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.

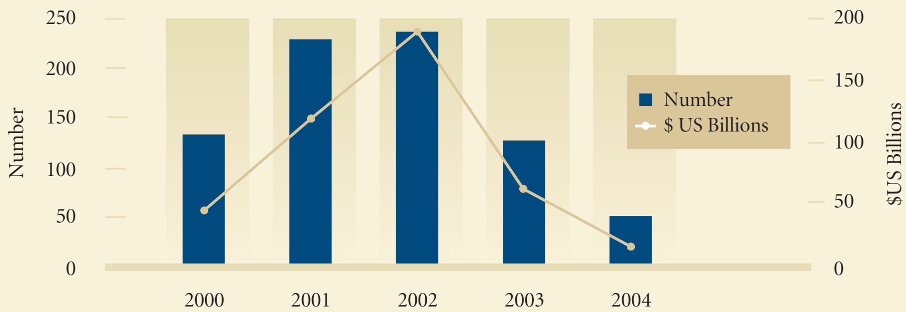
Canada's economy experienced substantial growth in the first half of 2004, led by the natural resources sector, which experienced a surge in energy and non-energy commodity prices. However, an appreciating Canadian dollar resulted in exports decelerating over the final few months of the year, bringing 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.

GLOBAL CORPORATE DEFAULTS



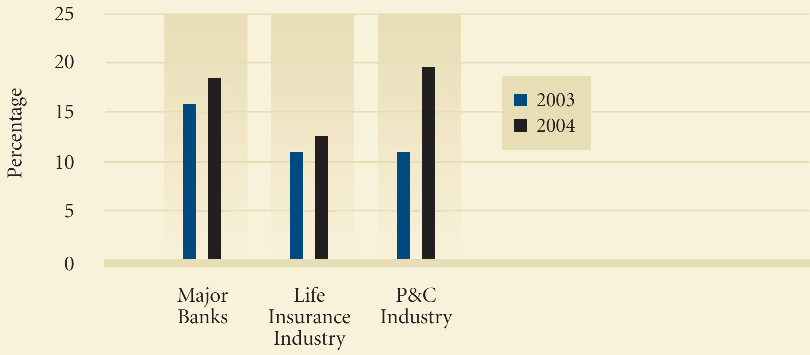
Improved corporate profits worldwide reduced defaults in 2004.
Source: Standard & Poor's

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.

RETURN ON EQUITY



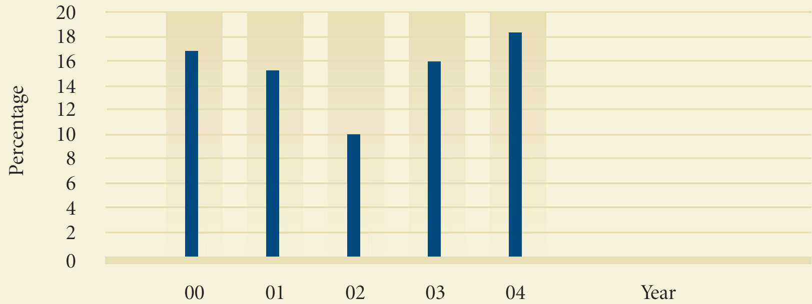
All financial services industries reported an increase in average return on equity in 2004.

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.

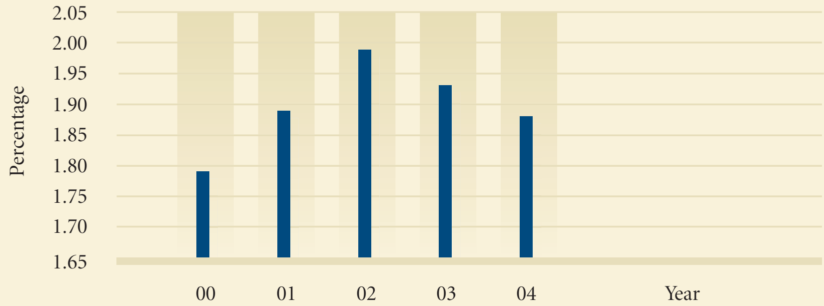
The improvement in operating performance came, in large part, from lower provisions for loan losses as a result of favourable economic conditions, recoveries, and reductions in the general reserve. Domestic retail banking performed strongly, despite the compression in interest margins resulting from 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.

MAJOR BANKS: RETURN ON EQUITY



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

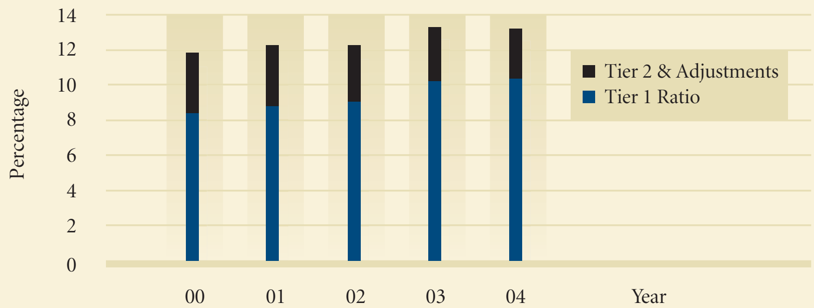
MAJOR BANKS: SPREAD – INTEREST INCOME LESS INTEREST EXPENSE / AVERAGE TOTAL ASSETS



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.

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.

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

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.

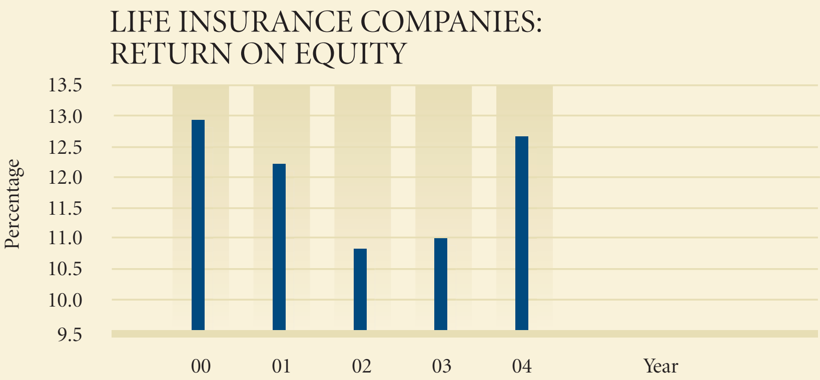
Driven by robust growth in the domestic economy and continued strong demand for household credit in 2004, the smaller deposit-taking institutions showed year-over-year improvements in operating results. While the majority of these institutions did not achieve the return on equity levels of the major 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.

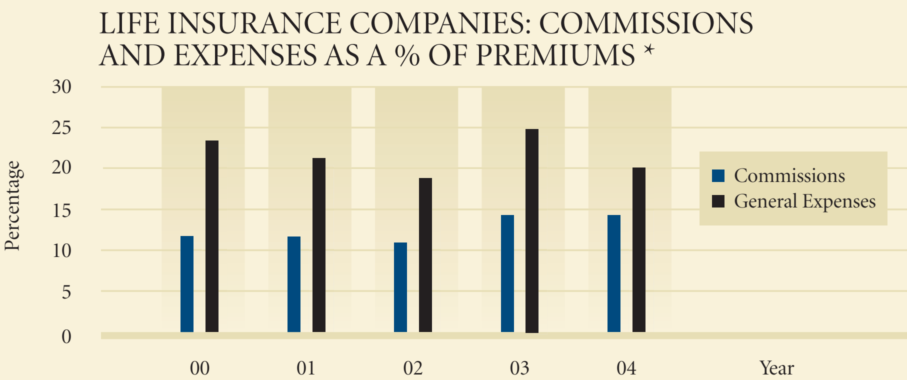
Life Insurance Companies

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

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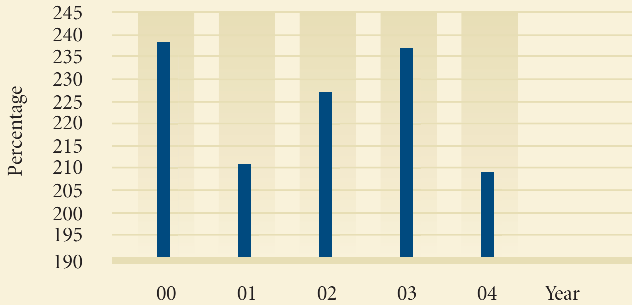
Specialist Supervisor,
FIG – Vancouver,
Supervision Sector

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.

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

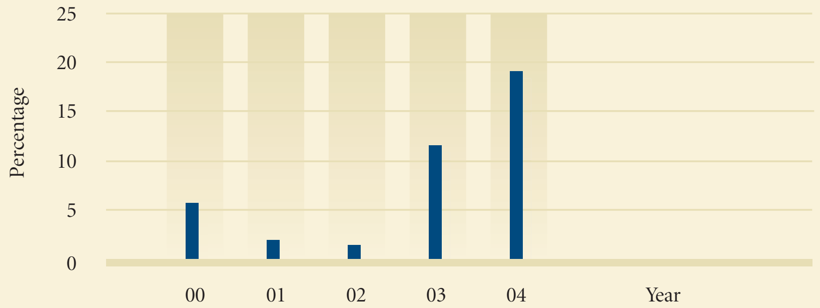
Going forward, the industry also needs to remain vigilant on actuarial matters. The reliance that auditors place on reports prepared by appointed actuaries is under review. There needs to be a focus on the quality of publicly disclosed information on actuarial liabilities, and OSFI supervisors have been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

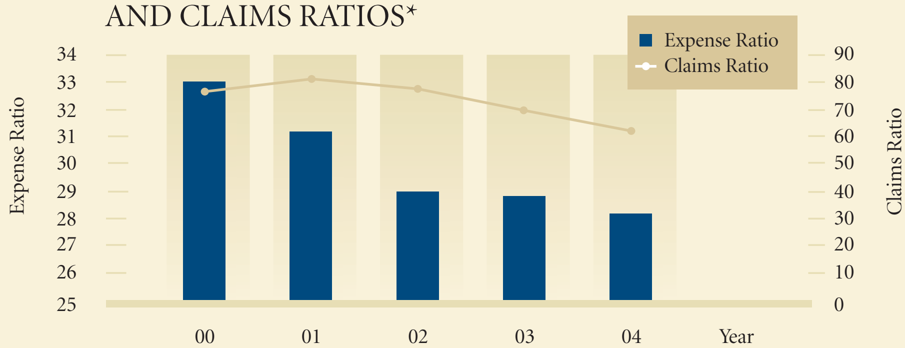
The Facility Association (residual automobile insurance market) rebounded in 2004, reporting a $500 million profit offsetting a $500 million loss the previous year. The number of drivers insured through the Facility Association dropped significantly.

P&C INSURANCE: RETURN ON EQUITY



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

P&C INSURANCE: EXPENSE AND CLAIMS RATIOS*



*Ratio of expenses and claims to earned premiums.

Rate increases and a reduction in auto insurance claims frequencies have improved P&C underwriting results.

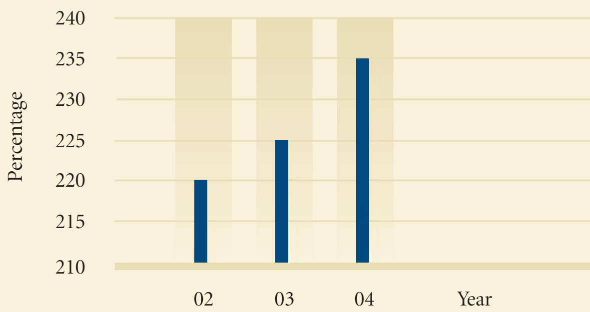
JUDY ORLANDO
Administrative Assistant, FIG – Vancouver, Supervision Sector

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%.

P&C INSURANCE: MCT/BAAT RATIOS



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.

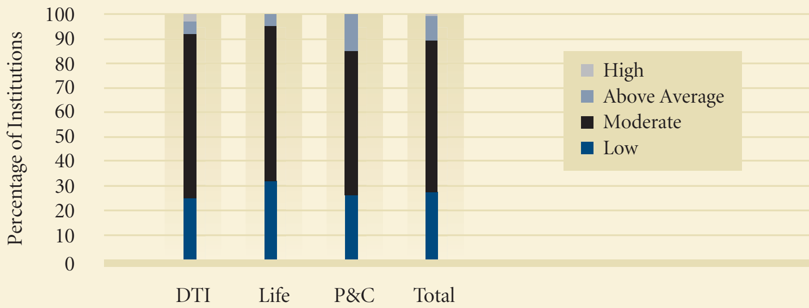
Composite Risk Ratings (CRR)

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.

COMPOSITE RISK RATING BY SECTOR

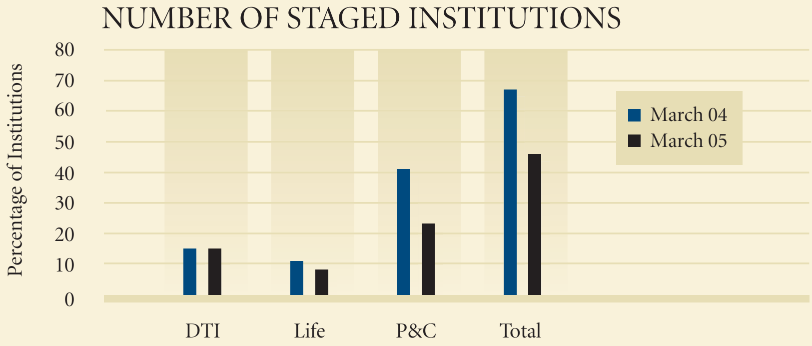


As at March 31, 2005, 90% of rated financial institutions were assessed as low or moderate risk.

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 Deterring 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.

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Supervision Sector

Approvals

Office of the Superintendent of Financial Institutions Act

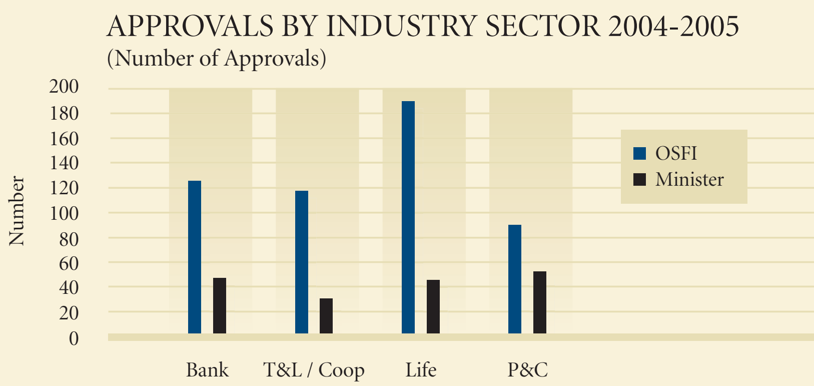
"The Superintendent has the powers, duties and functions assigned to the Superintendent by the Acts referred to in the schedule . . ."

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.



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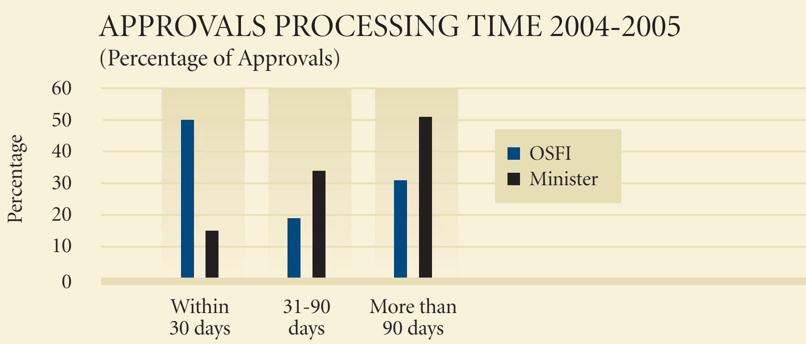
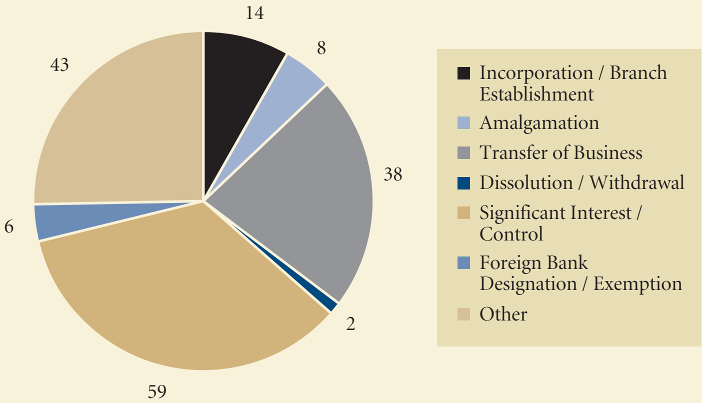
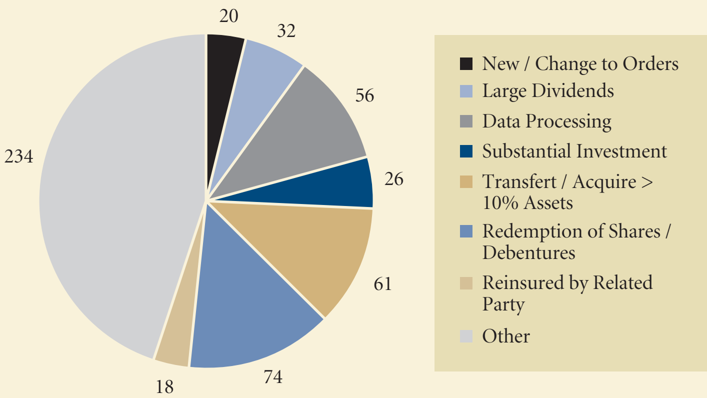


Ministerial approvals accounted for 25% of all approvals.

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.

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