability Forum and the methodology to accompany the insurance Core Principles. In December 1999, John Thompson, then a Deputy Superintendent of OSFI, retired from the position of IAIS Past-Chairman of the Executive Committee.

OSFI continued its participation in the Joint Forum, made up of bank, insurance and securities regulators from 13 countries. The Forum has examined supervisory issues arising from the activities of financial conglomerates and has released a number of papers setting out best practices and techniques.

In other activities, Superintendent John Palmer served, along with representatives of the Department of Finance and the Bank of Canada, on the Financial Stability Forum (FSF). The FSF was created by G-7 Finance Ministers in April 1999 to foster and coordinate international financial stability. Mr. Palmer also chaired an international working group created by the FSF to study and make recommendations on the role of offshore financial centres in the context of international financial stability.

In May 1999, OSFI participated in the inaugural Integrated Supervisors Conference, hosted by the Australian Prudential Regulation Authority in Sydney. Integrated supervisors have responsibility for regulating more than one financial sector industry, including, at minimum, banks and insurance companies. OSFI hosted the second such conference in Toronto in May 2000. OSFI also continued to participate in the governance and program delivery activities of The Toronto International Leadership Centre for Financial Sector Supervision, which, in 2000, added securities, insurance and conglomerate supervision to its portfolio of courses.

Office of the Chief Actuary

The Office of the Chief Actuary (OCA) has responsibilities that are significantly different from those of the other sectors within OSFI. Rather than fulfilling a regulatory or supervisory function, the OCA provides actuarial services for a variety of programs. These programs include the Canada Pension Plan (CPP) and Old Age Security (OAS), and pension and benefits plans covering members of the federal Public Service, the Canadian Forces, the Royal Canadian Mounted Police, federal judges and Members of Parliament.

In addition to preparing statutory actuarial reports on the financial status of the plans, the OCA provides the relevant government departments with actuarial advice on the design, funding and administration of these plans. OCA clients include Human Resources Development Canada, Finance, Treasury Board, Public Works and Government Services, the Canadian Forces, the RCMP and Justice.

In April 1999, a panel of three experienced, independent actuaries completed a formal review of the Seventeenth Actuarial Report on the CPP. The OCA has since worked actively on each of several recommendations flowing from this review.

In March 2000, the OCA hosted "Demographic and Economic Perspectives of Canada, Years 2000-2050," the first seminar designed to broaden the OCA's sources of advice and opinions concerning the assumptions made in preparing the CPP report.

A policy for supplying actuarial information and services on the CPP was adopted in April 2000. It standardizes the practices and ensures transparency in their operation.

Specific services provided during the year include:

- in February 2000, the OCA provided the Department of Finance with an actuarial cost certificate on the effects of Bill C-23, which amends the CPP to extend the definition of a common-law relationship to include same-sex couples;
- the Fourth Actuarial Report on the OAS was tabled in Parliament in June 1999;
- the actuarial report on the pension plan of the Members of Parliament was tabled in November 1999;
- actuarial advice was provided to the Government of Canada in connection with the 1999 Judicial Compensation and Benefits Commission; and
- ongoing advice and support was given to the Pension Advisory Committees of the Public Service, the Canadian Forces and the RCMP pension plan. Each Committee provides advice on the design, administration, and funding of the plan to the relevant Minister.

Deposit-taking Institutions: Deposit-taking institutions accept money from individuals or corporations in the form of deposits or similar financial instruments that are repayable at some time in the future. In Canada, banks, trust and loan companies, and credit unions are deposit-taking institutions.

MCCSR: The Minimum Continuing Capital and Surplus Requirement is a measure of capital adequacy for life insurance companies. It is a risk-based minimum requirement determined by applying factors for a number of risk components to specific on- and off-balance sheet assets or liabilities.

Regulation: Regulation is the setting of rules of good prudential behaviour for financial institutions and pension plans. This involves input into developing and interpreting legislation and regulations, issuing guidelines and considering requests from institutions and pension plans, as required by law.

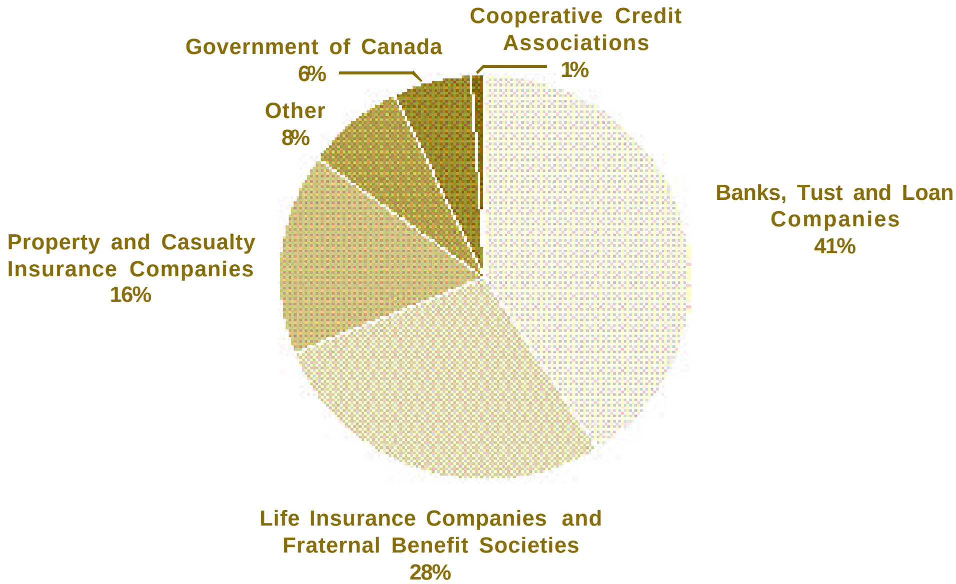
Staging (Staged Institutions): Staging is OSFI terminology for placing an institution on a graduated watch list, where each stage indicates more serious financial difficulty and more aggressive supervisory intervention. Five stages are outlined in the *Guide to Intervention for Financial Institutions*. Staged institutions are those where problems have been identified (i.e., at Stage 1 or higher).

Supervision: Supervision involves assessing the safety and soundness of financial institutions, providing them with feedback and intervening in a timely manner to achieve OSFI's mandate. This entails the evaluation of risk profiles, financial condition, risk-management processes, and compliance with applicable laws and regulations.

Minimum Capital Test: The Minimum Capital Test (MCT) is a proposed risk-based capital adequacy test for Canadian and provincial property and casualty insurers. The MCT is intended to replace the four separate asset-based solvency tests that currently exist under federal and provincial legislation. Compliance with the MCT is planned for year-end 2001 reporting.

As part of OSFI's accountability framework, a full and open dialogue is maintained with its stakeholders on the costs and benefits associated with fulfilling its mandate. Each year, OSFI explains its budget to industry stakeholders and seeks their input for the asset- or premium-based assessments on the industry and the modified user-pay program from which OSFI secures the bulk of its revenue.

BREAKDOWN OF REVENUE BY INDUSTRY TYPE



Office of the Superintendent of Financial Institutions
Actual Expenditure by Budget Item
(Dollars)

	1999-2000	1998-1999
SALARY		
Salary	33,018,628	30,711,090
Overtime	161,471	94,097
	33,180,099	30,805,187
TRAINING		
Travel - Training	265,868	238,091
Training and Development	996,614	784,920
	1,262,481	1,023,011
OTHER EXPENSES		
Travel - Regular	1,640,245	1,585,795
Relocation	323,438	80,493
Liquidation expenses	1,265,246	969,516
Postage and couriers	108,106	105,092
Telephones and paging services	358,384	359,620
Advertising services and Publishing	214,198	160,396
Printing	166,031	140,386
Professional and membership fees	279,512	107,283
Credit consultants fees & expenses	173,726	212,597
Meetings & hospitality	79,768	68,149
Temporary help	229,714	150,471
Other contracts	2,136,260	1,836,493
Rental	112,060	118,533
Accommodation	3,145,639	3,172,904
Tenant services	133,446	82,249
Subscription and reference books	228,478	203,160
Stationary and office supplies	290,817	233,327
Office equipment, furniture and fixtures	568,167	70,383
Miscellaneous	78,785	143,775
EDP consulting contract	634,602	845,565
EDP hardware/software	1,417,055	1,278,149
EDP other	590,622	406,422
Reorganization cost	1,778,703	2,877,584
Demutualization expenses	4,368,196	4,014,867
	20,321,197	19,173,669
TOTAL EXPENDITURES	54,763,778	51,001,867

ANNEX 2 – COMPLAINTS AND ENQUIRIES

Under the *OSFI Act*, OSFI is required to include in its annual report information respecting complaints and enquiries from consumers of financial institutions who have contacted OSFI.

OSFI's Complaints and Enquiries Unit responds to all enquiries or complaints consumers may have regarding federally regulated financial institutions and pension plans. By law, financial institutions are required to establish specific procedures for handling customer complaints. These procedures must be readily available to customers and must include information on how to contact OSFI.

When someone contacts OSFI, a complaints and enquiries officer analyzes the situation and, whenever possible, offers suggestions on how it can best be handled. Officers often respond directly to enquiries that are of a general nature. Complaints or enquiries that are more specific or relate to a specific institution are directed to individuals in the relevant institution. Many financial institutions have an ombudsman who offers an impartial appeal process for dissatisfied customers.

OSFI's toll-free telephone service, which has been available for the past five years, has resulted in a significant increase in the number of enquiries or complaints received. OSFI also receives complaints and enquiries through the mail and via the Internet. As indicated below, OSFI received 20,512 enquiries and 4,014 complaints during 1999-2000; 22,662 were received by telephone.

OSFI COMPLAINTS AND ENQUIRIES – APRIL 1, 1999 TO MARCH 31, 2000

	Banks	Trust & Loan	Life & P&C	Pensions	Redirected Equiries	Total
ENQUIRIES	2,945	436	8,897[1]	1,241	6,991	20,512
COMPLAINTS						
Cost of Borrowing	17	1	0	0	-	18
Service Charges	248	23	5	0	-	276
Quality of Service	502	29	22	0	-	553
Small Business	141	9	1	0	-	151
Legal/Contractual/ Products[2]	2,128	250	298[1]	0	-	2,676
Tied Selling Issues	8	1	0	0	-	9
Other[3]	125	11	123	72	-	331
TOTAL COMPLAINTS	3,169	324	449	72	-	4,014
TOTAL ENQUIRES AND COMPLAINTS						24,526

1 A large part of the calls and correspondence received for the life insurance industry relates to the demutualization process of the four insurance companies that occurred during the reporting period.

2 Legal/contractual/products: automatic banking machines (ABMs), accounts, credit cards, estate issues, insurance policy issues, investment products, loans, mortgages and privacy issues.

3 This category includes: financial status/stability, general information, legislation/regulations/guidelines, non-OSFI-related issues and OSFI-related issues.

Annex 3 – Disclosure of Information

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

OSFI's Role in Enhancing Disclosure

OSFI contributes to and promotes effective disclosure by publishing financial information directly, providing guidance to institutions on their disclosure and contributing as members of international supervisory groups that provide industry with guidance on best practices.

For several years, OSFI has released selected financial regulatory information on federally regulated financial institutions (FRFIs) through Ivation Datasystems Inc., a private-sector commercial database company that makes the information available to the public for a fee. In addition, OSFI publishes on its Web site a year-end balance sheet and income statement for each FRFI. Currently, OSFI is considering ways to enhance the financial information available – at no charge – on its Web site to ensure the information is substantially the same as that available from Ivation.

In 1997, OSFI issued disclosure guidelines to federally regulated deposit-taking and life insurance institutions. The guidelines outline minimum levels of disclosure of financial information, as well as information relating to risk management and control practices. The guidelines are intended to supplement the disclosures required by the Canadian Institute of Chartered Accountants (CICA) Handbook and other OSFI guidelines.

OSFI participates in the Transparency Group of the Basel Committee on Banking Supervision. The mandate of the Transparency Group is focussed on promoting market discipline. In fulfilling this mandate, the group develops best-practice guidance for disclosure by banks and conducts surveys on annual report disclosures made by large internationally active banks. Historically, OSFI's detailed reviews of the major Canadian banks' annual report disclosure have resulted in generally favourable findings when compared to their international peers.

OSFI is a member of the International Association of Insurance Supervisors (IAIS). The IAIS Task Force on Enhanced Disclosure is developing a paper dealing with disclosure principles for insurance companies. This paper should be finalized during 2000, after which work will begin on the development of a more detailed standards paper. In addition, the IAIS Accounting Subcommittee has been providing input from a supervisory perspective to the International Accounting Standards Committee's project on insurance accounting.

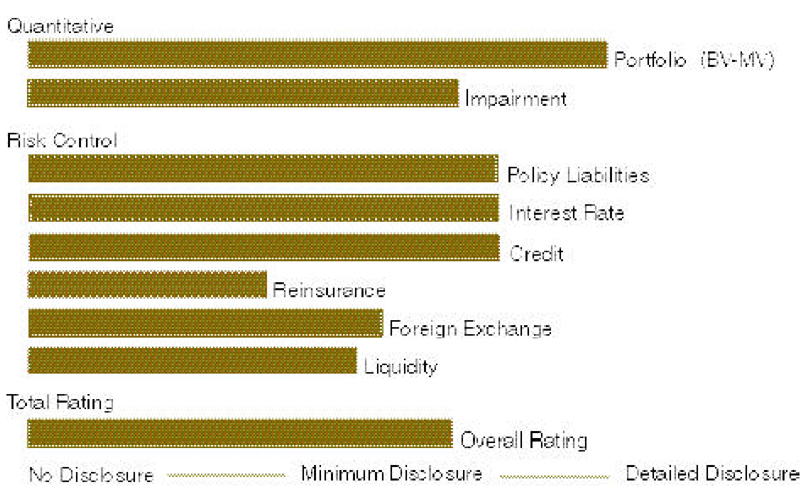
In June 1999, the Basel Committee on Banking Supervision, the Committee on the Global Financial System of the Group of Ten central banks, the IAIS and the International Organisation of Securities Commissions established the Multidisciplinary Working Group on Enhanced Disclosure. The Working Group is exploring the merits of enhanced disclosure through a pilot study involving a sample of leading financial intermediaries covering the full spectrum of financial activities. OSFI is coordinating the participation of two Canadian financial institutions in this pilot.

Focus on Life Insurance Disclosure in 1999 Review

Significant changes occurred in the Canadian insurance industry in 1999-2000. The most profound change resulted from the demutualization of four large life insurance companies. This has resulted in the federally regulated life insurance industry evolving from an industry dominated by a few large mutual companies to one that is dominated by stock companies. As the life insurance industry becomes more focussed on maximizing shareholder value and analysts become more familiar with the life insurance industry, there will be increased demand for detailed disclosure. As a result, OSFI directed the focus of its 1999 disclosure review to the life insurance industry. In the future, OSFI intends to turn its attention to a review of disclosures made by Property and Casualty insurance companies.

OSFI reviewed a sample of 1999 annual reports of large federally regulated life insurers. Although the review found these companies were in general compliance with the *Annual Disclosure Requirements (Life Insurance Enterprises)*, Guideline D-1A, OSFI believes improvements could be made in the level of detail provided. The following represents graphically the large life companies' compliance with the components outlined in D-1A:

Disclosure - Large Canadian Life Companies



OSFI found that the life industry has made strides in demystifying the general risk concepts associated with policyholder (actuarial) liabilities and the risks associated with their resultant cash flows. However, further progress is required to clarify the risks and the controls. Detail and discussion of underlying methodologies, assumptions and analytical techniques in deriving the policyholder liabilities would make the disclosure more meaningful. For example, the assumptions used in calculating the PfAD (the provision for adverse deviation included in the actuarial liabilities) and the MAD (the calculated margin for adverse deviation added to each assumption) could have a significant impact on both earnings and the level of reserves. Disclosure of such details will be in demand by industry analysts as their understanding of the insurance industry grows.

OSFI believes large insurance companies should provide a clearer picture of the participation of the Board of Directors in the monitoring and control of risk within each institution. Generally, the current involvement of the Board has been disclosed in broad statements with little, if any, detail. OSFI expects there will also be pressure to provide this information as equity analysts start to place more weight on management effectiveness and Board oversight in differentiating the risks associated with individual industry players.

A random review of the 1999 annual statements of smaller Canadian life insurers, foreign life branches and fraternal associations, all of which are subject to guideline D1-A, was also conducted. The results of OSFI's review indicated much less detailed disclosure, which generally met only the minimum level of compliance with OSFI's guideline. Often, the disclosure was devoid of management discussion and analysis, with little or no information provided on Board oversight. In recognition of these weaknesses, OSFI continues to work with the industry to enhance the industry level of disclosure.

Co-ordinated Efforts to Enhance Actuarial Disclosure

Several years ago, the Canadian Institute of Actuaries (CIA) and the Canadian Institute of Chartered Accountants (CICA) agreed on the form of a disclosure statement to be included by Canadian life insurance companies in the notes to published financial statements. The note discloses the nature of the risks to which the insurer is subject and contains a discussion of provisions in the statements to provide for these risks. However, the note does not usually contain specific disclosure of related financial information.

Through the CIA Committee on the Role of the Appointed Actuary, of which OSFI is a member, steps are being taken to promote disclosure of actuarial financial information. The committee has recently resumed its study of approaches toward financial disclosure and is receiving input from the CICA. In particular, the committee is developing a guideline on the disclosure of Embedded Value. It is expected that the larger life insurers will begin to disclose Embedded Value information in the next two years.

Life Insurance Seminar

In the belief that increased financial disclosure and the resultant increased market discipline will act to strengthen companies, OSFI will sponsor a seminar aimed at market analysts and rating agencies. The seminar, to be held in the fall of 2000, is intended to enhance the participants' understanding of some of the technical details of Canadian financial reporting for life insurance companies, particularly in the actuarial area. The seminar will be co-sponsored by the CIA.

Consumer Information

Canada enjoys one of the most advanced and well administered financial systems in the world. It is evolving steadily because of new technologies and increased competition, which offer more choice and opportunities for consumers and benefit Canadian society.

We welcome any questions about OSFI's role and responsibilities or any complaints and enquiries concerning OSFI-regulated institutions. In an effort to be as transparent and as accountable as possible, several methods are available to communicate with or obtain information about OSFI:

Internet

OSFI's Web site address is http://www.osfi-bsif.gc.ca

This 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 regulated by OSFI.

Consumer Complaints and Enquiries

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