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

Striking a Balance

OSFI Annual Report 2005-2006

OSFI BSIF

Canada

Striking a Balance

An Inukshuk is a unique stone sculpture built by the Inuit people in the Canadian Arctic to guide travelers on a safe journey. The stones are carefully chosen for how well they fit together, and the efforts of many people are needed to build each sculpture. The Inukshuk conveys the approach that guides OSFI's work – working together with various stakeholders to strike the right balance and ensure the safety and soundness of the Canadian financial system.

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Cat. No. IN-2006E-PDF ISBN 0-662-43403-X

OSFI at a Glance

- OSFI was established in 1987 to contribute to public confidence in the Canadian financial system. It is an independent agency of the Government of Canada and reports to the Minister of Finance.
- The financial services sector represents 6% of Canada's Gross Domestic Product, employs over 600,000 Canadians and pays $13 billion in taxes. A properly functioning, efficient financial services sector is essential to Canada's economy.
- OSFI supervises and regulates over 450 banks and insurers, and some 1300 federally registered private pension plans. As at March 31, 2006, these organizations managed a total of $2,875 billion of assets.
- The Office of the Chief Actuary, which is part of OSFI, provides actuarial services for the Canada Pension Plan, the Old Age Security program, the Canada Student Loans Program and other public sector pension and benefit plans.
- OSFI recovers all of its costs. OSFI is funded mainly through asset-based, premium-based or membership-based assessments on the financial services industry and a 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 various public sector pension and benefit plans.
- The International Advisory Group within OSFI assists selected emerging market economies in enhancing their supervisory system, through training programs or hands-on technical advice. Funding is provided by the Canadian International Development Agency.
- OSFI employs some 435 people in offices located in Ottawa, Montréal, Toronto and Vancouver.

Letter of Conveyance

The Honourable James M. Flaherty, P.C., M.P.
Minister of Finance
Ottawa, Canada K1A 0A6

Dear Minister:

Pursuant to section 40 of the *Office of the Superintendent of Financial Institutions Act*, I am pleased to submit to you the Annual Report of the Office of the Superintendent of Financial Institutions (OSFI) for the period April 1, 2005 to March 31, 2006.

This report also includes the report on the administration of the *Pension Benefits Standards Act, 1985* (PBSA), for the period April 1, 2005 to March 31, 2006, pursuant to section 40 of the PBSA.

Yours sincerely,

Nicholas Le Pan
Superintendent

Ottawa, September 27, 2006

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Superintendent's Message

Striking a Balance

OSFI's achievements are based on the need to balance the interests of many groups: depositors, policyholders and private pension plan members, as well as financial institutions and private pension plans. This makes our work both challenging and rewarding, and 2005-2006 was no exception. I am proud of how our employees dealt with both the complexity of the financial environment and the needs of individual Canadians, and used their expertise and good judgment to make effective decisions. This is how we are able to *strike the right balance*.

OSFI was created to contribute to public confidence in the Canadian financial system. A survey we released this past year confirmed Canadians are very confident that their financial institutions are stable, and they have little concern institutions might be getting into financial difficulty. The continued high level of public confidence in the Canadian financial system reflects the safety and soundness of the industry and, while there are several contributing factors, effective regulation and supervision is a key one.

OSFI's legislative mandate gives us clear direction about protecting the rights and interests of depositors, policyholders and private pension plan members. But it also includes the need to allow institutions to compete effectively and take reasonable risks, and it indicates that, despite our best efforts, financial institutions can fail and pension plans can be terminated. We must balance competitiveness with stability or, put another way, the rights and interests of various stakeholders with the overall goal of ensuring safety and soundness.

Rule making – a balance

One of our main roles is to advance and administer a regulatory framework. We do this in part by developing rules and guidelines for institutions. The challenge, however, is to know when rules are necessary. We do not want to create additional burden on institutions, so we consider and consult extensively before we propose new rules. We also look at ways to simplify or eliminate existing rules. For example, during 2005-2006, we participated in the consultation process led by the Department of Finance on the federal financial institutions legislative framework. Our proposals were designed to improve the efficiency and effectiveness of the regulatory framework.

Balancing the need to be thorough and efficient was evident in our approvals process. OSFI processed more than 600 applications for approvals during 2005-2006. We implemented performance standards establishing time frames for the processing of applications. Further, initiatives to reduce regulatory burden and streamline processes were partly responsible for a 13% reduction in approvals from last year.

Intervening – a balance

Intervention is a tool that we use judiciously and only when necessary. OSFI identified a number of issues and potential problems at institutions and with private pension plans and we intervened quickly to improve governance and control practices and to enhance safety and soundness. But, these interventions were done carefully, as we recognize there is a balance to be reached between intervening when it matters and intrusions that could stifle success. In determining when and how we intervene we always consider our mandate and whose interests we are charged with protecting. We recognize that the outcome may not always be satisfactory to all stakeholders.

At OSFI, our people make judgments every day and I am proud of the professionalism and integrity that we bring to our decisions. We don't always please regulated entities, but I believe we are fair in our dealings with them; we explain our decisions clearly and we follow due process.

OSFI supervises more than 450 financial institutions. This requires that we balance the need to maintain effective supervision with the need to focus risk assessment and intervention toward higher-risk areas. We must allow institutions to compete and grow their businesses, yet scrutinize their ability to manage the inherent risk of increasingly complex financial products through better controls. This becomes increasingly challenging as more Canadian institutions embrace globalization.

Developing international policy – a balance

Canadian institutions operating in foreign markets not only must comply with our regulations, but they must meet the rules set in other jurisdictions. OSFI is active in the development of international rules, such as accounting standards, to promote greater consistency across various jurisdictions.

The *International Convergence of Capital Measurement and Capital Standards: a Revised Framework*, or "Basel II", offers a new set of standards for establishing minimum capital requirements for banking organizations. It applies to all internationally active banks operating in the jurisdictions of members of the Basel Committee (G10 countries).

This initiative continued to be a key priority for OSFI in 2005-2006, as we prepared for full implementation. We drafted the Capital Adequacy Requirements guidelines for implementation in Canada which incorporate the more risk-sensitive capital standards proposed. As chair of the Basel Accord Implementation Group, I am confident Canadian banks are well positioned to take advantage of Basel II's provisions, and the improvements in risk measurement and management should benefit Canadian banks' ability to compete and maintain the strength of our financial system. OSFI is meeting this challenge through internal and external recruitment and the development of more intensive interaction with bank supervisors in other countries.

Combating money laundering and terrorism financing – a balance

Financial institutions must also balance their operational requirements against the need to combat money laundering and terrorism financing. In 2005, OSFI hosted an anti-money laundering and anti-terrorism financing information session to highlight OSFI's key initiatives and expectations. This session, the first of its kind held by OSFI, was attended by representatives from more than 120 financial and other institutions. OSFI also participated in consultations about proposals issued by the Government of Canada to strengthen Canada's anti-money laundering (AML) and anti-terrorism financing (ATF) framework, and furthered our supervision program regarding AML/ATF at federally regulated financial institutions.

Supervising private pension plans – a balance

Supervising some 1,300 federal private pension plans in Canada is one of our current challenges. Our actions and decisions affect plan members as well as the sponsors and administrators of the plans. While the situation with plan deficits stabilized by the end of fiscal 2005-2006, it remains fragile. Continued vigilance by OSFI, plan sponsors and administrators is warranted, especially in the handful of plans where the funding shortfall is significantly more than 10%. But while OSFI is mandated to protect private pension plan members, we must be careful to avoid actions that place defined benefit plans at a disadvantage. Balancing the interests of all stakeholders means considering various solutions, such as plan restructuring or plan termination. We recognize that some solutions may result in loss of benefits to members and as such are considered to be very much a last resort for plans. We expect that plan administrators and others responsible will thoroughly explore other options before pursuing these types of actions.

OSFI supervises more than 450 financial institutions. This requires that we balance the need to maintain effective supervision with the need to focus risk assessment and intervention toward higher-risk areas.

In 2005, we commissioned a firm to consult with key industry stakeholders of private pension plans to find out how they think we are performing. Overall, the findings revealed that we are viewed as being effective in discharging our mandate, and that our staff is knowledgeable, approachable and helpful. In the upcoming year, we will be taking steps to improve areas that were identified by our pension stakeholders, such as providing more feedback and dealing with approvals on a timelier basis.

Canada has set in place a public pension system that is expected to be sustainable and affordable well into the future in the face of changing demographic conditions. Ongoing review of the system, including actuarial studies performed by the Office of the Chief Actuary on various public pension programs, will help to ensure this remains the case. During 2005-2006, the Office of the Chief Actuary released its second mortality study of the Canadian population, and undertook actuarial reports for various plans, including the Old Age Security program.

Managing our affairs – a balance

We strike a balance in the way we manage our people and resources. Our employees excel at what they do. They are hard working and dedicated. In return we offer a competitive compensation program; provide interesting and challenging assignments; ensure they have a comfortable and safe environment and are recognized and rewarded for special contributions. We consult with our employees regularly and address their concerns and issues ensuring an appropriate balance between our expectations, their abilities and our mutual goals.

OSFI has done an excellent job at managing and controlling its operating costs, which are recovered from industry. This requires us to be vigilant and flexible as priorities can and do shift during the year and we must allocate resources to where they are needed most.

As a public institution, we are committed to being held accountable to Canadians. We welcome opportunities to meet with Parliamentarians and other interested parties to explain what we do and how we contribute to the financial sector and the economy.

Governance is important for all organizations and OSFI is no exception. We appointed four independent members to our audit committee this past year. While OSFI already had a strong internal audit function, this initiative further enhances the oversight of our operations. It is also consistent with our commitment to ensuring the highest levels of governance. The new members are Bernard Bougie, Michael Hasley, Anne Joynt and David Sullivan, and their wisdom and counsel have enhanced our governance.

In Conclusion

As we neared the end of this reporting period, we prepared to say goodbye to John Doran, who expressed his intention to retire after six years as Assistant Superintendent, Supervision Sector. John's expertise and knowledge of the financial services industry will be missed and we wish him well in his retirement. John's successor is no stranger to Canadian financial institutions. Ted Price joined OSFI in 2001 and brings considerable experience and a comprehensive understanding of the importance of our mandate to his new role.

Our philosophy is to continue building on our strengths, constantly assessing and measuring our performance, so that we retain our reputation as a world-class regulator. This is what Canadians expect and deserve from us.

As we make our way through another challenging year at OSFI, I am confident that we will continue to strike the right balance in meeting our mandate.

Finally, you may recall that in July 2006, I announced my intention to resign as Superintendent in mid-October of the same year. I have served in a senior capacity at OSFI for 11 years and as Superintendent for more than five. I am very proud of the work that OSFI has done during my term and have every reason to believe it will continue to be viewed as one of the top prudential regulator and supervisors in the world.

Nicholas Le Pan
Superintendent

Performance Highlights

OSFI's mandate is to ensure the safety and soundness of the Canadian financial system, while allowing federally regulated financial institutions and private pension plans to compete effectively and take reasonable risks. We balance competitiveness with stability; international rules with Canadian market realities; efficiency with thoroughness. This approach to striking a balance guided our performance during 2005-2006.

In OSFI's last Annual Report, we outlined our priorities for the coming year. In this section we report back on our major accomplishments in each program area.

In brief, here is what we said we were going to do in 2005-2006, and here are some highlights that illustrate what we accomplished.

Federally Regulated Financial Institutions

Priority

Accurate risk assessments of financial institutions and timely, effective intervention and feedback.

Steps Taken

- Intervened with a number of problem institutions to improve governance and control practices, and to enhance safety and soundness.
- Reduced the number of insurance institutions on OSFI's watch list reflecting, in large part, the improved health of the Property and Casualty (P&C) industry, as well as OSFI interventions. The number of staged P&C companies (those requiring enhanced intervention) at the end of 2005-2006 dropped sharply from the previous year.
- Assigned Composite Risk Ratings (CRR) on most institutions. Assigned a low or moderate CRR to 94% of rated institutions as at March 31, 2006 (compared to 90% the previous year); assessed less than 1% as high risk (similar to the previous year).
- Focused risk assessment and intervention activities toward higher risk areas. For example, OSFI increased its assessment of risk arising from foreign operations of Canadian financial institutions.
- Scrutinized financial institutions' capabilities to manage the inherent risk of increasingly complex financial products.
- Continued to focus on reputational risk issues, including anti-money laundering (AML) and anti-terrorism financing (ATF). Canada and other jurisdictions have stepped up their AML and ATF efforts.
- Reviewed the expected consequences of an avian flu pandemic for federally regulated financial institutions, including the adequacy of life insurers' capital to withstand the effects on claims and operations.

Priority

A balanced, relevant regulatory framework of guidance and rules that meets or exceeds international minimums.

Steps Taken

- Contributed to the modernization of the legislative corporate governance framework applicable to federal financial institutions, through Bill C-57.
- Responded to a consultation document issued by the Department of Finance on the federal financial institutions legislative framework, and made proposals designed to improve the efficiency and effectiveness of the regulatory framework.
- Continued to collaborate with standard setters, including the Canadian Accounting Standards Board, and the Auditing and Assurance Standards Board. Worked closely with the Canadian Institute of Actuaries to convey our views on acceptable standards and ensure they lead to acceptable valuations.
- Drafted Capital Adequacy Requirements (CAR) Guidelines for deposit-taking institutions, incorporating the more risk-sensitive capital standards proposed by the Basel Committee on Banking Supervision. Issued eight capital implementation notes communicating supervisory expectations and approval requirements for FRFIs applying to utilize the more advanced approaches available under the guidelines.
- Issued a Guideline on Capital Adequacy Requirements for Regulated Insurance Holding Companies and Non-operating Life Companies, designed to ensure there is adequate capital in a consolidated group led by a holding company.
- Issued a draft accounting guideline promoting sound risk management when financial institutions use the Fair Value Option available under Canadian Generally Accepted Accounting Principles.
- Issued guidelines to help ensure the Chief Agent and Principal Officer play a central role in the management of foreign insurance company branches and foreign bank branches in Canada.
- Participated in the drafting of the Department of Finance's Consultation Paper on strengthening Canada's anti-money laundering (AML) and anti-terrorism financing (ATF) framework, and consulted with federally regulated financial institutions.
- Hosted an AML/ATF information session, attended by more than 120 financial and other institutions, to highlight OSFI's key initiatives and expectations.
- Contributed to the development of sound international rules, through work with various groups including the International Association of Insurance Supervisors, Basel Committee on Banking Supervision, the Joint Forum, and the Financial Action Task Force.
- Played a key role in the Basel Committee on Banking Supervision (BCBS).
- Hosted a 'college of supervisors' to exchange information and discuss cross-border implementation approaches for Basel II with supervisors of major foreign subsidiaries of Canadian banks.

Priority

A prudentially effective, balanced and responsive approvals process.

Steps Taken

- Streamlined the framework governing OSFI's 'service charges'. As a result, the costs associated with the administration of the user fee system are expected to fall for both OSFI and financial institutions, although some minor adjustments may take place in the allocation of OSFI's base assessments.
- Processed 603 applications for approvals. Streamlining initiatives introduced by OSFI to reduce regulatory burden contributed to a 13% reduction in approvals from 2004-2005. However, the complexity of the approvals being reviewed has increased.
- Implemented and met performance standards establishing time frames for processing applications for regulatory approval and for other services subject to a user fee.
- Developed Transaction Instructions for applicants seeking to acquire a significant interest and/or legal control of a federally regulated financial institution, designed to enhance OSFI consistency in assessing applications.
- Developed Advisory and Transaction Instructions on the Legislative Framework for Foreign Banks, designed to enhance understanding of the regime that applies to foreign banks in Canada.
- Hosted a Legislation and Approvals Seminar, focused on issues related to OSFI's approvals process.

Federally Regulated Private Pension Plans

Priority

Accurate risk assessments of pension plans, timely and effective intervention and feedback, a balanced and relevant regulatory framework, and a prudentially effective and responsive approvals process.

Steps Taken

- Posted a 10% increase in the number of private pension plans on OSFI's watch list during 2005–2006, from 77 at the start of the fiscal year, to a low of 71, to a year end of 86 (67 were defined benefit plans and 19 defined contribution plans). Some plans remedied their problems and were removed from the list, in part through OSFI's actions.
- Identified defined benefit plans with an estimated solvency funding deficit (about 78% of supervised defined benefit plans as at December 2005, compared to 55% in December 2004). In part due to OSFI's efforts, almost all of these plans are dealing actively with their deficits through plan funding.
- Intervened successfully in many cases, both through the courts using our intervention powers and cooperatively, to avoid significant losses to plan members.
- Took actions with underfunded pension plans that continued to take contribution holidays, ranging from strongly encouraging plan sponsors to cease the contribution holidays to requiring enhanced notification to members and requesting early valuation reports.

- Dealt actively with late remittance issues in selected defined contribution plans.
- Published guidance on asset transfers and reductions of accrued benefits to clarify OSFI's expectations and improve transparency. Increased resources and refined internal processes to improve timeliness on approvals.
- Provided input to the May 2005 Department of Finance consultation paper on the regulatory framework for federally regulated defined benefit pension plans.
- Completed a number of detailed desk reviews of defined benefit plans and undertook a number of on-site examinations during the year, with a continued focus on governance and disclosure to members.
- Continued to promote responsible pension plan governance and actuarial practices by working closely with the Canadian Association of Pension Supervisory Authorities (CAPSA) and the Canadian Institute of Actuaries.
- Undertook comprehensive consultations with key industry stakeholders to understand perceptions of OSFI's performance. Overall, the findings revealed that OSFI is viewed as being effective in discharging its mandate, and that staff are knowledgeable, approachable and helpful. Areas for improvement were identified, such as providing more feedback and more information of a general nature, and dealing with approvals on a more timely basis.

International Assistance

Priority

Contribute to awareness and improvement of supervisory and regulatory practices for selected foreign regulators through the operation of an international assistance program.

Steps Taken

- Continued to offer unique 'in-house' programs that allow bank and insurance company supervisors from around the world to visit and learn at OSFI, and hosted many delegations to OSFI.
- Worked in 23 different jurisdictions, many of which the International Advisory Group (IAG) visited several times. Hundreds of foreign supervisors received the benefit of IAG's training.
- The focus moved from theory to implementation in several key jurisdictions, where IAG worked alongside foreign supervisors 'in the field'. Provided legislative and regulatory drafting expertise, and assisted with the selection process for senior level supervisory staff.
- Was awarded a substantial project in Chile, to assist the insurance regulator Superintendencia de Valores y Seguros to develop a risk-based supervision model and a risk-based capital test.
- Continued to be involved with the International Monetary Fund (IMF) / World Bank Financial Sector Assessment Program (FSAP), as 'experts' in the assessment of compliance with the Basel Core Principles and the IAIS Core Principles. Assisted several jurisdictions attempting to correct deficiencies identified during their FSAP assessment, or preparing self-assessments.

Office of the Chief Actuary

Priority

Contribute to financially sound federal government public pension and other programs through the provision of expert actuarial valuation and advice.

Steps Taken

- Undertook a number of actuarial reports for various plans, including the Old Age Security program, pension plans for members of Parliament, the Public Service, Canadian Forces and the RCMP.
- Completed the fourth annual actuarial review of the Canada Student Loans Program.
- Released the *Old Age Security Program Mortality Experience*, the second mortality study published by the OCA, estimating the mortality rates of Canadians based on the Old Age Security database.
- Hosted an interdisciplinary seminar entitled "Demographic, Economic and Investment Perspectives for Canada—Years 2006 to 2050", including speakers from the US Social Security Administration and the UK Government Actuary's Department.
- The Chief Actuary appeared before the House of Commons Standing Committee on Finance, ensuring an open, transparent and public lens for the independent work of the Chief Actuary.
- The Chief Actuary appeared before the Senate Standing Committee on Banking, Trade and Commerce to talk about demographic change that will occur in Canada within the next two decades and possible actions that could be taken to address the implications for public pension plans.

Corporate Responsibility

Priority

High-quality internal governance and related reporting.

Steps Taken

- In February 2006, appointed four independent members to OSFI's Audit Committee, who represent a majority of the committee, further enhancing the oversight of OSFI's operations.
- Created the position of Director, Strategic Planning and Performance Measurement, to better integrate the OSFI risk assessment, strategic planning and performance measurement process.
- Further rolled out the Enterprise Risk Management (ERM) process across OSFI, to allow for greater understanding and ownership of risks at the working levels.
- Conducted a survey of OSFI's web site users. Overall, the results were very positive, as a clear majority of respondents said they were satisfied with the content and functionality of the site.

Stéphane Dupel
Administrative Officer,
Human Resources and Administration Division,
Corporate Services Sector

Corporate Services

Priority

Resources and infrastructure necessary to support supervisory and regulatory activities.

Steps Taken

- Introduced Human Resources policies, practices and training programs to ensure compliance with the new *Public Service Modernization Act*.
- Continued to improve the integration of the Human Resources planning process with the business planning process.
- Implemented a number of venues to improve internal communication, such as focus groups and town halls, and updated OSFI's Intranet.
- Introduced a 360-degree feedback process for all executive staff, which will lead to personalized development plans in the following year's performance management process.
- Laid the groundwork for an updated comprehensive Threat and Risk Assessment, and completed the first step, a review of physical security at all OSFI locations.
- Created an internal working committee to plan how OSFI would deal with a possible avian flu pandemic, both from the perspective of maintaining internal business operations and from the perspective of effectively regulating and supervising financial institutions and pension plans.
- Completed the implementation of the multi-year Business Systems Integration Initiative, and made progress on the Electronic Document Management System.
- Initiated systems development to prepare for the introduction of the Basel II Framework.
- Introduced business intelligence tools in the supervision process to enhance reporting and analytical capability for data OSFI reviews on financial institutions.
- Created a Priority Project and Information Management/Information Technology Change Management Committee at the executive level, to formalize the process of reviewing IM/IT investments and ensure the best integration of technology and business requirements.

Priorities Going Forward

OSFI's priorities going forward are tied to the program activities OSFI undertakes and contribute directly towards achieving OSFI's strategic outcomes. OSFI has eight priorities related to its program activities and two priorities for program support. More details about these priorities may be found on OSFI's web site in the *Report on Plans and Priorities 2006–2007 to 2008–2009*.

1. Ensure that OSFI is in a position to review and approve applications that are submitted for approval under the Basel II capital framework.
2. Participate in and monitor international work on conceptual changes to accounting standards.
3. Accurate risk assessments of financial institutions and timely, effective intervention and feedback.
4. A balanced, relevant regulatory framework of guidance and rules that meets or exceeds international minimums.
5. A prudentially effective, balanced and responsive approvals process.
6. Accurate risk assessments of pension plans, timely and effective intervention and feedback, a balanced relevant regulatory framework, and a prudentially effective and responsive approvals process.
7. Contribute to awareness and improvement of supervisory and regulatory practices for selected foreign regulators through the operation of an international assistance program.
8. Contribute to financially sound federal government public pension and other programs through the provision of expert actuarial valuation and advice.
9. High-quality internal governance and related reporting.
10. Resources and infrastructure necessary to support supervisory and regulatory activities.

Corporate Responsibility

Responsibility and Mandate

Role

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

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

OSFI works with a number of key partners. Together, these organizations constitute Canada's network of financial regulation and supervision and provide a system of depositor and policyholder protection.

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.

Legislation

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

- *Bank Act*
- *Trust and Loan Companies Act*
- *Green Shield Canada Act*
- *Cooperative Credit Associations Act*
- *Insurance Companies Act*
- *Pension Benefits Standards Act, 1985*
- *Office of the Superintendent of Financial Institutions Act*

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

Mandate

OSFI was created to contribute to public confidence in the Canadian financial system, at the same time balancing the need for financial institutions to be able to compete.

Under our legislation our mandate is to:

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

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

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

Strategic Outcomes

From our mandate, OSFI has identified two strategic outcomes:

1. **To regulate and supervise to contribute to public confidence in Canada's financial system and safeguard from undue loss.**
   OSFI safeguards depositors, policyholders and private pension plan members by enhancing the safety and soundness of federally regulated financial institutions and private pension plans.

2. **To contribute to public confidence in Canada's public retirement income system.**
   This is achieved through the activities of the Office of the Chief Actuary, which provides accurate, timely advice on the state of various public pension plans and on the financial implications of options being considered by policy-makers

Who We Regulate

OSFI supervises and regulates all federally incorporated or registered deposit-taking institutions (e.g. banks), life insurance companies, property and casualty insurance companies, and federally regulated private pension plans. These 1,759 organizations managed a total of $2,887 billion of assets (as at March 31, 2006). *(See figure 1)* OSFI also undertakes supervision of provincially incorporated financial institutions on a cost-recovery basis under contract arrangements with some provinces.

(figure 1)

	Deposit Taking Institutions	*Life Insurance Companies*	*Property & Casualty Companies*	*Federally Regulated Private Pension Plans*	*Total*
Number of organizations	147	119	189	1,304	1,759
Assets	$2,292 billion	$388 billion	$91 billion	$116 billion	$2,887 billion

Program Activities

OSFI's strategic outcomes are achieved through program activities.

Regulation and Supervision of Federally Regulated Financial Institutions

The three sub-activities of this program are:

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

Regulation and Supervision of Federally Regulated Private Pension Plans

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

International Assistance

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

Rod Giles
Manager, Communications and Public Affairs, Corporate Services Sector

Office of the Chief Actuary

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

Corporate Services

The above functions are supported by corporate initiatives undertaken by the Corporate Services Sector, which contribute to the effectiveness and efficiency of OSFI.

Resources

Financial Resources

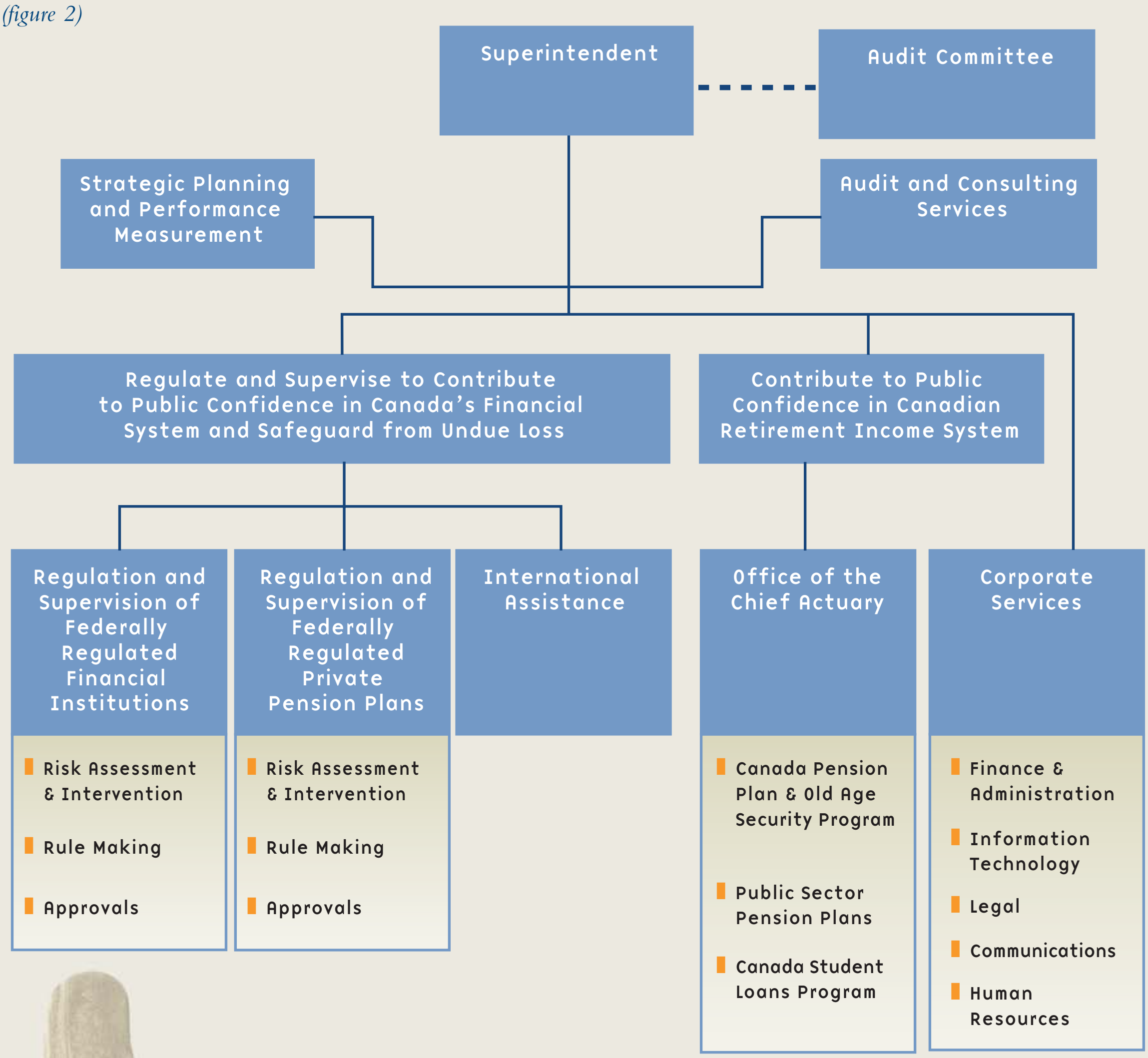
OSFI recovers all of its costs. The organization is funded mainly through asset-based, premium-based or membership-based assessments on the financial services industry and a user-pay program for selected services. A small portion of OSFI's revenue is derived from the Government of Canada, primarily for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

Human Resources

OSFI employs some 435 people in offices located in Ottawa, Montréal, Toronto and Vancouver.

The way OSFI meets its strategic outcomes is set out in the following chart.

(figure 2)



as at March 31, 2006

Executive Team

Nicholas Le Pan
Superintendent of Financial Institutions

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

Julie Dickson
Assistant Superintendent, Regulation Sector

Julie Dickson was appointed **Assistant Superintendent, Regulation Sector**, on January 1, 2000, having joined OSFI on April 1, 1999, as Special Advisor in the Regulation Sector. In her current role, she is responsible for capital and accounting issues; actuarial policies and reviews; regulatory approvals and compliance; guidelines, regulations and interpretations; international assistance and liaison; and pension plan supervision. Prior to joining OSFI, Ms. Dickson held positions in the Department of Finance, the Privy Council Office and the private sector. She is a member of the Basel Committee on Banking Supervision of the Bank for International Settlements and of the Accounting Standards Oversight Council of Canada. On June 9, 2006, Ms. Dickson was appointed **Deputy Superintendent.** She takes on a greater role in cross-sector issues and in representing OSFI externally.

John Doran
Assistant Superintendent, Supervision Sector

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

Donna Pasteris
Assistant Superintendent, Corporate Services Sector

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

Shortly following the end of fiscal year 2005-2006, John Doran retired as Assistant Superintendent, after six years with OSFI. The appreciation, recognition and best wishes of all of OSFI go with him. As John's successor, we welcome **Ted Price**, an experienced member of OSFI's senior management team, who will bring continued strong leadership in the Supervision Sector.

Accountability

Accountability Framework

OSFI's accountability framework comprises a variety of elements.

In addition to the Annual Report, OSFI reports to Parliament through the publication of a *Report on Plans and Priorities* (RPP) and a *Departmental Performance Report* (DPR). OSFI also produces and distributes to its stakeholders an annual *Plan and Priorities*. The Superintendent reports to the Minister of Finance on OSFI operations, and periodically appears before various House of Commons and Senate Committees.

OSFI participates in established international reviews jointly led by the World Bank/International Monetary Fund to determine whether OSFI is meeting internationally established principles for prudential regulators.

OSFI consults extensively with financial institutions, other government agencies and subject-matter experts on its regulatory rules before they are finalized. OSFI has its financial statements reviewed and approved by an Audit Committee, composed primarily of external members, and audited annually by the Auditor General. OSFI also reviews its budgets and business plans with stakeholder groups.

OSFI regularly conducts anonymous surveys of knowledgeable observers to assess its performance and effectiveness as a regulator. This includes OSFI's contribution to public confidence and how OSFI compares to other regulators. Survey results are disclosed on OSFI's web site.

The Office of the Chief Actuary (OCA) provides transparency regarding the Canadian public retirement income system through the production and subsequent tabling before Parliament of regular actuarial reports on the Canada Pension Plan (CPP), Old Age Security (OAS) program and public sector employee pension and benefit plans. Various of these reports are peer reviewed. The Chief Actuary periodically appears before various House of Commons and Senate Committees. The Superintendent chairs a committee of users of the services of the OCA to review OCA operations and overall budgets and business plans.

Strengthening OSFI's Accountability

In the spring of 2006, OSFI appointed independent members to its Audit Committee, who serve with the Superintendent. The independent members represent a majority of the committee, further enhancing the oversight of OSFI's operations. Consistent with the Controller General of Canada's approach to internal audit oversight, OSFI named one representative from the public sector.

Three of the new committee members were drawn from the private sector: Bernard Bougie, C.A., corporate director and a former senior partner with Deloitte & Touche; Michael Hasley, financial management consultant and corporate director, and a former senior financial executive at Sun Life of Canada and Guaranty Trust; and Anne Joynt, former President and CEO of Canada Post Corporation. The representative from the public sector is David Sullivan, C.A., Chief Internal Auditor for the Bank of Canada. Biographies of the audit committee members are available on OSFI's web site.

The mandate of the Audit Committee is to provide independent, objective advice, guidance and assurance to help OSFI efficiently and effectively achieve its business objectives and mandate. In order to give this support to the Superintendent, the Audit Committee will exercise active oversight of core areas of OSFI's accountability, risk and control processes. The committee is expected to meet at least four times a year, and members will serve a three-year term, with a maximum of two terms.

In the spring of 2006, OSFI appointed four independent members to its Audit Committee, who serve along with the Superintendent. The independent members represent a majority of the committee, further enhancing the oversight of OSFI's operations.

In the fall of 2005, OSFI created the position of Director, Strategic Planning and Performance Measurement, reporting to the Superintendent. The Director is responsible for strategic planning processes and key planning documents; for enhancing key management practices; and for coordinating corporate-level performance measures.

In 2005-2006, as part of OSFI's ongoing commitment to improved identification of risks and assessment of the quality of risk mitigants during the planning process, the Enterprise Risk Management (ERM) process was rolled out across OSFI. This process allows for greater understanding and ownership of risks at the working levels, and provides a consistent approach to risk management across the organization. The Director of Strategic Planning and Performance Measurement acts as OSFI's senior risk officer and ensures that the ERM results are incorporated into the corporate planning process.

Consultations with Pension Stakeholders

To monitor the status of OSFI's strategic outcomes, OSFI conducts periodic, anonymous, independent consultations with its stakeholders. This provides OSFI with an indication of its performance in certain areas, such as the appropriateness of its supervisory or rule-making practices and the usefulness of its feedback to institutions. It is one of the ways OSFI can find out if it is perceived to be striking the right balance.

In the summer of 2005, OSFI commissioned The Strategic Counsel to conduct the first such consultation with private pension plan sponsors and their professional advisors to explore perceptions of OSFI's performance and the current pension marketplace.[1] The consultation included both one-on-one interviews and an Internet survey.

The findings revealed that OSFI is viewed as being effective in discharging its mandate, and that staff are knowledgeable, approachable and helpful. Areas for improvement were identified, such as providing more feedback and more information of a general nature, and dealing with approvals on a more timely basis. More details can be found in this report in the chapter on Federally Regulated Private Pension Plans. The survey report, *Report on Pension Consultation*, is available on OSFI's web site.

Benefits to Canadians

Contributing to a Sound Economy

OSFI's strategic outcomes, supported by our plans and priorities, are intrinsically aligned with broader government priorities. A properly functioning financial system in which consumers and others, inside and outside Canada, who deal with financial institutions have a high degree of confidence, makes a material contribution to Canada's economic performance.

The financial services sector represents 6% of Canada's Gross Domestic Product, employs over 600,000 Canadians and pays $13 billion in taxes. A properly functioning, efficient financial services sector is key to Canada's economy. The achievement of OSFI's strategic outcomes, which are shared by other institutional partners within government and the private sector, provides an essential foundation for a productive and competitive economy.

Gauging Public Confidence

In June 2005, OSFI released the results of a survey gauging public confidence in financial institutions and private pension plans, *General Population Survey: Public Confidence in Canadian Financial Institutions 2005.*[2] The complete report is posted on OSFI's web site.

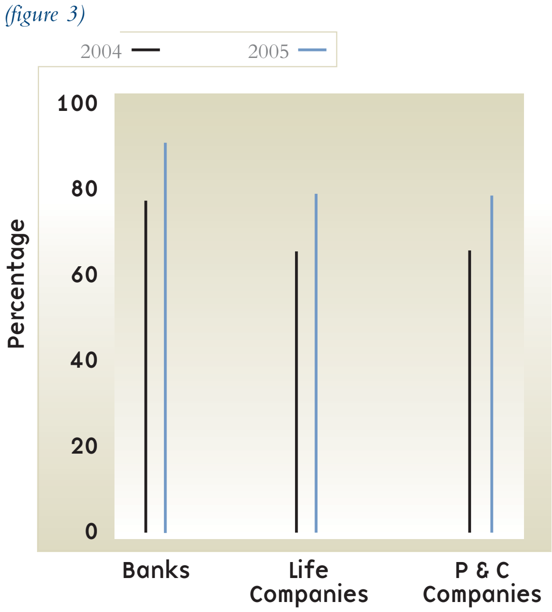
Canadians are very confident their financial institutions are stable, and express very little concern that institutions might be getting into financial difficulty. Canadians are also confident government regulation and oversight works to promote the financial health and stability of institutions.

- The vast majority of respondents (89%) expressed confidence that Canadian banks are financially healthy and stable (up from 78% in 2004). In an increase from the previous study, 78% expressed confidence in the financial health of the life insurance industry (up from 62% in 2004); and 77% expressed confidence in the financial health of the property and casualty insurance industry (up from 66% in 2004). *(See figure 3)*
- Canadians have a high level of confidence that senior management and boards of directors are working to ensure financial institutions are financially healthy and stable: banks (78%), life insurance companies (71%) and property and casualty insurance companies (70%).

[1] *The Strategic Counsel, an independent research firm working on OSFI's behalf, conducted 69 one-on-one interviews among plan sponsors or administrators and their professional advisors. OSFI provided a list of companies and key contacts but the final sample was selected by the research firm; OSFI does not know who was interviewed. Out of 399 sponsors who received an e-mail invitation to the web survey, 158 or 40% responded. Unless otherwise noted in the report, the findings reported emerged consistently across stakeholder groups.*

[2] *Decima Research conducted the survey on behalf of OSFI. The survey results were collected by telephone from a random sample of about 1000 Canadians, aged 18 and over, from across the country, during March and April 2005. With a sample of this size, the results are considered accurate within plus or minus 3.1%, 19 times out of 20.*

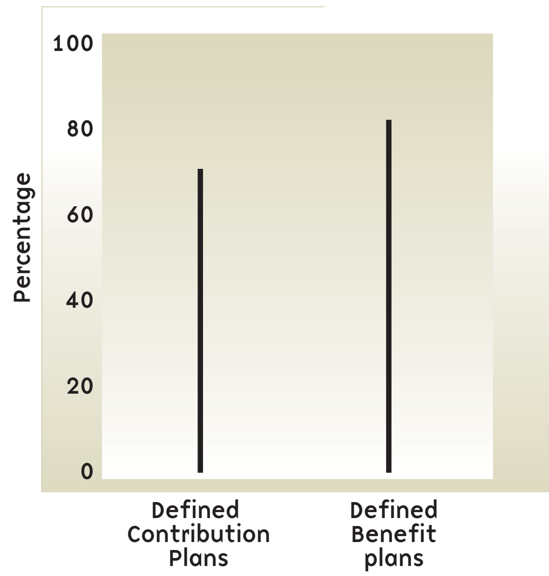
Public Confidence in Financial Institutions*
(figure 3)



*Combined responses of somewhat agree and strongly agree

Canadians are increasingly confident that their financial institutions are financially healthy and stable.

Public Confidence in Private Pension Plans*
(figure 4)



*Combined responses of somewhat agree and strongly agree

Canadians expressed a strong level of confidence that their private pension fund will be able to pay their benefits in retirement.

- The majority of respondents believe that government regulation and oversight works to ensure the financial health and stability of financial institutions: banks (68%), life insurance companies (54%) and property and casualty insurance companies (57%).
- Nearly nine out of every ten respondents (89%) believe the money they have deposited with banks is safe. Eight out of every ten Canadians (81%) believe insurance companies have adequate financial resources to pay their claims.
- A strong majority of Canadians (75% overall) believe their private pension fund will be able to pay their benefits in retirement. This applies to 82% of members of defined benefit plans, and 71% of members of defined contribution plans. (*See figure 4*)

Keeping Canadians Informed

OSFI continued to inform Canadians about our activities and plans, and to contribute to a dialogue on key issues facing the financial sector. As part of our commitment to transparency, OSFI made public various reports and findings, including its *Plan and Priorities 2006-2009; Report on Pension Consultation; General Population Survey: Public Confidence in Canadian Financial Institutions 2005*; several reports from the Office of the Chief Actuary, including an external peer review of the CPP Actuarial Report; and various internal audit reports. The full text of these findings and reports can be found on OSFI's web site.

To ensure that OSFI's web site is meeting the needs of its audience, OSFI conducted a survey of OSFI's web site users.[3] Overall, the results were very positive, as a clear majority of respondents said they were satisfied with the content and functionality of the site. Respondents also suggested some areas for improvement, for example, the search engine, the e-mail subscription customization features, and the format for downloadable documents and forms. OSFI will investigate and begin work on enhancements in 2006-2007. The survey report is available on OSFI's web site.

[3] *In the fall of 2005, the research firm ePenso.com invited over 4,800 e-mail subscribers to OSFI's web site updates to participate in the on-line survey. Of these, 448 responded, for a response rate of 9.3% and a resulting margin of error of plus or minus 4.4%, 19 times out of 20.*

In a 'behind-the scenes' initiative to increase efficiency and reduce duplication, effective November 2005, OSFI outsourced the handling of public telephone enquiries to the Canada Deposit Insurance Corporation Call Centre. Callers to OSFI's toll-free line now benefit from extended hours of operation and greater efficiency, as more officers are available to answer telephone calls and the call centre has up-to-date tracking technology. OSFI continues to furnish the information that is provided by the call centre to the public.

In accordance with federal government policies introduced in 2004, OSFI continued to publish information on travel and hospitality expenses incurred within OSFI by the Superintendent, Assistant Superintendents and Chief Actuary, as well as information on contracts over $10,000 issued by or on behalf of OSFI. The information is updated every three months on OSFI's web site.

During 2005-2006, the Superintendent and other OSFI subject-matter experts delivered nearly 40 presentations to industry and regulatory forums, both nationally and internationally, to such audiences as the World Bank, the Institute of International Bankers, the Global Association of Risk Professionals, the Empire Club, the Canadian Institute of Actuaries, and various House of Commons and Senate Committee hearings. Most of these presentations are available on OSFI's web site.

Nicholas Le Pan
November 9, 2005, Toronto

On November 9, 2005 Nicholas Le Pan spoke at an information session hosted by OSFI in Toronto for financial sector representatives. Mr. Le Pan highlighted some of OSFI's key initiatives and expectations with respect to anti-money laundering and anti-terrorism financing.

Sharing OSFI's Expertise

Throughout 2005-2006, OSFI shared its expertise with interested Canadians, including members of the general public, media, industry, regulators, and legislators:

- Served over 945,000 visits to OSFI's web site
- Handled 13,484 public enquiries
- Responded to 123 enquiries from Members of Parliament
- Replied to 137 enquiries from representatives of the news media
- Delivered nearly 40 speeches and presentations to industry and regulatory forums

Federally Regulated Financial Institutions

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 …deal with the situation in an expeditious manner."

Financial Environment

Understanding the balance institutions must achieve in order to thrive in foreign and domestic markets

Canada's major financial institutions continue to operate in an increasingly global environment. Their performance, and consequently their safety and soundness, are affected as much by foreign business and financial market conditions as by those in Canada. Understanding the balance institutions must achieve to compete and prosper, both nationally and internationally, is critical to OSFI's success as a supervisor.

Canada's financial institutions continued to benefit in 2005 from strength in both global and domestic economic and financial environments that has persisted for several years.

In 2005, the global economy continued to exhibit robust growth, led by solid expansion in the United States and China, and a pickup in domestic demand in Japan.

In Canada, the economy also grew at a healthy clip due to a strong labour market, healthy consumer activity, higher energy prices and low interest rates. Growth was somewhat moderated by the relatively weak performance of the manufacturing sector, which was affected by energy prices, competition and the appreciation of the Canadian dollar.

Supported by healthy economic growth, both domestically and abroad, Canadian financial institutions performed very well in 2005. Core earnings were at or near record highs.

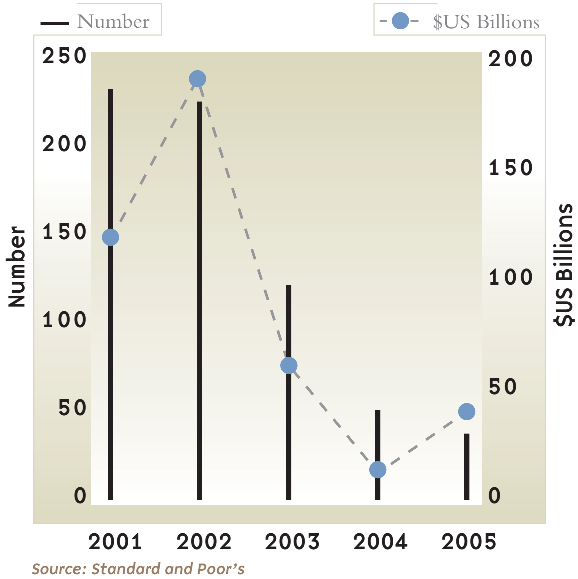
Capital levels continued to be strong and well above minimum regulatory requirements. The credit quality of the assets of the major Canadian banks was excellent. Enron-related provisions by three of the banks did not materially alter the safety and soundness of the Canadian banking system. The financial consequences of hurricanes Katrina, Rita and Wilma are not expected to have a significant effect on the financial strength of Canadian property and casualty insurers. *(See figures 5 and 6)*

In response to a number of developments in the financial environment, OSFI supervisors rebalanced their risk assessment and intervention activities on emerging areas of risk.

Management, corporate governance and oversight of risks in Canadian financial institutions are markedly improved compared to five or ten years ago. However, the risks facing financial institutions are becoming

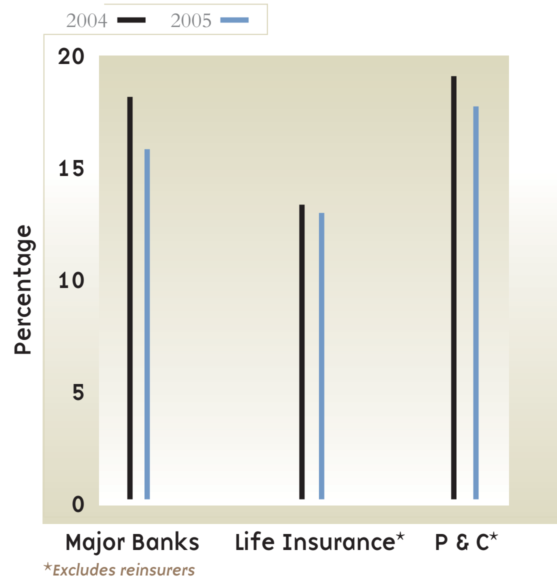
Supported by healthy economic growth, both domestically and abroad, Canadian financial institutions performed very well in 2005. Core earnings were at or near record highs.

Global Corporate Defaults
(figure 5)



Continued strong corporate profits worldwide in 2005 kept defaults at a low level.

Return on Equity
(figure 6)



The return on equity for all financial services industries declined slightly in 2005 but still remained strong.

more complex. There is the risk that the development of control processes may not be keeping pace with the inherent risk, particularly in smaller insti-tutions. As a result, OSFI supervisors are continuing to scrutinize institutions' capabilities to manage increasing risk.

On the global front, Canadian financial institutions are operating in an increasingly complex, international environment. There is greater interest in increased cross-border cooperation and an increasing reliance on OSFI by foreign regulators. As a result, OSFI has been increasing its assessment of risks arising from foreign operations and financial institutions' ability to manage those risks. At the same time, OSFI must be aware of influences affecting foreign parents of Canadian financial institutions that could materially and adversely affect Canadian operations.

Financial crime and the financing of terrorism are receiving greater attention by regulators than was the case a few years ago. OSFI has increased the number of resources focused on assessing financial institutions' ability to detect and deter money laundering and terrorist financing. OSFI's reviews indicate a need for further improvement in institutions' practices.

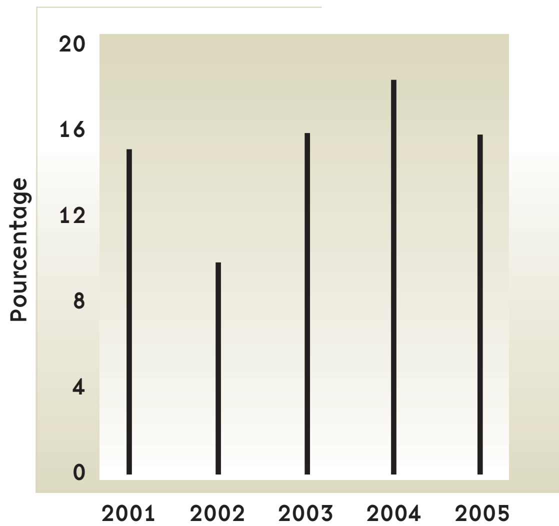
Major Canadian Banks

The six largest Canadian banks reported continued strong profitability in 2005. Average return on equity was 15.7%, compared with 18.3 % in 2004, with the decline largely attributable to the CIBC's CDN $2.5 billion provision for Enron-related legal settlements.

A benign credit environment continued to benefit the banks' financial performance. Although provisions for loan losses started to creep up from the very low levels of the past few years, and recoveries in corporate loans and reversals of the general allowance tapered off, there was no evidence of a significant turn in the credit cycle.

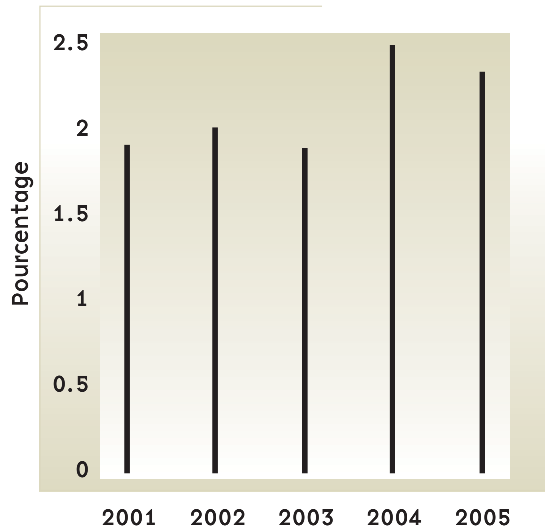
Domestic retail banking continued to be the key driver of earnings growth in 2005, supported by strong demand for mortgages, commercial loans, and core and business deposits, and by higher mutual fund fees and insurance revenues. Good expense control also contributed to the positive results. Consumer provisions edged up, although this was mainly due to strong retail loan growth. Higher short-term interest rates helped margins, although stiff competition continued to limit upside potential.

Major Banks: Return on Equity
(figure 7)



The major banks continued to report strong average returns on equity in 2005.

Major Banks: Net Interest Margin – Interest Income Less interest Expense/Average total Assets *(figure 8)*



Higher short-term interest rates in 2005 helped margins.

With favourable equity markets, wealth management posted strong results, while revenues from capital market activities were mixed and varied among the banks. (*See figures 7 and 8)*

The overall capital position of the major banks remained strong at the end of 2005. The average ratio of total capital to risk-adjusted assets was almost 13%, well above the Bank for International Settlements' 8% minimum threshold and OSFI's 10% target. These high capital levels should support continued increases in dividends, mergers and acquisitions, and common share repurchases. They also provide a buffer against unforeseeable adverse economic or financial developments. *(See figure 9)*

Overall, OSFI was satisfied with the financial condition and risk management practices of the major Canadian banks in 2005-2006. Looking ahead, however, the challenge is how to continue to grow and earn targeted rates of return in a highly competitive market. In seeking higher growth and rates of return, banks may take on risks that they will be challenged to manage or provide for adequately, with the result that overall risk may increase.

Globally, the regulatory and legal environment is changing rapidly. Within the next several years, financial institutions will be faced with changes to accounting standards, the implementation of Basel II, and changes in reporting requirements resulting from the increased focus on corporate ethics. Reputational risk issues, including anti-money laundering and anti-terrorist financing, continue to receive heightened attention from regulators. The financial, operational and reputational impact on banks if they are unable to manage these requirements could be large. OSFI supervisors continue to emphasize the need for the major banks to have appropriate mechanisms in place to measure and manage risks, including enhanced stress testing. Expense control should not undercut high-quality compliance and risk management.

Other Deposit-Taking Institutions

Smaller domestic deposit-taking institutions and foreign banks in Canada generally pursue niche-oriented strategies to remain competitive. Accordingly, the factors affecting these institutions are varied and the risks more specific to their individual strategies.

OSFI supervisors continue to emphasize the need for the major banks to have appropriate mechanisms in place to measure and manage risks, including enhanced stress testing.

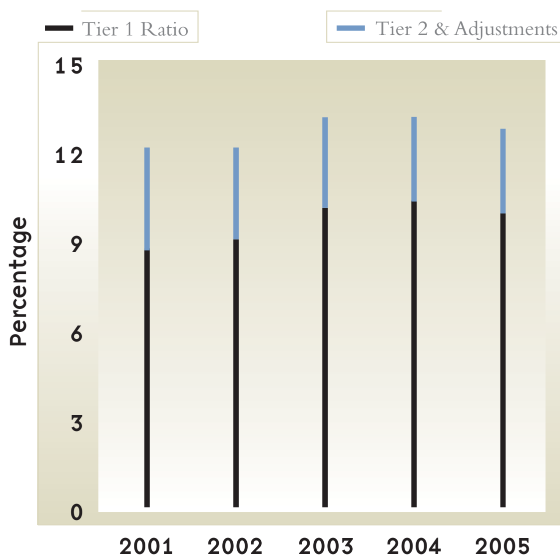
Driven by robust growth in the domestic economy and continued strong demand for financial products in 2005, the smaller deposit-taking institutions showed broad-based year-over-year growth in assets and net income. Capital ratios remained generally strong.

Given indicators that the credit environment may become less benign, OSFI will monitor the smaller deposit-taking institutions for potential deterioration in asset quality. Supervisors will also continue to monitor this group for compliance with anti-money laundering and anti-terrorism financing controls.

Life Insurance Companies

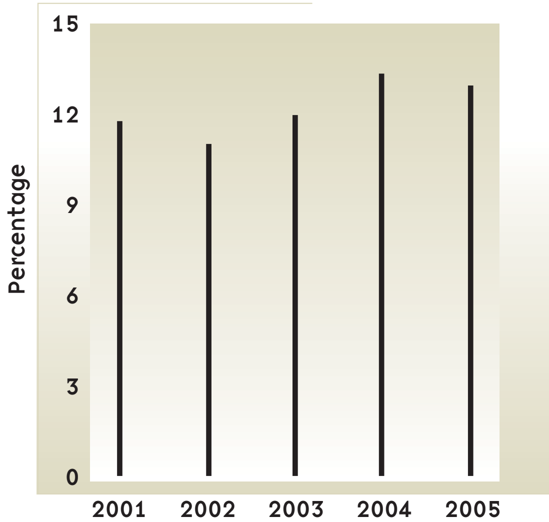
The Canadian life insurance industry reported solid financial results in 2005, with an average return on equity of 12.9%. The three largest life insurance companies, which dominate the market, generally outperformed the rest of the industry, reflecting differences in geographic coverage and economies of scale.

Major Banks: Risk-Weighted Capital Ratios
(figure 9)



Capital ratios for the six largest banks remained strong in 2005.

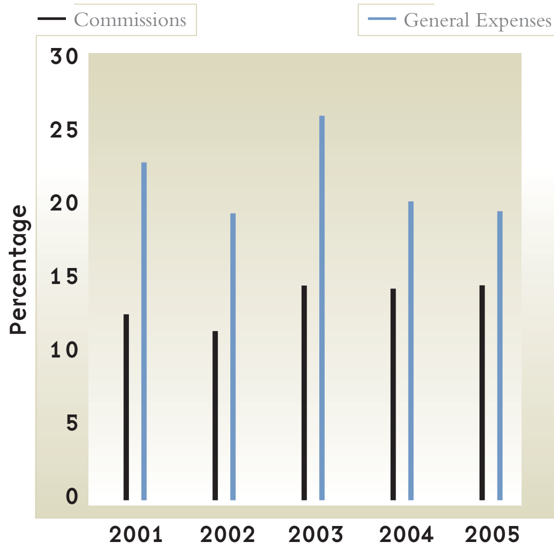
Life Insurance Companies: Return on Equity*
(figure 10)



*Excludes reinsurers

The profitability of the life insurance industry remained constant in 2005.

Life Insurance Companies: Commissions and Expenses as a % of Premiums*
(figure 11)



*Excludes reinsurers

Continued expense control contributed to the life insurance industry's strong performance in 2005.

Favourable equity markets in 2005 buoyed sales of annuity and wealth management products and boosted fee income. The relatively flat protection business generated a stable earnings stream. Expense control continued to be good. Numerous actuarial changes also positively impacted earnings. *(See figures 10 and 11)*

For the three largest life insurance companies, Canadian operations showed solid earnings growth. Their sizeable international operations also generally performed well, although there was some variation by territory and by company.

Capital ratios for the life insurance industry remained well above minimum regulatory requirements. OSFI has established a supervisory target ratio for Minimum Continuing Capital and Surplus Requirements (MCCSR) for Canadian companies. The average MCCSR ratio for Canadian life insurers in 2005 was 237%, significantly above the supervisory target capital level of 150%. Overall, asset quality remained strong. *(See figure 12)*

The outlook for the Canadian life insurance industry is stable, with improvements in profitability, asset quality and capital levels. However, the industry faces several challenges.

One such challenge is the potential adverse impact of a global pandemic on claims and operations. OSFI supervisors are reviewing the contingency plans of banks and insurers to deal with a flu pandemic. While there can be no guarantee of success, OSFI is satisfied with the progress made to date in this regard.

Given the importance of the three largest insurers' international operations to their overall performance, OSFI will continue to actively review these operations to ensure risk management capabilities are commensurate with the risks assumed.

OSFI supervisors are monitoring life insurance companies' management of reputational risk, especially with respect to financial reinsurance as a result of the changing regulatory environment in the U.S. and Canada.

The outlook for the Canadian life insurance industry is stable, with improvements in profitability, asset quality and capital levels.

Property and Casualty (P&C) Insurance Sector

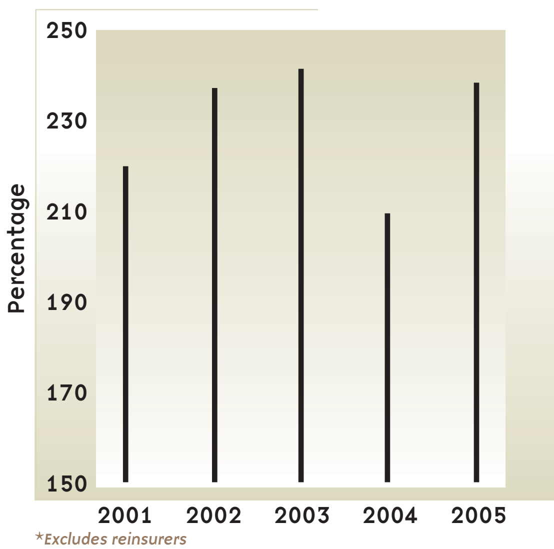
The property and casualty insurance industry reported another very profitable year in 2005. Average return on equity was 17.7%, compared to 19.1% the previous year. The industry has sustained, strong profitability since 2003, following several years of depressed earnings, which were attributable to extremely poor automobile insurance results (primarily in Ontario), soft commercial insurance markets, and lowered investment returns.

The turnaround is, in large part, the result of considerably improved underwriting profitability. Significant premium increases, as well as government reforms in several jurisdictions, have resulted in premium growth surpassing claims growth. The industry's increased profitability has also been supported by improved investment returns, which have been significantly enhanced by sizeable realized gains. These returns are not necessarily sustainable in the future. While profitability has been very strong for the industry overall, there has been significant variability among individual insurers. *(See figures 13 and 14)*

Internationally, the P&C sector was affected by numerous natural catastrophes worldwide. The 2005 hurricane season was the worst on record, with losses from Hurricanes Dennis, Katrina, Rita and Wilma estimated to exceed US $50 billion. With the exception of a few companies, the Canadian P&C industry has not been directly affected, other than by moderately increased reinsurance costs for 2006.

Canada has not been immune to natural catastrophes. Severe rainstorms in Winnipeg, Calgary and southern Ontario generated large insured losses. Losses in southern Ontario alone cost the industry approximately $500 million.

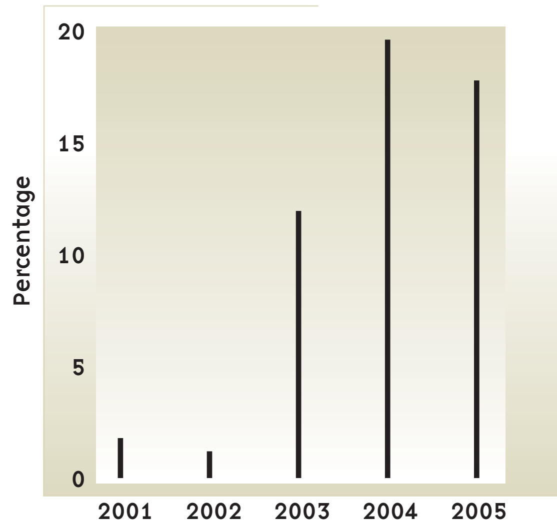
Life Insurance Companies: MCCSR Ratios*
(figure 12)



*Excludes reinsurers

In 2005, the MCCSR ratio of life insurance companies remained significantly above OSFI targets.

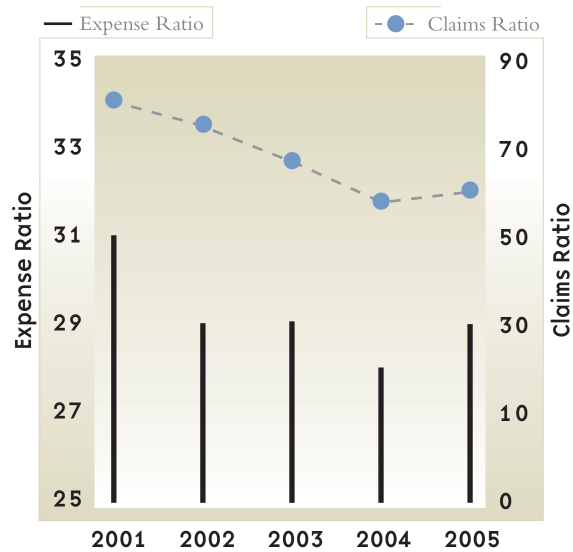
P & C Insurance: Return on Equity*
(figure 13)



*Excludes reinsurers

The performance of the P & C industry remained strong in 2005, due in large part to improved underwriting results.

P & C Insurance: Expense and Claims Ratios*
(figure 14)



*Ratio of expenses and claims to earned premiums; excludes reinsurers

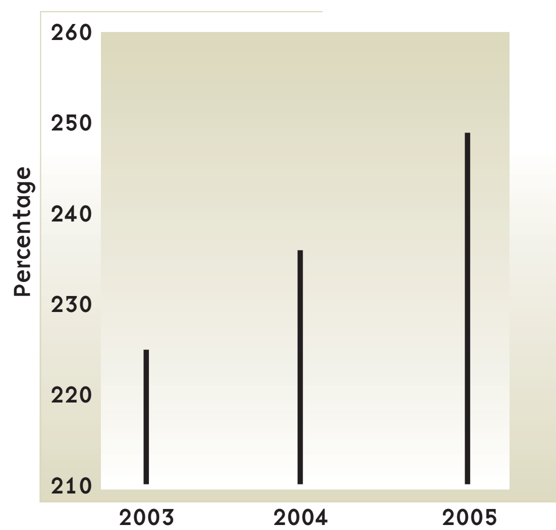
Strong pricing discipline contributed to good expense and claims ratios again in 2005.

Capital adequacy continued to strengthen in 2005. In 2003, OSFI introduced a new capital adequacy test – 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. The combined MCT/ BAAT ratio for the industry in 2005 was 249%, well above OSFI's minimum supervisory target of 150%. *(See figure 15)*

Historically, the P&C sector has experienced volatile pricing and profitability cycles. The unprecedented level of underwriting profitability over the past few years has been supported by remarkably strong pricing discipline in most business lines. Institutions have recognized the need to balance extremes in performance by having more oversight functions in place. Given these improvements, the number of staged P&C companies went from thirty in 2004 to seventeen in 2005, a 43% reduction.

However, given the inherent volatility of this sector, together with the impact of provincial government policies on certain lines of business, and the trend towards more frequent and severe natural disasters, OSFI will continue to monitor the P&C industry closely. Pricing behaviour, particularly signs of any weakening in terms of conditions, will be an area of focus.

P & C Insurance: MCT/BAAT Ratios*
(figure 15)



*Excludes reinsurers

MCT/BAAT ratios continued to strengthen in 2005, due to significant premium increases and improved investment returns.

Supervisory Policies

Balancing the benefits of competition with the risk of complex financial products

Financial Institutions

OSFI uses a world-class supervisory framework to identify and intervene on a timely basis when a financial institution's practices are imprudent or unsafe. This framework allows OSFI to balance the need of institutions to compete and grow, against their ability to manage the inherent risk of increasingly complex financial products.

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. OSFI has detailed guidance to assist supervisors in applying the framework.

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. This allows OSFI to balance the need to maintain effective supervision with the need to focus its resources on reviewing areas of an institution that are likely to have a material impact on its safety and soundness. OSFI also relies on the work of 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 consists of periodic on-site reviews at institutions to test controls and to confirm the adequacy of risk management and governance practices. OSFI also monitors the financial condition and affairs of institutions on an ongoing basis. In line with OSFI's early intervention mandate, problem companies are subjected to a higher level of review and intervention as appropriate.

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', '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 2006, 94% of all rated institutions were assigned a low or moderate CRR. Less than one percent was assessed as high risk. These ratings reflect that risk management practices and policies at Canadian financial institutions have, with a few

At the end of March 2006, less than one percent of all rated institutions was assessed as high risk. These ratings reflect that risk management practices and policies at Canadian financial institutions have, with a few exceptions, achieved a sound balance.

exceptions, achieved a sound balance. The percentage of institutions with a low or moderate risk rating has been steadily improving since 2002-2003, when OSFI started sharing risk ratings with institutions. The improvement is in part due to more favourable economic and financial conditions for Canadian financial institutions, but also reflects the strengthening of risk management control functions in a number of companies. *(See figure 16)*

Intervention Ratings

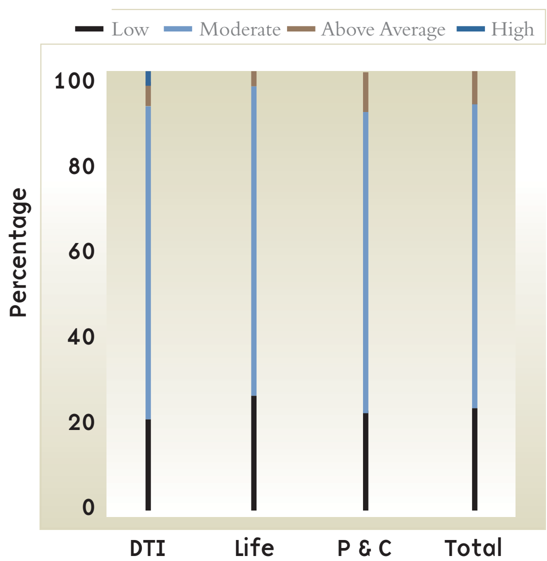
Financial institutions are assigned an intervention rating, as described in OSFI's Guide to Intervention for Federal Financial Institutions, which determines the degree of supervisory attention they receive. Broadly, these ratings are categorized as: normal (unstaged); early warning (stage 1); risk to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

The improved health of the property and casualty insurance industry contributed to another sharp drop in the number of staged institutions in 2005-2006 and all but one of the staged institutions were in the early warning (stage 1) category at the end of the year. *(See figure 17)*

There were no significant withdrawals from the Canadian market in 2005-2006. The liquidations of the Canadian branches of two United Kingdom-based P&C companies that were ordered wound up in the 1990s, were completed in early 2006 with all class of claimants receiving a dividend of 100 cents on the dollar plus interest.

Composite Risk Rating by Sector

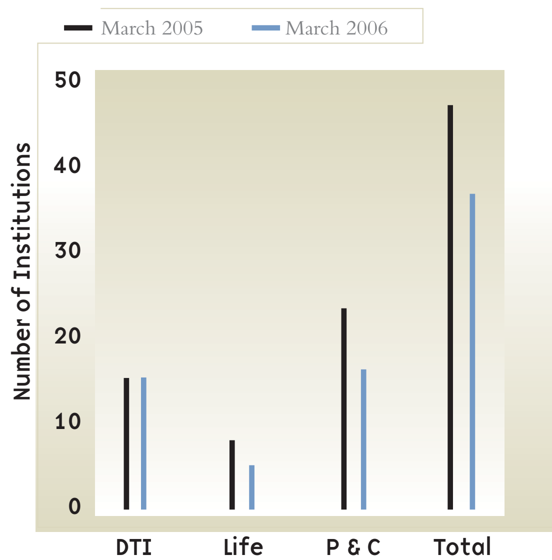
(figure 16)



As at March 31, 2005, 94% of rated institutions were assessed as low or moderate risk.

Number of Staged Institutions

(figure 17)



The improved health of the P & C industry contributed to another sharp drop in the number of staged institutions in 2005–2006.

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, guidelines, rulings and advisories, and working with various standard-setting agencies (domestic and international), plays a key role in OSFI's ability to achieve its mandate. During 2005-2006, OSFI continued to promote institutional behaviours that support good risk management. When setting rules and guidance, OSFI worked towards balancing the goals of safety and soundness with the need for institutions to demonstrate leadership and innovation in the marketplace.

Increasingly, rule development for the financial sector occurs internationally. OSFI also contributed, through international bodies, to the development of sound international rules that appropriately recognize the Canadian marketplace.

Domestic Rule Making

Balancing leadership and innovation with safety and soundness

Revisions to the Financial Institutions Legislation

As the administrator of the federal financial institutions legislation, OSFI was actively engaged in 2005 in two Department of Finance legislative reform initiatives.

First, OSFI contributed to Bill C-57, which modernized the corporate governance structure for federal financial institutions by introducing several important reforms and bringing the financial institutions statutes into line with changes made to the *Canada Business Corporations Act* (CBCA). Bill C-57 received Royal Assent in November 2005.

In addition, OSFI has been actively involved in the Government's five-year review of the financial institution statutes. The Department of Finance issued a formal consultation document as part of the 2005 Federal Budget that asked all Canadians for their view on how the federal financial institutions legislative framework could be enhanced. Stakeholders were asked to provide their feedback on a series of issues and to raise any other issues that could be addressed to improve the legislative framework.

OSFI has been engaged in the process of analysing suggestions made by public stakeholders, and has submitted numerous proposals of its own. The bulk of OSFI's proposals are designed to improve the efficiency and effectiveness of the regulatory framework by removing unnecessary restrictions and allowing all parties to focus their resources on the issues that matter most from a risk perspective.

Collaboration with Standard Setters

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.

In 2005-2006, OSFI and the CIA worked on the following emerging issues:

- Developing qualification standard certificates for the Appointed Actuary (AA) in Canada. This work is designed to ensure that an AA has the technical knowledge and relevant experience to competently fulfill the role.

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Business Analyst, Assistant Superintendent's Office, Supervision Sector

Pamela Hopkins
Managing Director, Assistant Superintendent's Office, Supervision Sector

- Reviewing the role of the auditor and the valuation actuary in light of the new Canadian Institute of Charted Accountants' (CICA) Audit Guideline AuG43 (both the CIA and OSFI assisted the CICA in the drafting of AuG43). OSFI also issued a draft revision of its Guideline E-15 related to the appointed actuary to avoid duplication of work required under AuG43.
- Implementing how the new CICA Section 3855 Accounting Standard on Fair Value of Assets impacts the valuation of policyholder liabilities.
- Enhancing the Minimum Continuing Capital and Surplus Requirements (MCCSR) by incorporating a new mortality component and new requirements for segregated fund guarantees developed by the CIA. These measures are expected to encourage better risk management.
- Participating in the development of a new standard and an educational note on MCCSR certification.

OSFI continued to participate in various working groups of the Canadian Accounting Standards Board (AcSB) and Auditing and Assurance Standards Board (AASB), and collaborated on several projects.

Capital Guidance

During 2005-2006, OSFI issued for comment an initial and revised draft of a new Capital Adequacy Requirements (CAR) Guideline for deposit-taking institutions. The updated guideline is designed to ensure Canada maintains a capital regime that is both reflective of international standards and appropriate to the Canadian environment.

The new draft Guideline incorporates the more risk-sensitive capital standards contained in the Basel Committee on Banking Supervision (BCBS) report *International Convergence of Capital Measurements and Capital Standards*. Two versions of the Guideline have been issued. CAR A is aimed at smaller institutions that generally have less complex operations, while CAR A-1 is directed towards the more complex operations of internationally active institutions. OSFI expects these revised regulatory capital requirements to become effective for the institutions' 2007-2008 fiscal year.

Prior to utilizing CAR A-1, financial institutions must receive OSFI approval with respect to a number of technical requirements. After consultation with the industry on how to communicate supervisory expectations for approval of these requirements, OSFI issued eight capital implementation notes over the course of 2005-2006. Working closely with the Canadian Bankers Association, OSFI also developed new capital adequacy reporting forms and instructions for the CAR.

OSFI issued letters to industry associations notifying them of OSFI's final decisions related to regulatory capital treatment of changes arising from the new Accounting Standard for Financial Instruments. This standard becomes effective for fiscal years beginning on or after October 1, 2006. The decisions relate to regulatory capital treatment of available-for-sale instruments, hedges, own credit risk, the fair value option and capital required. OSFI expects to issue formal guidance outlining these decisions in the 2006-2007 fiscal year. OSFI also expects to issue a capital advisory outlining how the treatment of the instruments under the new standards will be reflected in the calculation of regulatory capital.

OSFI will continue to enhance the MCCSR by working with the Canadian life insurance industry to develop more advanced risk measurement techniques. These techniques will include criteria for risk-sensitive methodologies based on specific models for use by companies that have the commitment and resources to implement them. This work is being carried out through the MCCSR Advisory Committee, whose members are senior representatives from the Canadian Life and Health Industry Association, the Canadian Institute of Actuaries, Assuris, the Autorité des marchés financiers and OSFI.

OSFI issued a Guideline on Capital Adequacy Requirements for Regulated Insurance Holding Companies and Non-operating Life Companies. The Guideline is designed to ensure there is adequate capital in a consolidated group led by a holding company to cover unexpected losses. This approach considers the adequacy of capital across the group, is more risk-sensitive and promotes good disclosure practices.

OSFI and the Insurance Bureau of Canada started fine-tuning the Minimum Capital Test for property and casualty insurers. The revisions, which will also prescribe capital treatment of items arising from the new Financial Instruments Accounting Standards, are expected to be in place for the first quarter of 2007.

During 2005–2006, OSFI continued to promote institutional behaviours that support good risk management.

Other Guidance

Fair Value Option

OSFI issued for comment draft accounting Guideline D-10: Accounting for Financial Instruments Designated as 'Held for Trading' (Fair Value Option). The draft Guideline promotes sound risk management when financial institutions use the Fair Value Option available under Canadian Generally Accepted Accounting Principles (GAAP). OSFI's draft Guideline included guidance on the use of the Fair Value Option issued by the International Accounting Standards Board (IASB) and the Basel Committee on Banking Supervision (BCBS).

OSFI believes that IASB and BCBS guidance are necessary to support a reliance-based regime and to promote reliable values through sound risk management practices within financial institutions. OSFI's approach promotes robust internal practices among institutions and helps increase confidence in the fair values used in the Fair Value Option. It is also intended to reduce the potential need for separate reporting of financial results for regulatory purposes.

Management of Foreign Financial Institution Branches Operating in Canada

OSFI sought to clarify its expectations with respect to the operation in Canada of foreign insurance company branches and foreign bank branches by issuing guidelines on the Role of the Chief Agent (CA) and the Role of the Principal Officer (PO). While providing necessary flexibility to recognize the differing nature of branch operations, OSFI aims to ensure that the CA and PO meet their oversight responsibilities in the management of Canadian branches, which represent an important portion of the financial services sector in Canada.

Anti-Money Laundering and Anti-Terrorism Financing Initiatives

In 2005, the Department of Finance released a Consultation Paper setting out the Government of Canada's proposals to strengthen Canada's anti-money laundering (AML) and anti-terrorism financing (ATF) framework. These proposals reflect the Government's goal of being at the forefront in the global fight against these crimes and thereby contributing to public safety in Canada and worldwide. The paper was designed to meet several key domestic and international requirements. OSFI participated in the drafting of the Consultation Paper as well as in subsequent consultations with federally regulated financial institutions.

During the year, OSFI's AML/ATF assessment program focused initially on smaller deposit-taking institutions, and then shifted to the large banking groups. Most financial institutions assessed have placed a high level of importance on establishing effective AML/ATF programs. OSFI is intervening where necessary to get institutions to deal with identified deficiencies.

OSFI recognizes that financial institutions must balance their operational requirements against the additional demands of combating money laundering and terrorism financing. In 2005, OSFI hosted an AML/ATF information session designed to highlight some of OSFI's key initiatives and expectations concerns to the federally regulated financial sector. This session, the first of its kind ever held by OSFI, was attended by representatives from more than 120 financial and other institutions. Similar events are planned for the future.

During 2005-2006, OSFI issued for comment a new Capital Adequacy Requirements Guideline, designed to ensure Canada maintains a capital regime that is both reflective of international standards and appropriate to the Canadian environment.

International Activities

Developing international rules that achieve a fair balance for Canadian institutions

The framework of rules for banks and life insurers is increasingly being set internationally. OSFI's role is to contribute to sound rules, make sure they respect Canadian realities, and implement them in a way that strikes a fair balance for Canadian institutions compared to their foreign competitors.

OSFI worked during the year to build further informal, but effective, relationships with foreign supervisors. In 2006-2007, 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.

International Association of Insurance Supervisors

OSFI continued to work with the International Association of Insurance Supervisors (IAIS), an international working group dedicated to enhancing the standards for life and property and casualty insurance supervision. For example, in 2005 OSFI played an important role in the production of several guidance papers, including one entitled Guidance Paper on Risk Transfer, Disclosure and Analysis of Finite Reinsurance. The paper provides a useful source of information to aid in the supervision of finite/financial reinsurance. OSFI also contributed to the IAIS's paper presented to the International Accounting Standards Board on proposed new insurance accounting rules. In addition, OSFI participated in the IAIS as a member of the Executive Committee, and the Budget and Technical sub-committees.

Joint Forum

OSFI is an active member of the Joint Forum which brings together international banking, securities and insurance supervisors. Significant benefits such as consistency in supervisory approaches are gained when regulators work together on issues of common interest across sectors and borders. Most recently, the Joint Forum completed work on outsourcing, credit risk transfer and business continuity planning.

OSFI is also involved in a number of other international groups, including the Financial Stability Forum, the Integrated Financial Supervisors, the Association of Supervisors of Banks of the Americas, and Le Groupe des superviseurs bancaires francophones.

Financial Action Task Force

OSFI continued to play an active role in the work of the Financial Action Task Force (FATF), which is the inter-governmental policy making body that develops and promotes national and international policies to combat money laundering and terrorism financing. In 2005, an OSFI financial expert participated in an FATF mutual evaluation. In addition, OSFI continues to participate in preparations for the next mutual evaluation of Canada's AML/ATF regime, which will be held in 2007.

OSFI is also represented on the Cross Border Banking Committee of the Bank for International Settlements, which deals with AML/ATF issues.

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Implementing the Basel Framework: Balancing Approaches to Banking Supervision

OSFI plays a key role in the BCBS

The Basel Committee on Banking Supervision (BCBS) provides a forum for cooperation on banking supervisory matters and has developed increasingly into a standard-setting body on all aspects of banking regulation. This includes the Basel II regulatory capital framework (Basel II) that introduces a more risk-sensitive capital standard for credit and operational risk in banking organizations, which better aligns with banks' own processes and supports enhancements in risk measurement and risk management.

The BCBS brings together supervisors and regulators of international banks from the G10 countries, of which Canada is a member. OSFI plays a key role in the BCBS through the vice-chairmanship (Superintendent Nicholas Le Pan) and committee membership (Assistant Superintendent Julie Dickson).

Promoting consistency across jurisdictions

Since publishing the Basel II Framework in 2004, the BCBS has shifted its focus from 'rules development' to 'rules implementation'. The BCBS Accord Implementation Group, chaired by Superintendent Le Pan, allows supervisors to share information and approaches to the implementation of Basel II, thereby promoting consistency across jurisdictions.

In 2005, OSFI hosted a 'college of supervisors' designed to exchange information and discuss cross-border implementation approaches with supervisors of major foreign subsidiaries of Canadian banks. Similarly, in its capacity as 'host supervisor', OSFI attended a number of supervisory colleges given by foreign supervisors. This focus on building relationships and sharing approaches with foreign supervisors has proven successful and is expected to continue as implementation progresses.

Canadian banks and OSFI are well advanced on efforts to implement Basel II, but ongoing work is required, particularly on qualifying for the more complex Advanced Internal Ratings-Based (AIRB) approach to calculating capital. The new capital framework and events in the market also require banks and OSFI to better focus on the measurement and management of operational risk and its relation to capital.

BCBS consultation papers outline supervisors' expectations

OSFI participated with other BCBS members in the development of two consultative documents in 2005-2006: *Sound Credit Risk Assessment and Valuation for Loans* and *Supervisory Guidance on the Use of the Fair Value Option by Banks under International Financial Reporting Standards.*

The first paper addresses how common data and processes may be used for credit risk assessment, accounting and capital adequacy purposes,highlighting provisioning concepts that are intended to be consistent with prudential and accounting frameworks. OSFI fully supports the principles outlined in the paper. The second paper focuses on supervisors' expectations for key policy positions and sound practices for banks that the BCBS believes will promote sound risk management and controls and maintain the integrity of regulatory capital measures. OSFI also supports this paper and has provided additional guidance through its guideline on use of the Fair Value Option.

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 incor-porations, orders authorizing the carrying on of business activities in Canada, corporate restructurings and ownership changes. OSFI's approvals process has focused on balancing the need to be both efficient and thorough, allowing for improvements in timeliness while ensuring complex transactions are carefully considered.

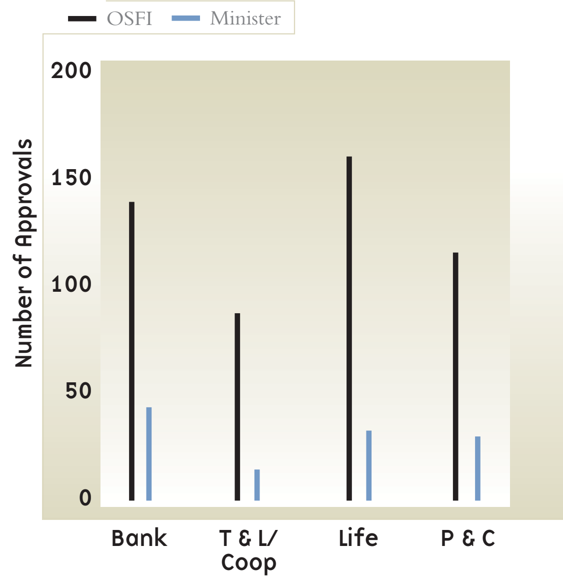
Applications and Opinions

Streamlining helps balance thoroughness and efficiency

OSFI processed 603 applications for approvals in 2005-2006. This represents a 13% reduction over the previous year's numbers (691 applications were processed in 2004-2005). The reduction is partly due to streamlining initiatives introduced by OSFI to reduce regulatory burden and balance thoroughness with efficiency. Also, the number and nature of approval applications fluctuates from year to year. *(See figure 18)*

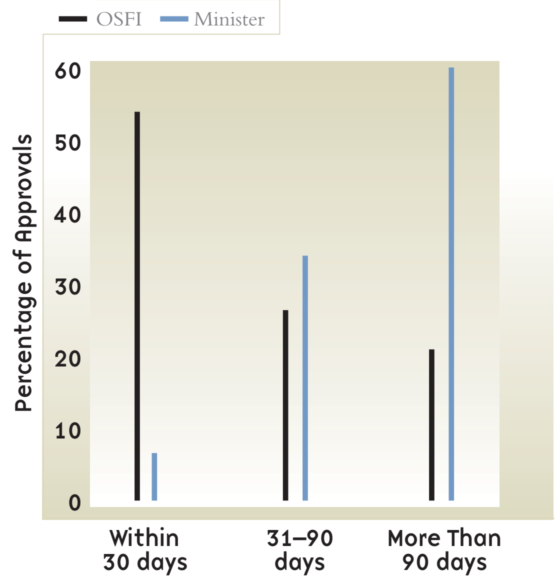
The trend towards innovative or ground-breaking initiatives has increased the complexity of many applications and, in some cases, raised new regulatory and/or public policy issues. Ministerial approvals accounted for 19% of the approvals processed by OSFI during the year. *(See figure 19)*

Approvals by Industry Sector 2005–2006
(figure 18)



OSFI processed 603 applications for approvals, a decrease of 13% over the previous year.

Approvals Processing Time 2005–2006
(figure 19)



Ministerial approvals accounted for 19% of all approvals.

More than 55% of applications processed in 2005-2006 were subject to the statutory "deemed approval" regime, where an application is automatically approved 30 days after receipt unless the Superintendent raises a concern. Major categories of Ministerial approvals related to the acquisition of control or a substantial investment in certain entities, certain reinsurance transactions, and the incorporation of a financial institution, including foreign branches. *(See figures 20 and 21)*

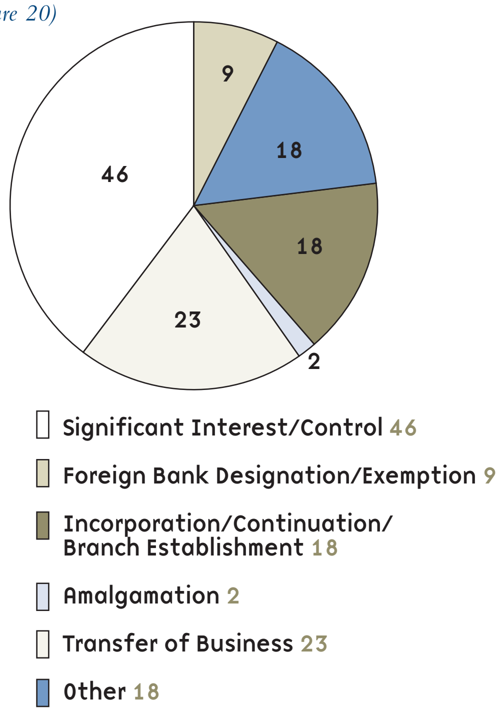
During 2005-2006, two new banks and three trust companies were incorporated or continued as well as six new insurance companies (three life and three property and casualty). Furthermore, three full-service foreign bank branches and four foreign insurance branches (one life and three property and casualty) were established.

New entrants in the insurance sector included two conversions of foreign branches of U.S. life companies to Canadian life insurance companies, sparked primarily by a U.S. tax ruling affecting annuity payments to Canadian annuitants of those branches. There were a number of ownership changes and reinsurance arrangements, resulting in large part from the rationalization of corporate structures in the insurance sector.

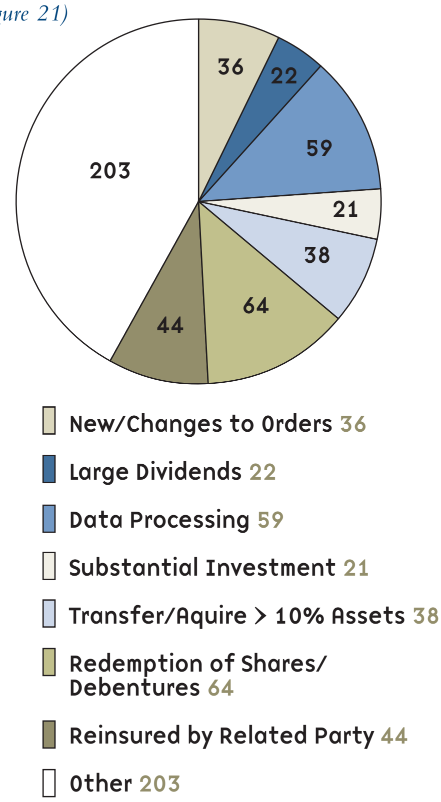
A number of banks and trust companies required approvals during 2005-2006 for ownership changes and/or corporate restructurings. There continues to be strong interest with respect to the incorporation or acquisition of banks or trust and loan companies and, on the part of foreign banks, the establishment or expansion of their operations in Canada. This trend is largely attributable to the more flexible ownership regime and other legislative changes introduced by Bill C-8 in 2001. This trend represents a challenge for OSFI due to the diversity of applicants, the often innovative or complex business proposals and corporate structures presented.

With respect to capital issues, 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 2005-2006.

Major Types of Ministerial Approvals
(Number of Approvals)
(figure 20)



Major Types of OSFI Approvals
(Number of Approvals)
(figure 21)

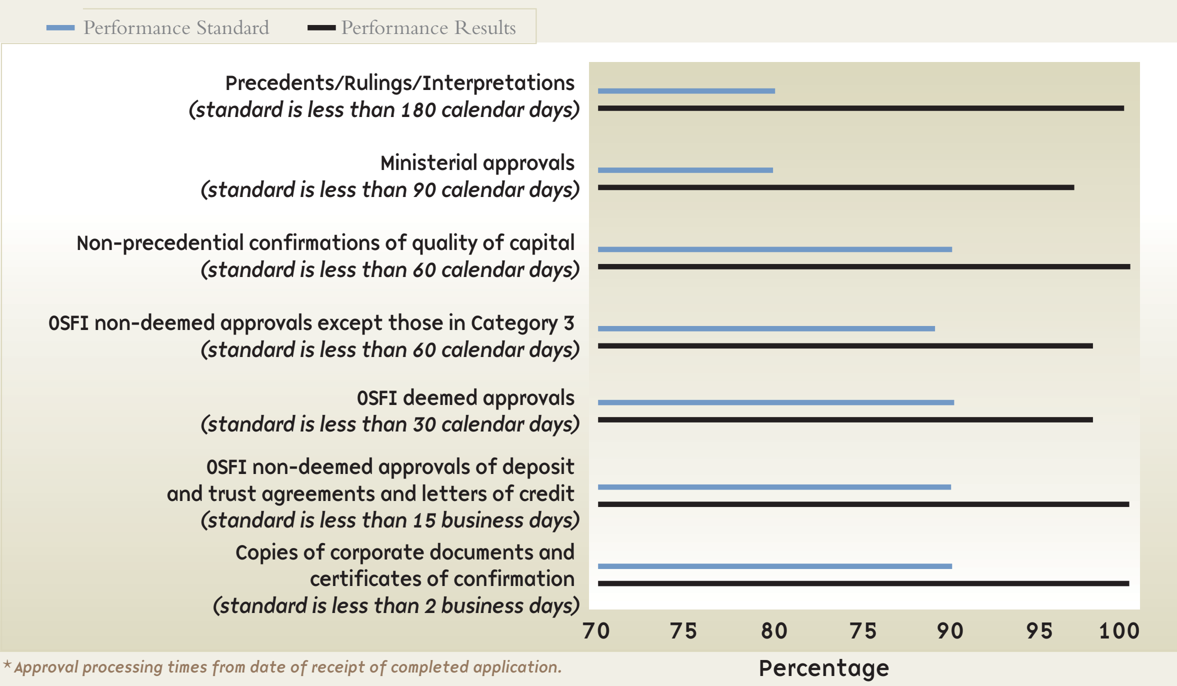


Performance Standards

Effective April 1, 2005, OSFI implemented performance standards establishing time frames for the processing of applications for regulatory approval and for other services subject to a user fee. This initiative is in keeping with OSFI's and the Government of Canada's commitment to enhance accountability and transparency relating to services provided. In 2005-2006, OSFI met all its established performance standards. (See figure 22)

OSFI Performance Against User Fee Service Standards 2005–2006*

(figure 22)



Approval processing times from date of receipt of completed application.

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 and publishes Advisories and Rulings.

In 2005-2006, OSFI developed a new Transaction Instruction for applicants seeking approval for the acquisition of a significant interest and/or the acquisition of legal control of a federally regulated financial institution. This instruction is designed to enhance consistency in assessing the applicant's financial strength, business experience and business plans for the institution. OSFI also developed an Advisory on the Legislative Framework for Foreign Banks, as well as Transaction Instructions for each of the ten regulatory approvals under Part XII of the *Bank Act*. This initiative was designed to enhance understanding of the regime that applies to foreign banks in Canada.

OSFI published three Rulings during the year: Insuring, in Canada, Risks – Group Policy; Classes of Insurance – Aquaculture Insurance; and Capital Structure – Conversion of Subordinated Debt. Three revised Transaction Instructions were also published. These revisions provide further guidance regarding applications for changes to the name under which a foreign bank or insurer operates in Canada; the relinquishment of control in fact of an entity; and exemptions to maintain and process information or data outside Canada. The latter Transaction Instruction outlined OSFI's streamlined approach for such exemptions.

In October 2005, OSFI hosted a Legislation and Approvals Seminar, the fourth since 2002, for financial institutions and their advisors. The seminar focused on issues relating to OSFI's approvals process, including service standards and user fees, as well as selected rule making initiatives, recent and prospective rulings and advisories, and a review of legislative initiatives. The results of OSFI's 2005 Approvals Process Consultation were also discussed. Given the positive feedback, OSFI will continue this initiative in the future.

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Manager, Approvals and Precedents, Regulation Sector

Greg Cowper
Manager, Legislation and Policy Initiatives, Regulation Sector

Federally Regulated Private Pension Plans

Office of the Superintendent of Financial Institutions Act

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

State of the Industry

Understanding the balance required to succeed in a challenging but stable environment

During 2005-2006, financial and economic conditions continued to create a challenging environment for the pension industry. Historically low long-term interest rates and the introduction of new actuarial rules had a negative impact on the financial position of most plans. Every six months OSFI conducts a series of calculations to estimate the solvency of the defined benefit plans it regulates. Based on this exercise, as at December 2005, over three quarters (78%) of all defined benefit plans supervised by OSFI had an estimated solvency ratio less than 1.0 (compared to 55% in December 2004).

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

As a result of the ongoing challenges facing pension plans and their sponsors, OSFI stepped up its efforts to proactively identify plans that pose a higher risk and to ensure that plan administrators take prompt corrective action where needed. During the year OSFI increased its resources for monitoring and assessing the financial health of plan sponsors and conducted a number of on-site reviews.

Reflective of the challenges faced by private pension plans, as at March 31, 2006, OSFI had seven applications outstanding to reduce accrued plan benefits, and was aware of a number of pending transactions of the same nature. OSFI's review of these applications will consider, among a number of things, the process that was followed to inform members of the reduction in their benefits and the authority provided under the terms of the plan to make such an amendment. OSFI views such actions as a last resort and also assesses whether that is better than alternatives available. In some cases restructuring plans is better for members than plan termination.

During 2005-2006, financial and economic conditions continued to create a challenging environment for the pension industry.

Risk Assessment and Intervention

Monitoring conditions and intervening when needed to achieve a balanced outcome

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

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

As at March 31, 2006, there were 1,304 private pension plans registered under the *Pension Benefits Standards Act, 1985*, (PBSA), covering over 575,000 employees. In 2005-2006, plan assets increased by 12%, to a value of approximately $116 billion. The great majority of members and assets that OSFI regulates are held in defined benefit plans. Over the past six years, there has been a small but steady increase in the proportion of defined contribution plans relative to the total number of plans. *(See figures 23, 24 and 25)*

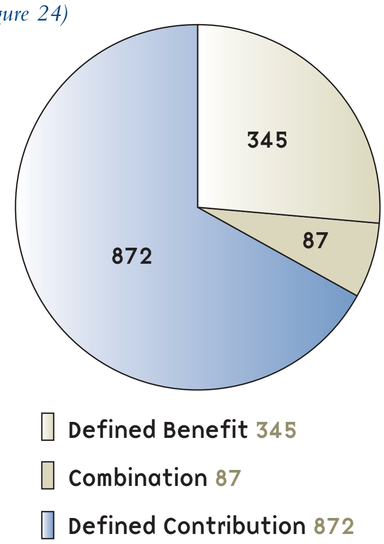
As at March 31, 2006, there were 1,304 private pension plans registered under the *Pension Benefits Standards Act, 1985*, (PBSA), covering over 575,000 employees.

Pension Plans by Type (last 4 years)
(figure 23)

	Y-E 2005–2006	*Y-E 2004–2005*	*Y-E 2003–2004*	*Y-E 2002–2003*
Total Plans	**1,304**	**1,284**	**1,256**	**1,205**
Defined Benefit	345	344	336	346
Combination	87	84	84	70
Defined Contribution	872	856	836	789
Total Membership	**576,000**	**572,000**	**547,000**	**579,000**
Defined Benefit	383,000	386,000	367,000	397,000
Combination	99,000	99,000	96,000	88,000
Defined Contribution	94,000	87,000	84,000	94,000
Total Assets	**$116 billion**	**$104 billion**	**$95 billion***	**$85 billion**
Defined Benefit	$95 billion	$85 billion	$78 billion	$70 billion
Combination	$18 billion	$16 billion	$15 billion*	$13 billion
Defined Contribution	$3 billion	$3 billion	$2 billion	$2 billion

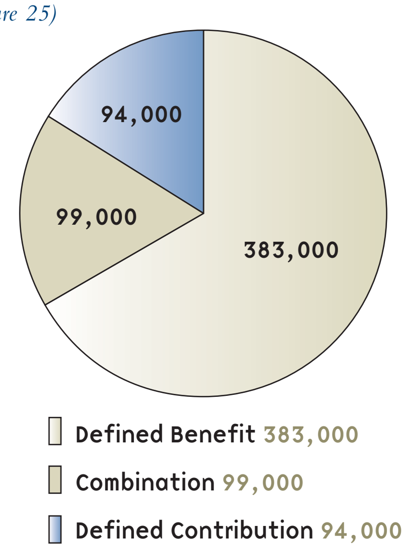
*restated

Pension Plans by Type*
(Number of Plans)
(figure 24)



*As at March 31, 2006

Membership by Plan Type*
(Number of Members)
(figure 25)



*As at March 31, 2006

Of the 1,300 private pension plans regulated by OSFI, only a third are defined benefit or combination plans, yet these plans account for 84% of membership.

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

The most recent pension plan financial statements filed during the 12-month period ending March 31, 2006 report that 58% of pension assets are invested in equities, 37% in debt instruments and 5% in diversified and other assets. *Equities* include investments in pooled funds, stocks, and shares in real estate, resource and investment corporations. *Debt instruments* include government and corporate bonds, mortgage loans, and deposits. *Diversified assets* cover balanced mutual and segregated funds and miscellaneous assets or other investments that are not included in the other two categories. Pension plans maintained essentially the same asset allocation as in the previous period.

Overall, the performance of equity markets in 2005 has improved the outlook for pension plans. The TSX composite index rose 21.9% over the year. Such positive returns were somewhat dampened by long-term interest rates that remained close to their historic lows.

The average estimated solvency ratio for all plans fell to 0.90 over the past year (compared to 1.00 the previous year). Estimated solvency ratios calculated by OSFI using year-end 2005 data showed that approximately 78% of all defined benefit plans supervised by OSFI were under-funded, meaning their estimated liabilities exceeded assets, with 80% of these under-funded plans having liabilities that exceeded their assets by more than 10%.

Given the current market environment and the impact of potential future adverse changes in economic conditions or financial markets, OSFI continued to carefully monitor both the condition of private pension plans and, to the extent possible, that of their sponsors, and intervenes when necessary.

Adjustments to Pensions

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

Inflation Protection

In 2005-2006, 34% of the plans that offer defined benefits reported increases in pensions being paid out, i.e. retirees' pensions (compared to 28% the previous year). Of these plans, 23% also increased deferred pensions.

Increases were based on full Consumer Price Index (CPI) in 35% of cases, 24% on partial CPI and 40% using other formulae, such as excess interest, a flat dollar amount, or a percentage of pension payment. In 77% of cases (80% in 2004-2005), adjustments were made as a result of collective agreements or were required by the plan text. In the remaining cases, employers made voluntary adjustments.

Source of Funds for Adjustments

During 2005-2006, 30% of the plans that made adjustments to pensions did so using surplus funds or gains (compared to 34% the previous year). The remainder used sources outside the pension fund, created unfunded liabilities, or used some combination of options to improve pensions.

In 25% of cases, plans used surplus/gains to improve benefits, while in 75% of the cases the employer reduced contributions through the use of surplus/gains. This is a change from 2004-2005, when 30% used surplus/ gains to improve benefits and 70% reduced contributions. The remaining defined benefit plans either did not have surplus/gains or chose to let their surplus/gains accumulate.

Supervisory Policies

Balancing the interests of all stakeholder groups

OSFI's approach to pension plan supervision is a balanced one that recognizes that plan administrators need to take reasonable risks in their investment and funding strategies and that plans or their sponsors can sometimes experience difficulties that lead to loss of benefits. While OSFI is mandated to protect private pension plan members, our approach means we are careful to avoid actions that could place defined benefit plans at a disadvantage. Despite considerable financial pressure on pension plans, there were very few cases of plans terminating with a reduction of benefits, and these affected a very small number of Canadians.

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

Early Warning Tests

OSFI has developed a series of early warning tests to detect risks based on information submitted in pension plans' filings. A first series of automated tests is run to identify higher-risk plans. These plans are then subjected to a more detailed analysis by OSFI's pension plan supervisors in an effort to assess whether further action should be taken. In 2005-2006, 30% of plans that remitted filings were subjected to a more detailed review.

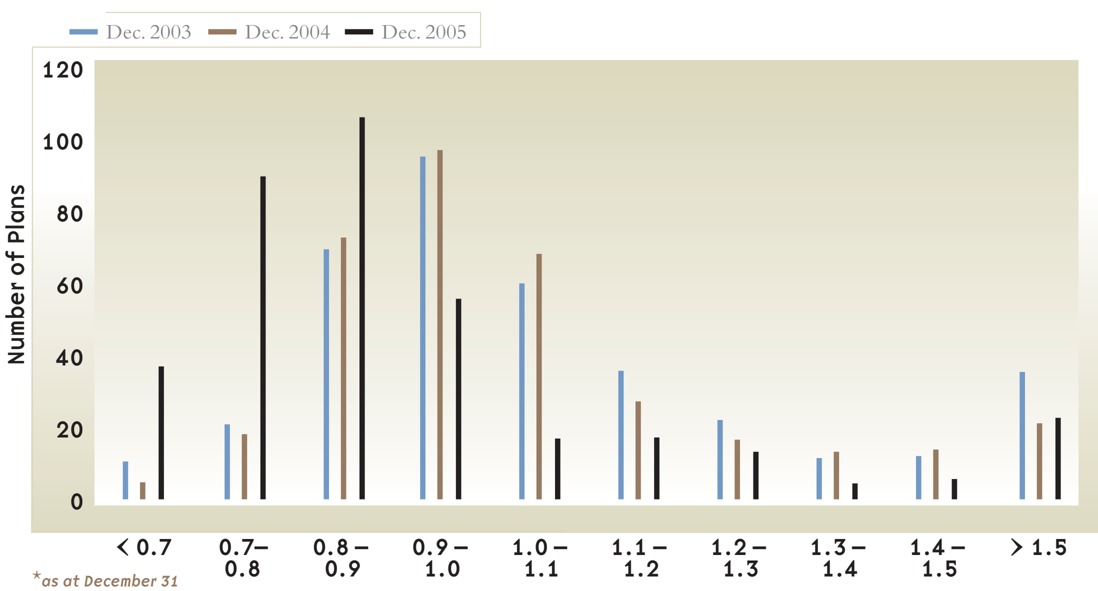
Solvency Testing

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

This test is now run on a semi-annual basis and is used to estimate solvency ratios for all defined benefit pension plans. Depending on the results, plan administrators are contacted and asked to validate these results and/or to provide additional information on their pension plans. If the estimated solvency ratio is close to or less than one, or if the plan's risk profile warrants, various interventions are considered, including, but not limited to, requests for early filing of valuation reports, which may identify the need for additional payments to fund identified deficits. This test has provided OSFI with important information, which has allowed it to intervene earlier in at-risk pension plans. *(See figure 26)*

In addition, OSFI continued to identify underfunded pension plans that were taking contribution holidays in 2005-2006. In certain circumstances it was OSFI's view that the taking of contribution holidays was not prudent. These situations were all dealt with to OSFI's satisfaction. OSFI took action, ranging from strongly encouraging plan sponsors to cease contribution holidays, to requiring enhanced notification to members and/or requesting early valuation reports, triggering enhanced funding.

Defined Benefit Plans – Estimated Solvency Ratio Distribution (past 3 years*)
(figure 26)



Over the past three years, the estimated solvency ratios calculated by OSFI show a continuing shift of plans towards 0.90 and below.

The number of private pension plans on OSFI's watch list increased during 2005-2006 from 77 at the start of the year to 86 at the end of the year.

On-Site Examinations

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

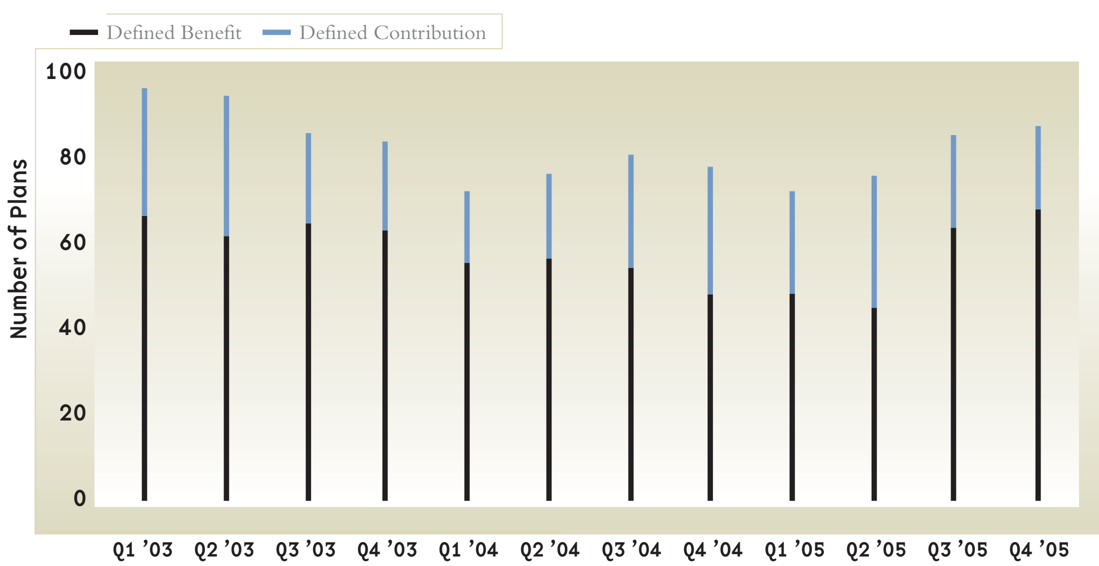
Watch List

In deciding whether and how to intervene, OSFI considers the size of the plan's deficit and the sponsor's capacity to fund it. Pension plans that give rise to serious concern, due to their financial condition or for other reasons, are placed on a watch list and are actively monitored. The number of private pension plans on OSFI's watch list increased during 2005-2006 from 77 at the start of the year to 86 at the end of the year. Of these, 67 were defined benefit plans (48 in 2004-2005) and 19 were defined contribution plans (29 in 2004-2005). During the course of 2005-2006, 42 new plans were added to the watch list and 31 were removed, in part due to OSFI's intervention.[4] *(See figure 27)*

Intervention

In 2005-2006, OSFI dealt with a number of late remittance issues in respect to pension plans. OSFI worked actively with plan sponsors, administrators, custodians and other officials trying to find reasonable solutions to protect members' benefits.

Watch List Trend by Plan Type (past 3 years)
(figure 27)



Note: Data prior to Q1'05 have been adjusted to reflect current methodology.

During 2005-2006, the pension plan industry continued to face funding pressure.

[4] *Data prior to 2005-2006 have been restated to reflect a change in the way OSFI counts Watchlist plans. Plans with no specific concerns but that are related to Watchlist plans are now excluded from the count.*

Indu Arora
Senior Supervisor, Private Pension Plans Division, Regulation Sector

Guidance

Balancing the rights of beneficiaries with the needs of plan sponsors

In July 2005, OSFI released its instruction guide on asset transfers between defined benefit plans. The guide sets out the general principles and detailed criteria and requirements that OSFI will generally expect to be satisfied before granting permission to transfer assets between registered plans under the PBSA or under another jurisdiction, with the exception of portability transfers. OSFI has since approved a number of asset transfer cases and is continuing to review other outstanding applications.

In the spring of 2006, OSFI published an instruction guide for authorization of amendments to reduce benefits in defined benefit pension plans. The principles and requirements set out in this guide are intended to ensure the protection of members', former members' and other beneficiaries' rights and interests under the PBSA and to ensure the minimum funding requirements for the ongoing pension plan will be met.

In May 2005, the Department of Finance released a consultation paper entitled *Strengthening the Legislative and Regulatory Framework for Defined Benefit Pension Plans Registered under the Pension Benefits Standards Act, 1985.* The paper sought stakeholders' views on a number of matters ranging from partial plan terminations under the *Pension Benefits Standards Act, 1985*, to funding of defined benefit plans, with the aim of maintaining a balance between the interests and incentives of private sector plan sponsors and plan members. The consultation closed in September 2005 with a wide range of views being submitted from a wide number of stakeholders.

In the spring of 2006, the Federal Government announced as part of its budget that it would move forward with proposed regulatory change to give defined benefit pension plans temporary relief in respect of funding solvency deficits in response to difficult circumstances. During the year OSFI will be developing additional guidance in respect of these proposed regulations.

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

OSFI carefully considered the effect of the "Monsanto" decision in the context of the federal *Pension Benefits Standards Act, 1985* (PBSA). Despite certain similarities between them, the PBSA and Ontario's pension legislation differ in a number of important respects.

Debbie Smith
Manager,
Regulatory Information Division,
Corporate Services Sector

For example, unlike the Ontario pension legislation, the PBSA does not trigger the wind up of a pension fund including a distribution of surplus when a pension plan is terminated, either in whole or in part.

During 2005-2006, OSFI considered a small number of partial termination reports that were filed with the Superintendent in recent years. Decisions on these reports had been deferred pending the decision in the “Monsanto” case. OSFI followed-up with plan administrators to obtain relevant information, including the plan’s financial position and provisions contained in pension plan documents relevant to full and partial plan terminations. OSFI will continue to communicate directly with the administrators of individual pension plans to obtain any required information and inform them of progress on reports that have been filed with OSFI but not yet approved.

OSFI continued to promote responsible pension plan governance and actuarial practices by working closely with the Canadian Institute of Actuaries and the Canadian Association of Pension Supervisory Authorities (CAPSA). OSFI is a member of CAPSA, a forum for discussing common issues faced by federal and provincial pension plan supervisory authorities.

Approvals

Federally regulated private pension plans are required to seek approval from the Superintendent of Financial Institutions for different types of transactions affecting pension plans, including plan registration, asset transfers (including mergers and spin-offs), full and partial plan terminations, refunds of surplus, or reduction of benefits.

During the year, OSFI processed 110 applications for approval and received 89 new requests. In 2005, 38 new plans were registered with OSFI. Of these, 6 were defined benefit plans. A further 18 registered plans, affecting about 1,000 members, informed OSFI that they were terminating or consolidating with other plans. No refunds of surplus were approved during 2005-2006.[5]

Jean-Claude Primeau
Director, Actuarial, Policy and Approvals,
Private Pension Plans Division, Regulation Sector

[5] *Previous annual reports (2003-2004 and 2004-2005) indicated that no refunds of surplus were approved during the periods reported. However, based on a recent review of OSFI records, 3 refunds of surplus were approved during these periods.*

Highlights of 2005 Consultations with Pension Stakeholders

Are we striking the right balance?

OSFI, as the primary regulator of federally administered private pension plans, interacts with representatives of federally regulated private pension plans, and professionals who act on behalf of these plans, in order to fulfil its mandate. In 2005, OSFI commissioned The Strategic Counsel, an independent research firm, to consult with these stakeholders to explore perceptions of OSFI and the current pension marketplace.[6] This allows OSFI to know if we are striking the right balance.

The consultations comprised a series of confidential one-on-one interviews with plan sponsors and professionals representing a cross-section of the large defined benefit plans regulated by OSFI, and an Internet study among a cross-section of plan sponsors who did not participate in the one-on-one interviews. The interviews and the Internet survey were conducted from July through September of 2005.

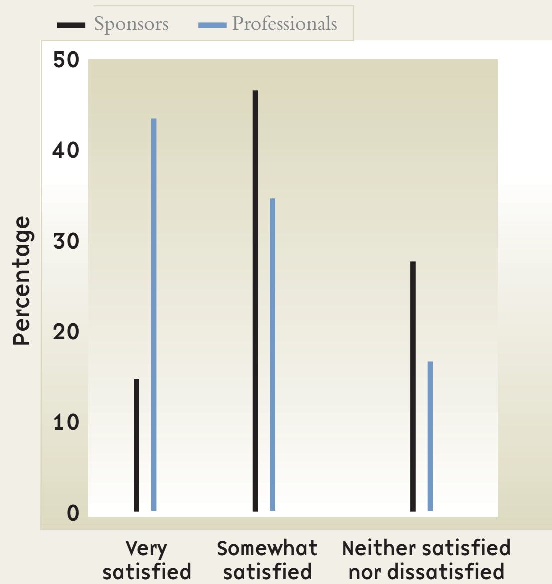
Overall, the findings revealed that OSFI is viewed as being effective in discharging its mandate, and that staff are knowledgeable, approachable and helpful. Areas for improvement were identified, such as providing more feedback and more information of a general nature. The complete survey report, *Report on Pension Consultation*, is available on OSFI's web site.

Detailed Findings

OSFI needs to balance "getting our job done" with "doing it in a more timely and informative manner".

- OSFI is viewed as being effective in the discharge of its mandate through its monitoring of plans and willingness to intervene. *(See figure 28)*
- Sponsors and professionals generally hold positive impressions of OSFI pension staff. Staff are described as knowledgeable, approachable and helpful. *(See figure 29)*

Satisfaction with OSFI as a Regulator
(figure 28)

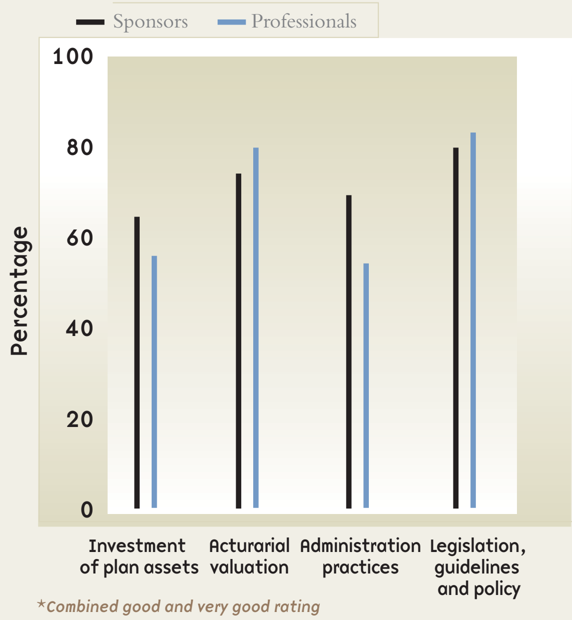


Among sponsors (62%) and professionals (79%), satisfaction with OSFI as a regulator of federal private pension plans is moderately high.

- In two particular areas, timeliness in valuation reviews and response to general inquiries, OSFI receives strong positive ratings for its service timeliness. In other areas there is a perceived need for improvement in timeliness, i.e., reacting to industry concerns about guidance, management reports and approvals processing. *(See figure 30)*

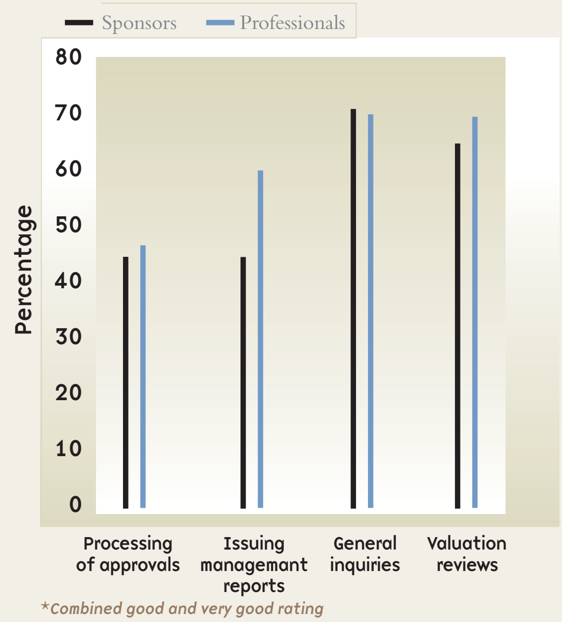
[6] *OSFI provided The Strategic Counsel, an independent research firm, with a list of pension plan sponsors, external actuaries, lawyers, and insurance representatives. The research firm invited 399 of these stakeholders to participate in a web survey, and 158 (40%) responded. The research firm also conducted 69 one-on-one confidential interviews among sponsors or administrators of large defined benefit plans and their professional advisors. The samples were selected independently from the list by the research firm and OSFI does not know who was interviewed. Unless otherwise noted, the findings reported emerged consistently across stakeholder groups.*

Knowledge of OSFI Staff*
(figure 29)



OSFI staff receive good ratings from sponsors (from 65% to 77%) and professionals (from 55% to 83%) for knowledge levels in four areas.

Perceptions of OSFI's Timeliness*
(figure 30)



The majority of sponsors and professionals hold positive impressions of OSFI's timeliness with valuation reviews (65% and 70%) and general inquiries (71% and 70%), but give less positive ratings for management reports (45% and 60%) and approvals processing (45% and 47%).

- Both the *PBSA Update* and OSFI's website receive strong positive ratings as information sources among users of these information channels.
- In the areas of approvals and valuations, sponsors want OSFI to keep them informed about receipt of and outcome of valuations, and they want more open interaction during the approvals process.
- There is a call from sponsors and professionals for OSFI to be more proactive in providing information of a general nature for the industry that will assist plans in their administration practices, e.g., best practices in plan administration and governance, and also for OSFI to provide more guidance in certain areas.

International Assistance

As interconnectivity in the global financial system continues to increase, Canadian financial institutions are exploring business opportunities outside of Canada. Canada and other G-7 governments recognize that upgrading the supervisory capacity of emerging market regulatory bodies can enhance the stability of the global financial system. This is particularly relevant as countries deal with significant implementation issues related to the new Basel II accord.

Canada plays an important role in this regard, in part through OSFI's technical assistance program, which helps selected emerging market economies improve the supervisory systems for their financial institutions. OSFI's technical assistance program is also of benefit to Canadian financial institutions, as it strengthens supervisory regimes and increases confidence in foreign jurisdictions in which some Canadian institutions operate.

OSFI's International Advisory Group (IAG), founded in 2001, conducts needs assessments and provides hands-on technical advice, training, workshops and seminars, primarily to supervisors in the Caribbean, Asia, Eastern Europe and Africa. The Canadian International Development Agency (CIDA) provides the bulk of the funding, however IAG has recently explored alternate sources of funding. This includes competing for contracts and undertaking 'fee for service' work. IAG has achieved considerable success in this regard.

OSFI also offers unique 'in-house' programs that allow bank and insurance company supervisors the opportunity to visit and learn at OSFI. During 2005-2006, IAG hosted many international delegations to OSFI.

IAG offers bilateral and multilateral training programs and provides technical assistance in various locations outside of Canada. Training often extends beyond the typical classroom setting and is developed to meet the needs of the specific jurisdiction, including hands-on technical advice, consulting services and follow-up.

During 2005-2006, IAG worked in 23 different jurisdictions, many of which it visited several times. In the process, hundreds of foreign supervisors received the benefit of IAG's training. *(See figure 31)*

As IAG's ongoing relationship with key jurisdictions matures, the focus has moved from theory to implementation. IAG is particularly proud of the successes it has achieved working alongside foreign supervisors 'in the field'. IAG continues to provide legislative and regulatory drafting expertise, and has played a key role in the selection process for senior-level supervisory staff. IAG has addressed industry participants and regulators on important subjects such as corporate governance and Basel II, and has supported foreign regulators with their industry consultation processes.

For several years, OSFI's International Advisory Group has held individual in-house programs in Ottawa for banking and insurance supervisors from all parts of the world. This photo includes participants from Australia, Bulgaria, Guatemala, Malaysia, Nigeria, Pakistan, Tanzania, Alberta and Saskatchewan. OSFI staff included in the picture are Kim Norris, Janet Dubeau, Jean Sarazin and Ralph Lewars. Missing from the photo is James Bruce.

Again in 2005-2006, IAG was particularly involved with the International Monetary Fund (IMF)/World Bank Financial Sector Assessment Program (FSAP). In addition to serving as 'experts' in the assessment of compliance with the Basel Core Principles and the International Association of Insurance Supervisors Core Principles, IAG continues to be significantly involved with several jurisdictions, which are either attempting to correct deficiencies identified during their FSAP assessment or attempting a self-assessment. In 2005-2006, IAG continued its work in Thailand, and was awarded a substantial project in Chile.

IAG is involved in a number of longer-term projects. Of particular note is the Dominican Republic, where IAG has been active since a major banking collapse in 2003. IAG is also working in Malaysia to help implement a system of risk-based supervision for banks and insurance companies. Foreign supervisors continually seek IAG's particular expertise in this area.

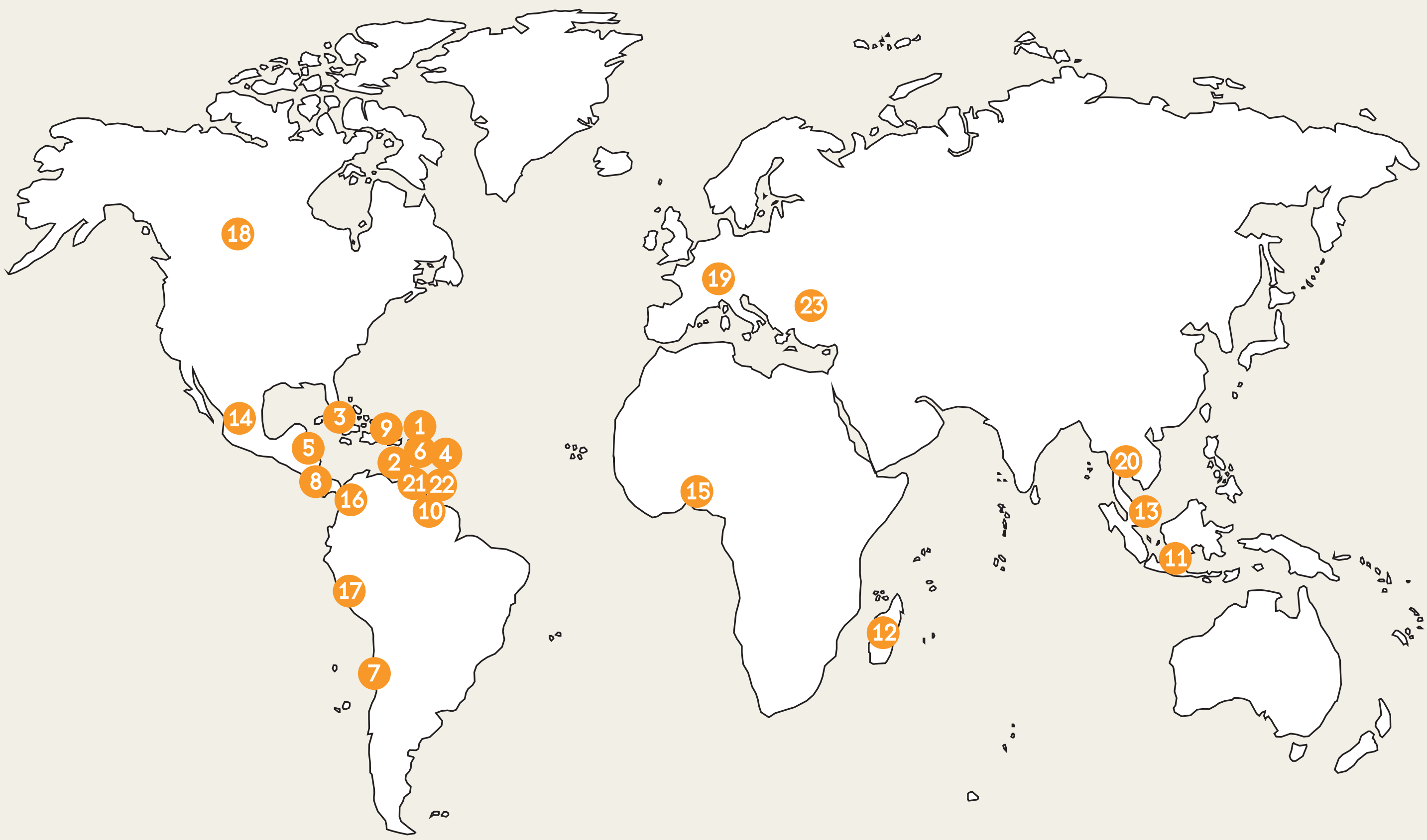
IAG attempts to partner with other technical assistance providers around the world, where feasible, in order to achieve efficiencies and economies. Individuals with significant financial institution regulatory and supervisory experience, knowledgeable in 'today's' supervisory techniques and principles, staff IAG. This positions IAG well to provide effective—and current—technical assistance to the benefit of emerging and developing bank and insurance supervisors.

OSFI continues to support the Toronto International Leadership Centre for Financial Sector Supervision through its role on the Board of Directors. Founded in 1998, the Centre is unique. Individuals with substantial experience in financial supervision from Canada and abroad help supervisors acquire the knowledge and leadership skills to build effective supervisory regimes in their countries. IAG provides resources, most notably Program Leaders, to assist with the delivery of the Centre's programs, both in Toronto and around the world.

OSFI's technical assistance program is of particular benefit to Canadian financial institutions, as it strengthens supervisory regimes and increases confidence in foreign jurisdictions in which some Canadian institutions operate.

During 2005-2006, the International Advisory Group worked in 23 different jurisdictions, many of which it visited several times.

(figure 31)



1. *Anguilla*	7. *Chile*	13. *Malaysia*	19. *Switzerland*
2. *Antigua and Barbuda*	8. *Costa Rica*	14. *Mexico*	20. *Thailand*
3. *Bahamas*	9. *Dominican Republic*	15. *Nigeria*	21. *Trinidad & Tobago*
4. *Barbados*	10. *Guyana*	16. *Panama*	22. *St. Vincent & the Grenadines*
5. *Belize*	11. *Indonesia*	17. *Peru*	23. *Ukraine*
6. *British Virgin Islands*	12. *Madagascar*	18. *Saskatchewan*	

Office of the Chief Actuary

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

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

Role and Responsibilities

The federal government, through the Canada Pension Plan in conjunction with the provinces and territories, and through public sector pension arrangements and other social programs, has made commitments to Canadians and is responsible for ensuring the sustainability of these commitments. In the case of the Canada Pension Plan, these commitments have been made in conjunction with the provinces and territories, that are co-stewards of the plan. Some are long-term, and it is important that decision-makers, Parliamentarians and the public understand the inherent risks these commitments present. The Office of the Chief Actuary has a vital and independent role to play in this process. The OCA provides appropriate checks and balances on the future costs of the different pension plans and social programs that fall under the OCA's responsibilities.

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

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

The OCA also provides the relevant government departments, including the executive arm of provincial and territorial governments, who are co-stewards of the CPP, with actuarial advice on the design, funding and administration of these plans. OCA clients include Human Resources and Social Development, Finance, Treasury Board Secretariat, Public Works and Government Services, National Defense, Veterans Affairs, the RCMP and Justice Canada.

Developments

The Office of the Chief Actuary is required by law to produce an actuarial report on the Canada Pension Plan every three years. The next report will be published in 2007.

In 2005, more than 4 million Canadians received CPP benefits, with a total value of approximately $25 billion. These benefits included pensions, survivors and orphans benefits, and disability benefits. The 21st Actuarial Report on the Canada Pension Plan, published in 2004, confirmed the long-term viability and financial sustainability of the CPP. In its report, the OCA confirmed that the legislated 9.9% combined employer-employee contribution rate for 2006 and thereafter is expected to be sufficient to pay for future expenditures and to accumulate assets of more than $140 billion by 2010 as larger numbers of Canadians reach retirement age.

In May 2005, the OCA released the findings of an external peer panel commissioned to review the 21st Actuarial Report on the Canada Pension Plan. The findings indicate that the work done by the OCA on the 21st Actuarial Report on the CPP was competently prepared, the assumptions used in the Actuarial Report are reasonable and as a result, the conclusions of the Chief Actuary regarding the sustainability of the CPP are well supported.

OCA Hosts Inter-Disciplinary Seminar

As recommended by the peer review panel, the Office of the Chief Actuary continues its program of inter-disciplinary seminars with presentations from experts on subjects relevant to the preparation of future actuarial reports. In March 2006 the OCA hosted a seminar entitled "Demographic, Economic and Investment Perspectives for Canada—Years 2006 to 2050". Since the actuarial work done for the CPP is increasingly of interest to more and more Canadians, particularly as they grow older, for the first time media representatives were invited.

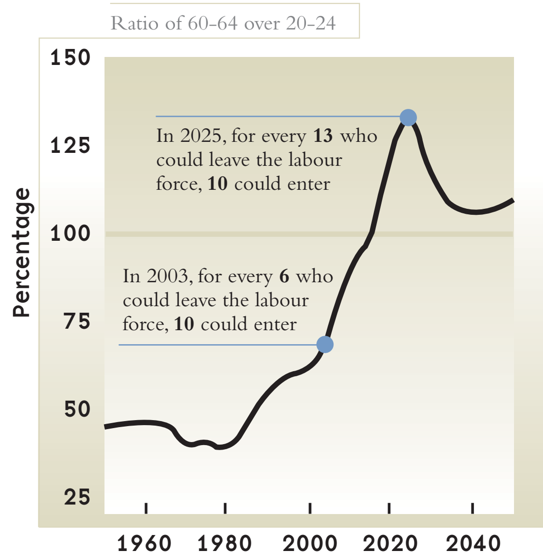
The Deputy Chief Actuary from the Social Security Administration in the United States discussed the applicability of stochastic processes on the long-term financial status of the OASDI Program. An actuary from the United Kingdom Government Actuary's Department spoke on mortality trends in the 20th and 21st centuries and evolution of life expectancies. Two economists discussed the potential impacts on the CPP of future Canadian productivity and inflation, respectively. These seminars, as well as feedback from periodic independent reviews of the actuarial reports on the CPP, provide the OCA with valuable input.

Appearances before Parliament

The Chief Actuary appeared before the House of Commons Standing Committee on Finance on May 12, 2005, ensuring an open, transparent and public lens for the independent work of the Chief Actuary. The Chief Actuary discussed the CPP and its independent peer review process. It was mentioned that the OCA is funded by fees charged for actuarial services and in part by an annual parliamentary appropriation for services related to public sector pensions.

The Chief Actuary appeared before the Senate Standing Committee on Banking, Trade and Commerce on October 20, 2005 to talk about issues dealing with the demographic change that will occur in Canada within the next two decades and possible actions that could be taken to address the implications for public pension plans. In 2005, there were 255,000 Canadians who reached age 65. By 2030, this number is projected to double to 510,000, progressively creating an imbalance in the labour market. A labour shortage may occur as older workers retire with a resulting extended period of high labour demand. For example, in 2015 the number of persons retiring is expected to catch up with the number of newcomers, and in 2025 the number of persons retiring will surpass the number of newcomers in a proportion of 13 to 10. *(See figure 32)*

Canada's Future Labour Shortage
(figure 32)



After 2015, more people are expected to leave the labour force than those who enter it.

Wan-Yi Huang
Actuarial Officer, Public Pensions, Office of the Chief Actuary

Actuarial studies performed by the OCA on various public pension programs will help to ensure Canada's retirement system will remain sustainable and affordable well into the future in the face of changing demographic conditions.

Framework of a Well-balanced Retirement System

The Canadian retirement income system includes diversification of both sources of income (private and public pensions) and funding approaches. A mix of full funding (RPP/RRSP), partial funding (CPP/QPP) and pay-as-you-go funding (OAS/GIS) is well recognized for its capacity to adapt to changing conditions, including the aging of the population. The combination of Old Age Security (OAS), the Guaranteed Income Supplement (GIS), the compulsory contributory pension plans (CPP and QPP), private employer pension plans and individual saving plans has contributed significantly to reducing poverty among seniors over the past three decades.

Canada has set in place a public pension system that is expected to be sustainable and affordable well into the future in the face of changing demographic conditions. Ongoing review of the system, including actuarial studies performed by the OCA on various public pension programs, will help to ensure this remains the case.

Reports, Services, Presentations and Special Studies

The OCA completed a number of reports in 2005-2006, including actuarial reports on the pension plan for the members of Parliament and on the Old Age Security program, which will be used as a basis for future reviews done by the OCA. These reports were subsequently tabled before Parliament, and provide actuarial information to decision-makers, Parliamentarians and the public, increasing transparency and confidence in the retirement system. The OCA also completed its fourth annual actuarial review of the Canada Student Loans Program.

Other services provided by the OCA during the year included:

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

The Chief Actuary made presentations to the Conference Board of Canada Pensions Summit, the National Academy of Social Insurance Seminar, the Public Service Pension Advisory Committee, the Northwind Professional Institute on the Canadian Response to the Evolution of the Retirement Security Net, the Financial Management Institute of Canada on the Canadian Approach to Finance Retirement: A Diversified Approach Based on Fairness, Solidarity and Responsibility, and the Fertility Symposium at the Society of Actuaries Annual Meeting.

The OCA is continuously involved in preparing various experience studies and research covering a wide range of social security, demographic and economic issues that may affect the financial status of pension or benefit plans. Some of these studies also serve to support policymakers in developing and analysing various policy options in the context of plan reforms. The information presented in these studies could benefit private sector organizations that evaluate social security or private pension plan schemes. The OCA released its fifth actuarial study in February 2006, "Old Age Security Program Mortality Experience", which is the second mortality study published by the OCA.

Ongoing Improvements

In 2006-2007, the OCA will maintain the tradition of continual improvements to the actuarial methods by applying more extensive and sophisticated stochastic analysis as it was recommended by the CPP peer review panel. The OCA will study and implement most recommendations made by the peer reviewers. As well, the OCA will complete and send statutory triennial actuarial reports to the President of Treasury Board on the RCMP, Canadian Forces and Public Service Pension Plan.

Jean-Claude Ménard
Chief Actuary

Jean-Claude Ménard was appointed **Chief Actuary** in August 1999. He is responsible for preparing the actuarial reports of the Canada Pension Plan, the Old Age Security program, the Canada Student Loans Program, and pension and benefits plans for federal public servants, the Canadian Forces, the RCMP, federal judges and members of Parliament. Prior to joining OSFI, Mr. Ménard held progressively senior roles with the Quebec Pension Board, culminating in his appointment as Chief Actuary and Director of Valuation in 1995. From 1992 to 1994, he served as vice-chairman of an Examination Committee of the Society of Actuaries. Since 2002, he has been vice-president of the Technical Commission of Statistical, Actuarial and Financial Studies of the International Social Security Association.

The Chief Actuary appeared before the Senate Standing Committee on Banking, Trade and Commerce to talk about demographic change that will occur in Canada within the next two decades and possible actions that could be taken to address the implications for public pension plans.

Balancing Future Pension Benefits with Changing Mortality Rates

OCA Study Provides Vital Information for Canada's Public Pension Planners

Number of Canadians receiving Old Age Security will more than double by 2030

Canadians are living longer than in the past. The population at ages 65 and over is expected to more than double from 2003 to 2030, and it will increase as a proportion of total population from 13% to 23%. Understanding the changing mortality rates of Canadians is key to ensuring the financial viability of Canada's public pension plans. *(See figure 33)*

The Old Age Security (OAS) program provides basic retirement benefits to almost all Canadians aged 65 and over. The basic pension paid is increased by the Guaranteed Income Supplement (GIS) for those beneficiaries with low incomes, high income beneficiaries may receive a reduced pension depending on their income. Under the OAS program, which is financed from general revenues, the number of recipients of the basic pension is expected to more than double from 4.0 million in 2003 to 8.9 million in 2030.

In February 2006, the Office of the Chief Actuary released the *Old Age Security Program Mortality Experience*, the second mortality study published by the OCA. It presents estimates of the level of mortality as measured from the mortality experience of Canadian resident beneficiaries of the OAS. The results will be used by the OCA to assess the mortality of the overall Canadian population and of Canada Pension Plan and OAS beneficiaries when producing the OCA's next triennial actuarial reports on the CPP and OAS.

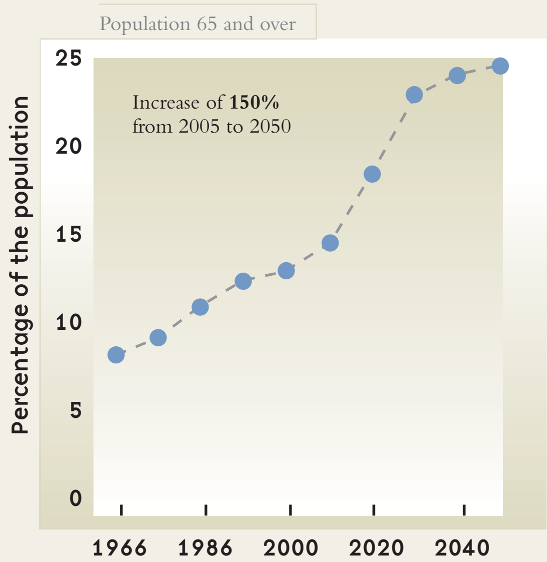
For the first time, this study provides Canadian demographers with access to mortality results based on the OAS database. The volume and the quality of the administrative data make this study extremely reliable for any Canadian expert interested in the mortality trends of seniors.

Study confirms that life expectancies vary by socio-economic status

The aging of the Canadian population has increased substantially since the inception of the OAS program in 1952. In 1951, life expectancies at age 65 were 13.3 years for males and 15.0 years for females. Intuitively, individuals with an overall healthier lifestyle, associated with a higher income, are expected to experience lower mortality than those with a lower standard of living. This study looks at life expectancies based on socio-economic status, defined by income. *(See figure 34)*

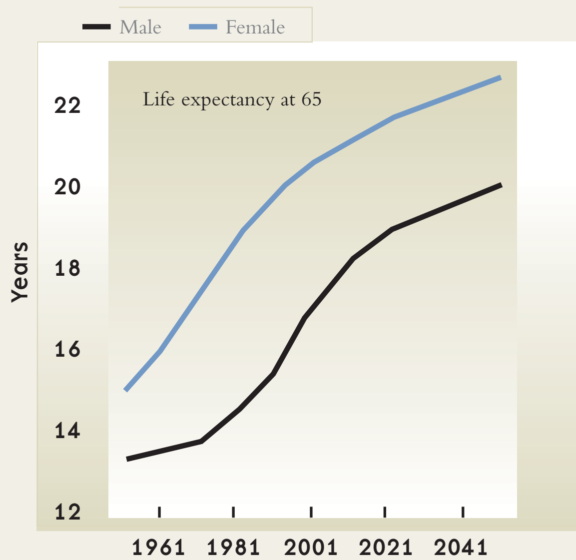
- Life expectancies at age 65 for those with a lower income, who receive both OAS and GIS benefits, are 15.0 years for males and 19.0 years for females. For those with a higher income who receive reduced OAS benefits, the life expectancies at age 65 are 19.5 years for males and 22.4 years for females.
- OAS beneficiaries who are immigrants experience lower mortality than beneficiaries who were born in Canada. Several factors, including medical and employability screening prior to entry to Canada, as well as cultural and lifestyle characteristics, explain the greater life expectancies of immigrants and their relative better health.

Canadian Aging
(figure 33)



Significantly more Canadians are expected to live longer in the future.

Increase in Life Expectancies
(figure 34)



Life expectancy at age 65 is steadily increasing for Canadians.

Corporate Services

Balancing hard work and dedication with a rewarding work environment

Enhancing transparency in Human Resources planning

OSFI introduced several HR policies, practices and training programs in 2005-2006 to ensure compliance with the new *Public Service Modernization Act*, which is designed to modernize human resources management in the federal government. These changes provided OSFI the opportunity to enhance its labour relations environment; to respond to employee issues surrounding transparency and access within the staffing process; and to clarify management's role and accountabilities with respect to HR matters.

Sector staffing plans were developed in 2005-2006 to achieve a stronger balance between OSFI's Human Resources planning and business planning. These sector-specific plans will be communicated to all staff at the beginning of the fiscal year. Employees will learn about staffing actions planned throughout the year and about the skills, knowledge and competencies deemed to be in short supply or considered to be assets when selecting candidates. This will enhance the transparency of OSFI's staffing process and help staff be more proactive in their career planning.

Sector staffing plans were developed to achieve a stronger balance between OSFI's Human Resources planning and business planning.

Developing staff

Beginning in the fall of 2005, OSFI introduced a 360-degree feedback process for all executive staff. This process solicits feedback on leadership behaviours from peers, direct reports and the individual's manager. As it is phased-in, the process will lead to personalized development plans as part of the following year's performance management process.

The leadership development series, which was introduced in 2004-2005, continues. The program consists of leadership skills and business process training.

Improving internal communications

In 2005-2006, OSFI introduced a number of venues to allow more two-way communication, such as informal meetings between employees and sector heads. OSFI held focus groups with employees on topics of strong interest, including communication, performance management and change management. A series of town halls was held, to explain OSFI's planning process and budget results to all interested staff.

Building stronger working relationships

"Cool Work, Amazing People" was the theme of OSFI's Employee Conference, held January 11 to 13, 2006. The conference included workshops and presentations by the Executive, an industry panel and guest speakers. Employees reported that they gathered insight into some key issues facing OSFI, gained a better understanding of the work done by others at OSFI, and built closer relationships with their co-workers, especially those from other office locations.

Employees at OSFI learn a lot about the comings, goings and doings of their colleagues from their Intranet site *"OSFINet"*. In January 2006, an updated version of the site was launched, featuring daily news items, updates on current topics, and an executive communications corner. Manager's and Employee's Toolkits provide quick links to working tools and reference materials.

Connie Dickson
Human Resources Advisor, Human Resources and Administration Division, Corporate Services Sector

Managing risks to the working environment

In 2005-2006, OSFI laid the groundwork for a comprehensive Threat and Risk Assessment which will look at all aspects of OSFI's security program, from physical to personnel to information management and technology. The findings will identify any vulnerabilities and allow OSFI to implement supplementary safeguards, as needed, to maintain risk at an acceptable level, while balancing the need to support efficient operations. The first step, a review of physical security at all of OSFI's locations, was completed in March 2006.

OSFI introduced a 360-feedback process for executive staff, which will lead to personalized development plans as part of the performance management process.

In early 2006, OSFI created an internal working committee to develop plans on how OSFI would deal with a possible avian flu pandemic, both from the perspective of maintaining business operations internally and from the perspective of effectively regulating and supervising financial institutions and pension plans. The committee will continue to review internal issues such as employee health and safety, communications and business resumption planning, while also looking externally to see what preparations federal financial institutions are taking, assessing potential impacts on the financial system as a whole, and coordinating information with other regulators.

Enabling information management

OSFI has a multi-year IM/IT strategy that is dependent on implementing technology to support centrally managed information stores. These stores will allow information to be efficiently captured, stored and shared, and managed as a strategic asset. The technology is standardized across the organization and will allow for an integrated approach to information management and delivery.

In support of the above strategy, OSFI began the implementation of business intelligence and data warehouse tools as part of a multi-year strategy to consolidate data, standardize reporting interfaces and enhance analytical capability. This will provide OSFI employees with easier access to existing data, enable more comprehensive cross sector reporting, and improve system flexibility allowing OSFI to more easily respond to changes in the financial sector. New data architecture and standards were developed to ensure that data accuracy, quality and security levels remained high in the new data warehousing environment. During 2005-2006, four internal applications began using this new technology, and more are planned in 2006-2007. The systems development required to support the introduction of the Basel Framework will take full advantage of these new systems and will be implemented in 2006-2007.

In addition, OSFI began the next phase of its Electronic Document Management System (EDMS) project to reorganize the balance of its electronic records to improve information sharing. EDMS will allow OSFI employees to share information more easily and ensure our electronic corporate records continue to be managed effectively in accordance with government policy. This phase of EDMS will be completed in 2006-2007.

As planned, OSFI completed the implementation of its multi-year Business Systems Integration Initiative (BSII), including the Core Supervisory Workflow System and the Supervision Planning Application. This project was designed to re-engineer core supervision processes, and allow OSFI to better allocate its resources to high-risk areas. These changes will allow OSFI to continue to be well positioned to respond to changes and challenges in the financial services industry.

A Priority Project and IM/IT Change Management Committee was created to enhance the process of reviewing IM/IT spending, to ensure technology projects achieve the expected business value.

Christine Walker
Senior Director,
Finance and Informatics Services,
Corporate Services Sector

Financial Statements

Budget and Assessment Highlights

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

Highlights for the 2005-2006 budget, as compared to estimates, include:

- OSFI met its target, as communicated to financial industry associations, of keeping the overall increase in assessment fees under 4%. Total base assessments to financial institutions were in fact 5.0% lower than the estimates that had been communicated to industry, and represented a growth of 1.2% over the previous year.
- Assessments are differentiated to reflect the costs incurred by OSFI's activities related to each industry group. Base assessments on the deposit-taking sector rose by 5.1% from the previous year to reflect OSFI's increased efforts in that sector in support of the New Capital Adequacy Framework (Basel II) implementation and Anti-Money Laundering/Anti-Terrorist Financing activities. Base assessments on the P&C insurance sector decreased by 0.5% due to the significant economic improvements in this industry. Base assessments on the life insurance sector decreased by 5.9%.
- Surcharges to problem institutions were approximately 29% lower than estimates for the year, and 37% lower than the previous year, mainly due to improved economic conditions in the P&C insurance sector and hence a lower than planned number of staged institutions.
- User fees for applications for approval were almost 10% higher than estimated, in part due to the full-year effect of the 30% fee increase that was implemented effective August 2004, and in part due to increased volumes throughout the year of high-value transactions. User fees were approximately 32% higher than the previous year.
- Actual overall expenses were 2.9% below budget estimates and up 2.0% over the previous year. A higher vacancy rate and a drop in the employee benefits rate set by Treasury Board contributed to lower than planned expenses. These reductions were offset by an increase in Information Management/Information Technology (IM/IT) spending due to continued investments to support OSFI's regulatory and supervisory activities.
- During 2005-2006, OSFI refined its cost allocation methodology and as a result, a greater share of the Corporate Services costs was allocated to the Regulation and Supervision of Federally Regulated Private Pension Plans program and the Office of the Chief Actuary program.
- The average number of full-time equivalent employees during the year was 434, or 27 less than budget estimates and 19 less than the previous year. The reduction from the previous year was largely in the Regulation and Supervision of Federally Regulated Financial Institutions program, where the average number of full-time equivalents dropped by 27. There was an increase of 5 in the Regulation and Supervision of Federally Regulated Private Pension Plans program.
- OSFI upheld during 2005-2006 its approved maximum head count at 475 full-time equivalents, notwithstanding the rapidly growing complexity of the financial services industry. This compares favourably to other major regulators. OSFI ended the year with an actual head count of 436.

Financial Highlights

Background

OSFI recovers its costs from several revenue sources. OSFI is funded mainly through asset-based, premium-based or membership-based assessments on the financial services industry and a user-pay program for selected services.

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

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

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

Overall, OSFI fully recovered all its expenses for the fiscal year 2005-2006.

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

The Office of the Chief Actuary is funded by fees charged for actuarial services relating to the Canada Pension Plan, the Old Age Security program, the Canada Student Loans Program and various public sector pension and benefit plans, and by a parliamentary appropriation.

Federally Regulated Financial Institutions

Revenues

Base assessments to industry rose $0.7 million, or 1.2%, for the year ended March 31, 2006. Revenue from user fees and charges decreased by $0.9 million, or 15.5%, from the previous year, mainly due to lower surcharges in the P&C insurance sector as a result of a reduction in the number of problem institutions during the year.

User fees from approvals were $0.7 million, or almost 32%, higher than the previous year. The coming into force, in August 2004, of the second of a two-year fee increase of 30% per year was compounded by an increase in the number of approvals required. The phased-in increase in user fees was implemented to better reflect the actual cost of providing approvals and to apply a more equitable method of recovering costs.

Cost-recovered services revenue from major banks related to implementing the internal ratings-based approach of the New Basel Capital Accord was $3.0 million, an increase of $0.5 million from the previous year.

Expenses

Total expenses were $69.3 million, a $0.7 million, or 1.0%, increase from the previous year.

Human resources costs, the main driver of OSFI expenses, reflect the result of planned growth in employee compensation and additional resources in support of the New Capital Adequacy Framework (Basel II) and Anti-Money Laundering/Anti-Terrorist Financing activities. During the year OSFI also increased its performance-related pay, which is available to employees at all levels within the organization. These increases were offset by a reduction in the actual average number of full-time equivalent employees as a result of OSFI's technology/process reengineering initiative during 2004-2005. Benefits from the reengineering resulted in the elimination of certain positions and vacancies that were no longer needed, with corresponding ongoing annual savings of $1.4 million.

OSFI continued to implement its information management/technology plan and make related improvements to its business processes. During 2005-2006, OSFI's significant incremental IM/IT investments were in support of Basel II, and enabling technologies for information management and enhanced reporting and analytics to support its supervisory and regulatory activities. The improved reporting and analytics offer supervisors more capability to analyze data from, and information pertaining to, the regulated financial institutions.

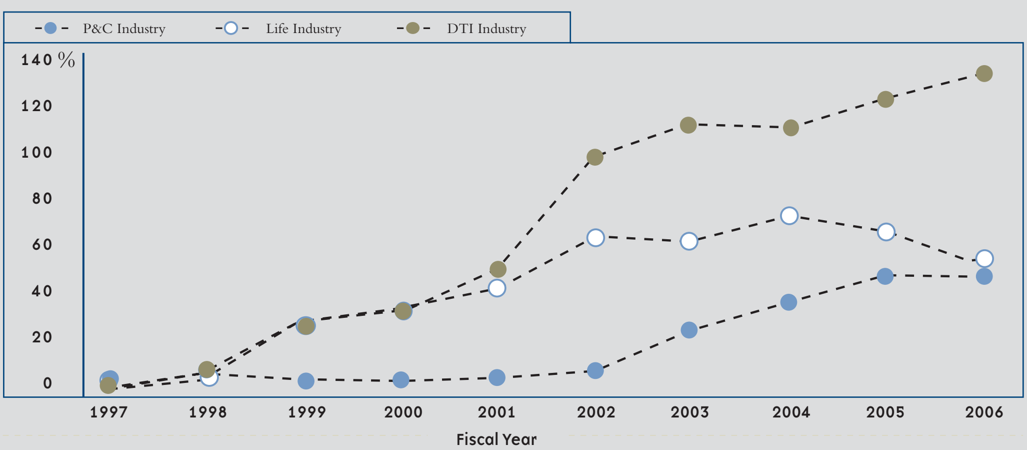
Financial Institution Assessments by Industry

OSFI assessments are differentiated to reflect the costs incurred by each industry group. The chart below shows the growth of base assessments by industry group over the past nine years. Base assessments are the costs allocated to an industry, less specific fees for approvals and surcharges for problem institutions. Assessments for the P&C sector over this nine-year period rose less than for other industry sectors. From 2002-2003 to 2004-2005, however, assessments on the P&C industry grew faster, reflecting an increase in OSFI's time due to economic conditions and a greater number of staged institutions in this industry.

In the last two years, the increase in base assessments to the deposit-taking industry reflects heightened activity on parts of the New Capital Adequacy Framework (Basel II) implementation, increased efforts on Anti-Money Laundering/Anti-Terrorist Financing activities, and international work on conceptual changes to accounting standards. Although the latter impacts all industries, OSFI's efforts during 2005-2006 were most heavily weighted on the deposit-taking industry. The reduction in assessments to the life industry since 2004-2005 reflects the impact of consolidation among the major companies in this industry.

Base Assessments by Industry

Cumulative Growth Rates from Fiscal Year 1997



Federally Regulated Private Pension Plans

Fees Assessed

OSFI's costs for regulating and supervising pension plans are recovered from an annual fee charged to plans, based on the number of plan members. Plans are assessed a fee when applying for registration under the PBSA and when filing the Annual Information Return. Total fees assessed during the fiscal year ending March 31, 2006, were $3.8 million, up from $3.4 million a year earlier.

The fee rate is established based on OSFI's estimate of current year costs to supervise pension plans, adjusted for any excess or shortfall of fees in the preceding years. The estimate is then divided by the anticipated assessable membership to arrive at a per member fee. The rate established for fiscal year 2005-2006 was $12 per assessable member, an increase of $1 from the previous year.

The aforementioned excess or shortfall of fees in any particular year is amortized over five years in accordance with the fee formula set out in regulations. Past years' surpluses have historically kept fee rates down; in 2003-2004 and 2004-2005, however, OSFI incurred unplanned expenses related to problem pension plans that depleted the surplus position. The rate established for fiscal year 2006-2007 is $16.50 per assessable member.

Expenses

The cost of administering the PBSA for fiscal year 2005-2006 was $5.4 million, up from $4.9 million the previous year. This increase is largely driven by an increased focus on Pension Plan issues due to the higher number of "at-risk" pension plans. As a result, OSFI increased its staff complement in the Pensions area during the period to enhance its supervision, rule-making and approvals activities. In addition, during 2005-2006, OSFI refined its cost allocation methodology and as a result, a greater share of the Corporate Services costs was allocated to the Regulation and Supervision of Federally Regulated Private Pension Plans program.

Fees Assessed and Expenses

For Fiscal Years 1999-2000 to 2005-2006 ($000, except Basic Fee Rate)

Year	*1999-2000*	*2000-2001*	*2001-2002*	*2002-2003*	*2003-2004*	*2004-2005*	*2005-2006*
Fees Assessed	3,875	3,765	3,332[1]	3,270	3,549	3,444	3,846
Expenses	3,589	3,239	3,439	3,163	4,322	4,919	5,442
Basic Fee Rate[2] per Member	12.00	12.00	11.00	10.00	11.00	11.00	12.00

1 *Restated from $3,439 to report fees assessed on a cash basis.*

2 *The minimum and maximum annual assessment per plan is derived by multiplying the annual assessment by 20 and 10,000 respectively. With an annual assessment of $12.00 per member, the minimum annual assessment is $240 and the maximum is $120,000.*

International Assistance

Expenses for International Assistance were largely unchanged from the previous year. The normal inflationary increase in human resources costs was offset by a decrease in non-personnel-related costs, specifically due to non-recurring costs in 2004–2005. Revenues from the Canadian International Development Agency for this activity cover approximately two-thirds of its costs; in 2005-2006, additional revenues were received for technical assistance services provided to the government of Chile. The difference between expenses and revenues for this program is funded by base assessments from federally regulated financial institutions.

Office of the Chief Actuary

The Office of the Chief Actuary (OCA) is funded by fees charged for actuarial services and by an annual parliamentary appropriation. The increase from the prior year in the expenses of the OCA is mainly attributed to planned growth in employee compensation and to the greater share of Corporate Services costs attributed to this program to reflect its fully loaded cost. This greater share is being phased-in over a period of three years effective 2005-2006.

Management's Responsibility for the Financial Statements

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

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

OSFI's Executive Committee oversees management's preparation of the financial statements and ultimately approves the financial statements and related disclosures. The Audit Committee reviews and discusses with management and the external auditor, OSFI's audited annual financial statements and all significant accounting estimates and judgements therein and recommends to the Superintendent the approval of the audited financial statements.

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

Nicholas Le Pan
Superintendent

Donna Pasteris
Assistant Superintendent
Corporate Services

Ottawa, Canada
May 19, 2006

Auditor General of Canada
Vérificatrice générale du Canada

AUDITOR'S REPORT

To the Minister of Finance

I have audited the statement of financial position of the Office of the Superintendent of Financial Institutions as at March 31, 2006 and the statements of operations and equity of Canada and cash flows for the year then ended. These financial statements are the responsibility of the management of the Office of the Superintendent of Financial Institutions. My responsibility is to express an opinion on these financial statements based on my audit.

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

In my opinion, these financial statements present fairly, in all material respects, the financial position of the Office of the Superintendent of Financial Institutions as at March 31, 2006 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

Douglas Timmins

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

Ottawa, Canada
May 19, 2006

240 rue Sparks Street, Ottawa, Ontario K1A 0G6

Office of the Superintendent of Financial Institutions

STATEMENT OF FINANCIAL POSITION

As at March 31, 2006 (in thousands of dollars)

	Note	2006	2005
Assets			
ASSETS			
Cash Entitlement		$ 34,144	$ 30,969
Accounts Receivable	5	5,076	11,567
Accrued Pension Plan Fees		2,751	1,155
Accrued Base Assessments		319	846
Capital Assets	4	11,625	9,819
TOTAL ASSETS		**$ 53,915**	**$ 54,356**
Liabilities and Equity of Canada			
LIABILITIES			
Accrued Salaries and Benefits		$ 11,293	$ 11,305
Accounts Payable and Accrued Liabilities	5	3,662	5,857
Unearned Base Assessments		3,529	2,420
Other Unearned Revenue		853	542
Employee Future Benefits	6	7,040	6,694
		$ 26,377	**$ 26,818**
EQUITY OF CANADA		**27,538**	**27,538**
TOTAL LIABILITIES AND EQUITY OF CANADA		**$ 53,915**	**$ 54,356**
Commitments and Contingencies	12		

Nicholas Le Pan

NICHOLAS LE PAN
Superintendent of Financial Institutions

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

Office of the Superintendent of Financial Institutions

STATEMENT OF OPERATIONS AND EQUITY OF CANADA

For the year ended March 31, 2006 (in thousands of dollars)

	Note	2006	2005
Regulation and Supervision of Federally Regulated Financial Institutions			
Revenue	10	$ 69,657	$ 69,227
Expenses	10,11	69,317	68,657
Net Results before Filing Penalties Revenue		340	570
Filing Penalties Revenue	8	805	365
Net Results		1,145	935
Regulation and Supervision of Federally Regulated Private Pension Plans			
Revenue	10	5,442	4,919
Expenses	10,11	5,442	4,919
Net Results		–	–
International Assistance			
Revenue	10	1,431	1,211
Expenses	10,11	1,771	1,781
Net Results		(340)	(570)
Office of the Chief Actuary of Canada			
Revenue	10	3,636	3,253
Expenses	10,11	4,391	3,977
Net Results		(755)	(724)
NET RESULTS OF OPERATIONS BEFORE GOVERNMENT FUNDING		50	(359)
Government Funding	7	755	724
NET RESULTS OF OPERATIONS FOR THE YEAR		805	365
EQUITY OF CANADA, BEGINNING OF YEAR		27,538	27,538
Filing Penalties Earned on Behalf of the Government	8	(805)	(365)
EQUITY OF CANADA, END OF YEAR		$ 27,538	$ 27,538

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

Office of the Superintendent of Financial Institutions

STATEMENT OF CASH FLOWS

For the year ended March 31, 2006 (in thousands of dollars)

	Note	*2006*	*2005*
CASH FLOWS FROM OPERATING ACTIVITIES			
Cash Receipts from Financial Institutions, Pension Plans and Other Government Departments		$ 93,596	$ 76,252
Cash Paid to Suppliers and Employees		(83,782)	(77,626)
Insurance Company Liquidations (Net)	9	(1,017)	59
Filing Penalties Revenue Remitted to the Consolidated Revenue Fund	8	(805)	(365)
Net Cash Provided by (Used in) Operating Activities		**7,992**	**(1,680)**
CASH FLOWS FROM INVESTING ACTIVITIES			
Acquisition of Capital Assets	4	(4,817)	(7,382)
Net Cash Used in Investing Activities		**(4,817)**	**(7,382)**
NET INCREASE (DECREASE) IN CASH ENTITLEMENT		**3,175**	**(9,062)**
CASH ENTITLEMENT AT BEGINNING OF YEAR		**30,969**	**40,031**
CASH ENTITLEMENT AT END OF YEAR		**$ 34,144**	**$ 30,969**

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

Office of the Superintendent of Financial Institutions

Notes to the Financial Statements

For the year ended March 31, 2006

1. Authority and objectives

Mandate

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

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

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

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

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

In addition, OSFI supports initiatives of the Canadian government to assist selected emerging market economies to strengthen their regulatory and supervisory systems. This program incorporates activities related to providing help to other selected countries that are building their supervisory and regulatory capacity. This program is largely funded by the Canadian International Development Agency, and is carried out directly by OSFI and through its participation in the Toronto International Leadership Centre for Financial Sector Supervision.

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

Notes to the Financial Statements

For the year ended March 31, 2006

2. Revenue and spending authority

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

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

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

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

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

3. Significant accounting policies

a) Basis of presentation

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

b) Revenue recognition

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

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

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

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

Notes to the Financial Statements

For the year ended March 31, 2006

3. Significant accounting policies (continued)

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

Filing penalties are penalties levied against financial institutions when they submit late and/or erroneous financial and corporate returns due to OSFI. Penalties levied are not available to reduce the net costs that OSFI assesses the industry (i.e., they are non-respendable) and are remitted to the Consolidated Revenue Fund. Filing penalties are charged in accordance with the *Administrative Monetary Penalties (OSFI) Regulations*.

c) Cash entitlement

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

d) Capital assets

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

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

e) Employee future benefits

(i) Pension benefits

OSFI's eligible employees participate in the Public Service Pension Plan which is sponsored and administered by the Government of Canada. Supplementary retirement benefits may also be provided in accordance with the *Special Retirement Arrangements Act*. Pension benefits accrue on pensionable service at a rate of 2 per cent per year up to a maximum period of 35 years, times the average of the best five consecutive years of earnings. The benefits are integrated with the Canada/Québec Pension Plan benefits and they are indexed to inflation.

Both the employees and OSFI contribute to the cost of the Plan. OSFI's responsibility with regard to the Plan is limited to its contributions. Actuarial liabilities are recognized in the financial statements of the Government of Canada, as the Plan's sponsor.

Notes to the Financial Statements

For the year ended March 31, 2006

3. Significant accounting policies (continued)

(ii) Severance benefits

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

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

(iii) Other future benefits

The federal government sponsors a variety of other future benefit plans from which employees and former employees may benefit during employment or upon retirement. The Public Service Health Care Plan and the Pensioners' Dental Service Plan are the two major plans available to OSFI employees and retirees. OSFI's responsibility with regard to these two plans is also limited to its contributions.

f) Specified purpose account for insurance company liquidations

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

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

g) Use of estimates

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

h) Contingencies

Where it is likely that a contingency existing at the financial statement date will result in a loss, OSFI accrues its financial effects the extent to which the amount of the loss is known or can be reasonably estimated.

Notes to the Financial Statements

For the year ended March 31, 2006

4. Capital assets

($ thousands)	*Gross Book Values*			*Accumulated Amortization*			*Net Book Values*	
Category	*Opening Balance*	*Additions (net)*	*Closing Balance*	*Opening Balance*	*Amortization Expense (net)*	*Closing Balance*	*2006*	*2005*
Leasehold Improvements	$ 5,691	$ (507)	$ 5,184	$ 1,820	$ (1,130)	$ 690	$ 4,494	$ 3,871
Furniture and Fixtures	3,074	300	3,374	1,321	(29)	1,292	2,082	1,753
Office Equipment	503	(189)	314	344	(142)	202	112	159
Informatics Hardware	2,644	(1,020)	1,624	1,955	(1,007)	948	676	689
Informatics Infrastructure	3,113	(1,233)	1,880	2,670	(1,360)	1,310	570	443
Informatics Software	8,196	(912)	7,284	5,292	(1,699)	3,593	3,691	2,904
Total	**$ 23,221**	**$(3,561)**	**$ 19,660**	**$ 13,402**	**$ (5,367)**	**$8,035**	**$ 11,625**	**$ 9,819**

Amortization expense for the year ended March 31, 2006 was $3,013 thousand (2005: $2,636 thousand). Net additions and net amortization expense include the impact of removing $8,378 thousand in fully amortized assets that had reached the end of their service life.

5. Related party transactions

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

OSFI recorded expenses of $18,236 thousand (2005: $19,702 thousand) and revenue of $5,675 thousand (2005: $4,752 thousand) from transactions with other government departments during the year.

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

($ thousands)		*Related Parties*	*External Parties*	*Total*
2006	Accounts Receivable	$ 197	$ 4,879	$ 5,076
	Accounts Payable and Accrued Liabilities	1,297	2,365	3,662
2005	Accounts Receivable	577	10,990	11,567
	Accounts Payable and Accrued Liabilities	1,922	3,935	5,857

Notes to the Financial Statements

For the year ended March 31, 2006

6. Employee future benefits

a) Pension benefits

OSFI and all eligible employees contribute to the Public Service Pension Plan. This pension plan provides benefits based on years of service and average earnings at retirement. The benefits are fully indexed to the increase in the Consumer Price Index. The estimated employer contributions to the Public Service Pension Plan during the year were $5,650 thousand (2005: $5,798 thousand).

b) Severance benefits

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

($ thousands)	*2006*	*2005*
Accrued Benefit Obligation, beginning of year	**$ 7,016**	**$ 6,497**
Current service cost	598	555
Interest cost	360	386
Benefits paid	(611)	(772)
Actuarial loss	318	350
Accrued Benefit Obligation, end of year[1]	**7,681**	**7,016**
Unamortized net actuarial loss	(641)	(322)
Accrued Benefit Liability	**$ 7,040**	**$ 6,694**
Net Benefit Plan Expense		
Current service cost	598	555
Interest cost	360	386
Benefit Expense	**$ 958**	**$ 941**

[1] *The cost corresponding to annual changes in the accrued benefit liability is recovered from OSFI's various sources of revenue outlined in Note 3 to the financial statements. Amounts collected in excess of benefits paid are presented on the Statement of Financial Position under the heading of Cash Entitlement.*

The significant actuarial assumption adopted in measuring OSFI's accrued benefit obligation is a discount rate of 4.25% (2005: 5.13%).

For measurement purposes, management's best estimate for the general salary increases to estimate the current service cost and the accrued benefit obligation as at March 31, 2006 is an annual economic increase of 2.5% for the plan year 2007 (2005: 2.5% for the plan year 2006). Thereafter, an annual economic increase of 2.5% is assumed (2005: 2.9%). The average remaining service period of active employees covered by the benefit plan is 11 years (2005: 11 years).

Notes to the Financial Statements

For the year ended March 31, 2006

7. Government funding

OSFI receives an annual parliamentary appropriation pursuant to Section 16 of the OSFI Act to support its mandate relating to the Office of the Chief Actuary. In this fiscal year, OSFI was granted $755 thousand (2005: $724 thousand).

8. Filing penalties

Filing penalties are levied quarterly to financial institutions when they submit late and/or erroneous financial and corporate returns due to OSFI during the preceding calendar quarter. Penalties levied by OSFI are remitted to the Consolidated Revenue Fund. The funds are not available for use by OSFI and are not included in the balance of the Cash Entitlement. As a result, the penalties do not reduce the amount that OSFI assesses the industry in respect of its operating costs.

During 2005-2006, OSFI levied $805 thousand (2005: $365 thousand) in late and erroneous filing penalties.

9. Specified purpose account for insurance company liquidations

During the year, the Superintendent was discharged from his appointment as liquidator of English and American Insurance Company Limited and Orion Insurance Company PLC.

The following activity occurred in this account:

($ thousands)	*2006*	*2005*
Opening Balance	**$ –**	**$ 59**
Recoveries deposited	1,017	37
Distribution of assets from liquidated estates	–	(416)
Other transactions in respect of liquidation expenses	–	320
Closing Balance	**$ 1,017**	**$ –**
Remaining insurance company liquidations under control of the Superintendent	6	8

Notes to the Financial Statements

For the year ended March 31, 2006

10. Segmented information

Revenue by Business Activity

($ thousands)	2006					2005				
	Base Assessments	*Cost-Recovered Services*	*Pension Plan Fees*	*User Fees and Charges*	***TOTAL***	*Base Assessments*	*Cost-Recovered Services*	*Pension Plan Fees*	*User Fees and Charges*	***TOTAL***
Regulation and Supervision of Federally Regulated Financial Institutions	$ 60,878	$ 3,794	$ –	$ 4,985	**$ 69,657**	$ 60,171	$ 3,157	$ –	$ 5,899	**$ 69,227**
Regulation and Supervision of Federally Regulated Private Pension Plans			5,442		**5,442**		52	4,867		**4,919**
International Assistance		1,431			**1,431**		1,211			**1,211**
Office of the Chief Actuary		3,399		237	**3,636**		3,209		44	**3,253**
TOTAL REVENUE	**$ 60,878**	**$ 8,624**	**$ 5,442**	**$ 5,222**	**$ 80,166**	**$ 60,171**	**$ 7,629**	**$ 4,867**	**$ 5,943**	**$ 78,610**

Expenses by Business Activity

($ thousands)	*2006*	*2005*
Regulation and Supervision of Federally Regulated Financial Institutions		
Risk Assessment and Intervention	$ 49,093	$ 48,659
Rule Making	13,477	13,829
Approvals	6,747	6,169
Total	**69,317**	**68,657**
Regulation and Supervision of Federally Regulated Private Pension Plans	**5,442**	**4,919**
International Assistance	**1,771**	**1,781**
Office of the Chief Actuary		
Canada Pension Plan and Old Age Security	1,427	1,360
Public Pension Plans	2,346	2,059
Canada Student Loans Program	618	558
Total	**4,391**	**3,977**
TOTAL EXPENSES	**$ 80,921**	**$ 79,334**

Notes to the Financial Statements

For the year ended March 31, 2006

11. Revenue and expenses by major classification

($ thousands)	*For the year ended March 31*				
	2006	*2005*	*2004*	*2003*	*2002*
Revenue					
Base Assessments	$ 60,878	$ 60,171	$ 58,166	$ 56,460	$ 53,497
Cost-Recovered Services	8,624	7,629	7,140	6,266	3,405
Pension Plan Fees	5,442	4,867	4,322	3,155	3,434
User Fees and Charges	5,222	5,943	6,762	4,221	3,089
Total Revenue Earned from Respendable Sources	**80,166**	**78,610**	**76,390**	**70,102**	**63,425**
Filing Penalties Revenue	805	365	211	710	–
Total Revenue	**80,971**	**78,975**	**76,601**	**70,812**	**63,425**
Expenses					
Human Resources	55,254	57,448	55,801	52,215	48,853
Information Management/Technology	10,418	7,972	8,129	5,519	3,144
Facilities	6,247	5,789	5,109	5,098	4,878
Travel	3,333	2,998	2,860	2,953	2,281
Administration	2,623	2,512	2,444	2,059	2,402
Professional Development	1,551	1,062	1,254	1,727	1,537
Professional Services	1,495	1,553	1,683	1,237	1,298
Total Expenses	**80,921**	**79,334**	**77,280**	**70,808**	**64,393**
Net Results of Operations before Government Funding	**50**	**(359)**	**(679)**	**3**	**(968)**
Government Funding	755	724	890	707	917
Net Results of Operations Including Non-Respendable Filing Penalties Revenue	**805**	**365**	**211**	**710**	**(51)**
Filing Penalties Revenue Earned on Behalf of the Government	(805)	(365)	(211)	(710)	–
NET RESULTS OF OPERATIONS	**$ –**	**$ –**	**$ –**	**$ –**	**$ (51)**
AVERAGE NUMBER OF EMPLOYEES	**434**	**453**	**466**	**454**	**419**

Notes to the Financial Statements

For the year ended March 31, 2006

12. Commitments and contingencies

a) Commitments

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

($ thousands)	
2006–2007	$ 4,664
2007–2008	4,624
2008–2009	4,429
2009–2010	2,250
2010–2011	2,150
	$ 18,117

b) Contingencies

OSFI is involved in claims and litigation for which provisions have been made to the extent determinable, in accordance with accounting policy note 3 h).

Appendix 1

Disclosure of Information

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

OSFI reviewed a sample of financial institution annual reports and regulatory disclosures for institutions' 2005 fiscal years, and was satisfied with the results. This review concluded that:

- The deposit-taking institutions selected for review comply with quantitative and qualitative disclosure requirements.
- The life insurers selected for review comply with quantitative and qualitative disclosure requirements.

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

OSFI has issued separate disclosure guidelines for deposit-taking institutions, life insurance companies and P&C insurance companies, setting out minimum requirements for information disclosure on financial, risk management and control practices. These requirements supplement disclosures required by the Canadian Institute of Chartered Accountants (CICA) Handbook under generally accepted accounting principles (GAAP) and other OSFI guidelines.

OSFI issued for comment a draft accounting guideline D-10, Accounting for Financial Instruments Designated as Fair Value Option. The draft guideline includes disclosure guidance for financial institutions that choose to use the Fair Value Option available under Canadian GAAP. As well, OSFI has been working on the implementation of the New Capital Adequacy Framework (Basel II) of which Pillar III – Market Discipline will require enhanced disclosures by banks of capital and risk management practices.

OSFI implemented the new Life-1 reporting forms for year end 2005 to enhance financial statement disclosures of life insurers. Other domestic efforts in insurance included OSFI's work with the Canadian Institute of Actuaries (CIA) in developing a model for annual disclosure of gains and losses by source, and participation in the development of guidance issued by the CIA on the methodology of these calculations. In 2004, OSFI issued a new guideline which requires public disclosure of the source of earnings by Canadian life insurance companies for their 2004 fiscal year. This disclosure will be more useful for the 2005 public disclosures since comparative numbers will now be available. Embedded value disclosure is already a reporting feature of several large Canadian life insurers.

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

- Through its participation in the Basel Committee on Banking Supervision, OSFI has been active in some of the work of the International Accounting Standards Board (IASB). This is especially important now that the CICA will be adopting international accounting standards for publicly accountable entities.
- OSFI actively monitors and provides input on the work of the Enhanced Disclosure Subcommittee of the International Association of Insurance Supervisors (IAIS). The Enhanced Disclosure Sub-Committee is charged with drafting standards and guidance papers aimed at enhancing the standards of disclosure. In October 2005, the IAIS issued a new standard entitled Standard on Disclosures Concerning Investment Performance and Risks for Insurers and Reinsurers. The IAIS is currently developing a new standard on disclosure concerning life insurance performance. This standard is expected to be final in October 2006.

Appendix 2

Financial Institutions and Pension Plans Regulated by OSFI

	Number[1]	*Assets*[2, 3] *($ millions)*
Banks		
Domestic	21	1,905,673
Foreign Bank Subsidiaries	26	109,446
Foreign Bank Branches	24	37,078
Trust and Loan Companies		
Bank-owned	30	203,298
Other	38	16,829
Cooperative Credit Associations	7	14,931
Cooperative Retail Association	1	4,826
Life Insurance Companies		
Canadian-incorporated	45	361,997
Foreign Branches	53	18,429
Fraternal Benefit Societies		
Canadian-incorporated	12	5,838
Foreign Branches	9	1,523
Property and Casualty Insurance Companies		
Canadian-incorporated	93	65,825
Foreign Branches	96	24,838
Pension Plans	1,304	116,576

1 *Number of regulated companies as at 31 March 2006. Includes institutions in the process of liquidation or termination and institutions limited to servicing existing business. A list of institutions regulated by OSFI can be found on OSFI's web site at* ***www.osfi-bsif.gc.ca*** *under "Who We Regulate".*

2 *As at 31 March 2006 where available, otherwise 31 December 2005.*

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

Appendix 3

Summary of Asset Breakdown[1] for Pension Plans Regulated by OSFI

As at March 31, 2006 with comparative figures for the year ended March 31, 2005
(in millions of dollars)

	2006			2005		
Cash	**$**	**291**	**0.2%**	$	324	0.4%
Debt Securities						
Short Term Notes, Other Term Deposits	$	3,381	2.9%	$	3,273	3.1%
Government Bonds		25,053	21.5%		22,098	21.2%
Corporate Bonds		6,776	5.8%		6,702	6.4%
Mutual Funds – Bonds, Cash Equivalent & Mortgage		6,573	5.6%		6,010	5.8%
Mortgage Loans		1,230	1.1%		1,234	1.2%
General Fund of an Insurer		102	0.1%		96	0.1%
Total Debt Securities	**$**	**43,115**	**37.0%**	**$**	**39,413**	**37.8%**
Equity						
Shares in Investment, Real Estate or Resource Corporation	$	6,281	5.4%	$	4,920	4.7%
Common and Preferred Shares		47,066	40.4%		40,989	39.4%
Mutual Funds – Stocks		11,958	10.3%		11,501	11.0%
Mutual Funds – Real Estate		323	0.3%		573	0.6%
Real Estate		1,756	1.5%		1,279	1.2%
Total Equity	**$**	**67,384**	**57.9%**	**$**	**59,262**	**56.9%**
Diversified and Other Investments						
Mutual Funds – Balanced	$	2,854	2.4%	$	2,500	2.4%
Segregated Funds		1,586	1.4%		1,469	1.4%
Other		1,060	0.9%		1,071	1.0%
Total Diversified and Other Investments	**$**	**5,500**	**4.7%**	**$**	**5,040**	**4.8%**
Other Accounts Receivables (Net of Liabilities)	**$**	**285**	**0.2%**	**$**	**151**	**0.1%**
TOTAL NET ASSETS	**$**	**116,576**	**100.0%**	**$**	**104,190**	**100.0%**

[1] *Represents asset distribution as reported in the financial statements of pension plans whose year-end falls between January 1 and December 31 of respective years.*

How to Reach OSFI

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

Toll-free Information Service

OSFI operates a toll-free information service from 8:30 a.m. to 6:00 p.m. Eastern Time, Monday through Friday. It can be reached by calling **1 800 385-8647** or 613-990-6011 for local (Ottawa-Gatineau) calls.
E-mail: **extcomm@osfi-bsif.gc.ca**

Internet

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

Publications

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

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