



Office of the Superintendent of
Financial Institutions Canada

Bureau du surintendant des
institutions financières Canada

Office of the Superintendent of Financial Institutions (OSFI)

Plan and Priorities 2007-2010



OSFI
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**OSFI Plan and Priorities 2007 – 2010
Executive Summary**

Introduction

Each year, the Office of the Superintendent of Financial Institutions (OSFI) produces a three-year planning document, referred to as the Plan and Priorities. It is intended primarily for the use of employees to guide their goal- and day-to-day priority-setting, but is also shared with other key stakeholders through posting to OSFI's external Web site.

Our Core Work

- Accurate risk assessments of financial institutions and pension plans, and timely, effective intervention and feedback
- A balanced, relevant regulatory framework of guidance and rules for financial institutions and pension plans
- A prudentially effective, balanced and responsive approvals process
- Provision of expert actuarial valuations and advice that contribute to financially sound federal government public pension and other programs
- High-quality internal governance and related reporting, and resources and infrastructure that support supervisory and regulatory activities

Economic, Industry and Regulatory Environment

- The North American economy is slowing but still growing. The general consensus is that expansion will continue through 2007, but at a moderate pace.
- Canadian financial institutions are operating in an increasingly complex, international environment.
- OSFI's supervisory efforts will be optimized through development and maintenance of working relationships with foreign regulators.
- Increasingly complex financial products mean that more effort is required, on the part of institutions and OSFI, to assess risk.
- There is a need for financial institutions to adopt international accounting standards over the next five years. This may add to the volatility of earnings; current risk management practices may not be adequate.
- Basel II implementation in November 2007 will change the way financial institutions run their businesses and the way OSFI supervises.
- Long-term interest rates remain low, contributing to challenges for the pension industry. Canada's pension environment is increasingly litigious; court decisions increasingly affect OSFI's work.

OSFI's Risks and Priorities

OSFI uses an Enterprise Risk Management framework to identify and divide external and internal risks. Following are the risks highlighted through this year's process as well as how we intend to deal with them.

External Risks	How we will respond
Shocks to the economy and cyclical in the industry	Readiness Planning: Carry out table-top exercises on our crisis planning and Business Resumption Plan; develop OSFI's pandemic flu plan and review of what institutions are doing in this area; ensure resources are in place to identify and deal with problem institutions; emphasize institutions' stress-testing capabilities.
Basel II Capital Accord	Review and process applications submitted for approval under the Accord so that the implementation date of November 1, 2007, is met.
Financial Sector Assessment Program (FSAP)/Financial Action Task Force (FATF)	Work with the Bank of Canada and Canadian banks to complete appropriate stress tests; provide information to International Monetary Fund so it can assess our compliance with four banking standards; provide input to the Department of Finance for the FATF review.
Change to international financial reporting standards (IFRS)	Determine implications of accounting changes for Canadian financial institutions and supervisors; develop a process for changing data collection and reporting.
Minimum Continuing Capital Surplus Requirement (MCCSR)	Develop and agree on a capital framework for life insurance companies over the next five years; develop implementation criteria for risk-sensitive methodologies and internal models, including for interest rate, credit and other risks.
Internal Risks	How we will respond
People	Identify changing human resources requirements; ensure timely availability of staff; better allocate available resources to identified risk and priority areas.
Pensions Systems and Processes	Contribute to policy analysis of the <i>Pension Benefits Standards Act, 1985</i> ; continue to make the pensions approvals more timely; train new employees; upgrade the internal information technology system; monitor and determine the implications of court decisions affecting private pension plans.

OSFI's Mandate and Activities

Mandate

OSFI's legislated mandate was established in 1996 and changes are not expected in the 2007-2010 planning period. Under the legislation, OSFI's 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.

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

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.

OSFI's accountability framework is made up of a variety of elements. 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 regularly conducts anonymous surveys of knowledgeable observers on its operations, consults extensively on its regulatory rules before they are finalized and issues an annual report and has its financial statements and related control processes audited annually by the Auditor General. Related reports are disclosed on [OSFI's Web site](#).

OSFI's internal audit group conducts assurance audits based on a comprehensive five-year risk-based plan. Audit results are reviewed by the Executive and the Audit Committee at regularly scheduled meetings. OSFI strengthened its internal audit program considerably in 2006-2007 in accordance with the new Treasury Board Secretariat audit policy. Effective the first quarter of 2006, OSFI appointed four external members to its Audit Committee, who serve with the Superintendent. The independent members represent a majority of the

committee. In addition, more resources were added to the internal audit program. More information is available on OSFI's Web site under [About OSFI/Audit Committee](#).

The Office of the Chief Actuary (OCA) was established within the organization as a separate unit to provide actuarial and other services to the Government of Canada and provincial governments who are Canada Pension Plan (CPP) stakeholders. The accountability framework for the OCA established by OSFI makes clear that the Chief Actuary is the person solely responsible for actuarial opinions made by the Office. More information is available on OSFI's Web site under the [Office of the Chief Actuary](#).

Activities

OSFI has a number of key responsibilities that it must perform to meet its mandate and strategic objectives. In any year there may be specific activities or new initiatives related to these responsibilities.

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

Activities include timely risk assessments and intervention and recommending appropriate changes in financial institutions practices and processes as necessary. OSFI's use of a modern supervisory framework contributes to its objective to limit losses to depositors and policyholders in the case of serious problems.

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

Activities include communication and consultation with financial institutions and the industry during the rule development process, and effective contributions to international regulation and standard setting. OSFI's objective is to produce rules and guidance that are timely, relevant and meet or exceed international minimums.

A prudentially effective, balanced and responsive approvals process

Activities include operation of a timely, clear and transparent approvals process for legislative and non-legislative approvals. OSFI's objective is to make decisions that balance prudence with the recognition that institutions must take reasonable risks in order to operate in a competitive environment.

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

Activities include timely risk assessments and interventions and providing clear reports and recommendations to supervised plans. Constructive and timely communication and consultation with the pension plan industry during the development of regulations, rules and other guidance contributes to the development of a balanced regulatory framework. OSFI is also responsible for the operation of a timely, clear and transparent approvals process for private pension plans. These activities contribute to OSFI's objective of

limiting losses, or potential losses, to plan members as a result of the termination or restructuring of plans.

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

Activities include providing high-quality and timely reports such as triennial Actuarial Reports which are tabled in Parliament in respect of the Canada Pension Plan (CPP), the Old Age Security program, and federal public sector employee pension and insurance plans. The Office of the Chief Actuary (OCA) also provides expert and timely actuarial advice to Parliament on public sector pensions and, since 2001, is responsible for undertaking the actuarial review of the Canada Student Loans Program.

High-quality internal governance and related reporting, and resources and infrastructure necessary to support supervisory and regulatory activities

Activities include developing and implementing cost-effective information management systems that contain relevant, accurate and timely internal and external data. OSFI must maintain a robust technology infrastructure that meets acceptable security and performance standards. The objective is to ensure that OSFI has the processes and systems in place to enable a motivated and skilled workforce to focus on its supervisory and regulatory activities.

Key Risks and Threats

Economic, Industry and Regulatory Environment

The North American economy is slowing but still growing. With uncertainty about whether the credit cycle has peaked, low unemployment and benign inflation numbers, economic analysts have been hard-pressed to generate economic forecasts. The general consensus is that expansion will continue through 2007, but at a moderate pace, although there are risks to consider and some indicators of possible changes to come.

Canadian financial institutions are operating in an increasingly complex, international environment. OSFI, as supervisor of the consolidated operations of Canadian financial institutions, assesses risks arising from offshore operations and monitors Canadian institutions' ability to manage those risks. In order to do this, there is greater interest in increased cross-border cooperation. OSFI needs to continue to develop and maintain working relationships with foreign regulators to optimize its supervisory efforts.

Financial institutions face risks from financial products that are becoming more complex. In response, institutions are placing greater reliance on a variety of enhanced analytical techniques and risk-transfer mechanisms to better manage and measure risk. Transactions

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are becoming more complex, and it is sometimes difficult to determine to what extent the risk is being transferred.

Globally, the regulatory environment is changing rapidly. There is a growing focus on principles-based versus rules-based regulation, which OSFI is taking note of.

Financial institutions will be faced with adopting international accounting standards over the next five years. Key accounting changes will be with respect to insurance, consolidation, business combinations, pensions, revenue recognition and measurement of fair value. These changes could add to the volatility of earnings and may not always be adequately covered by current risk management practices.

Canadian banks will implement Basel II in November 2007. The requirement for better risk management, including operational risk, and the increased use of advanced techniques such as stress testing, will result in important changes in the way financial institutions run their business and the way OSFI supervises.

Insurance companies may face changes under International Association of Insurance Supervisors (IAIS) which is currently developing a standard for life insurance company disclosure. This standard may require changes in Canadian institutions' public disclosure and may require OSFI to develop and consult on new guidelines.

Financial and economic conditions continue to create a challenging environment for the pension industry. Long-term interest rates remain low. The Canadian pension environment is increasingly litigious, and court decisions increasingly affect OSFI's work.

Enterprise Risk Management

The environment within which OSFI operates presents an array of challenges to the achievement of its mandate and objectives. While many of these challenges are consistently present, the extent to which they present a risk to OSFI's objectives varies depending on economic and financial conditions and the financial industry environment. OSFI's ability to achieve its mandate depends on the timeliness and effectiveness with which it identifies, evaluates, prioritizes, and develops initiatives to address areas where its exposure is greatest.

OSFI's Enterprise Risk Management (ERM) framework divides risks into external and internal categories. The external risk category consists of economic and financial conditions, the financial industry environment, OSFI's legal environment and catastrophic events. External risks arise from events that OSFI cannot influence, but must be able to monitor in order to mitigate the impact. The internal risk category consists of risks that can broadly be categorized as people, processes, systems, and culture. OSFI's ERM program has identified several key risks to the achievement of its mandate and objectives.

External Risks

Shocks to the Economy

Various events over the past few years have focussed the attention of financial institutions and their regulators on their ability to respond adequately in a crisis or a pandemic, both from a prudential and a human resources perspective.

Cyclical in the Industry

Financial institutions face risks as a result of potential changes in the economic environment. For example, an economic downturn could negatively impact the earnings of financial institutions, stretch OSFI's resources and affect its ability to supervise effectively and intervene in a timely fashion.

Basel II Capital Accord

The new international capital framework will have major implications for financial institutions and OSFI. In particular, the new framework will encourage larger banks to use enhanced risk-based measures of business performance to drive their internal assessment of capital needs.

Canadian banks and OSFI are well advanced with implementation efforts, but continued focus and ongoing work are required for institutions to either adopt the Standardized approach or to qualify for the more complex Advanced Internal Ratings-Based approach to calculating capital. The new capital framework and events in the market also require banks and regulators to better focus on the measurement and management of operational risk and its relation to capital. Due to the size of this undertaking, there is a risk that Basel II implementation will strain the capacity of both, financial institutions and OSFI.

Financial Sector Assessment Program (FSAP) / Financial Action Task Force (FATF)

The International Monetary Fund (IMF) is planning to conduct a financial sector assessment of Canada, likely in early 2007. Canada was first assessed in 1999 and found to be compliant with international banking and insurance standards. Canada has asked to be assessed in 2007 against compliance with four of the newly revised banking standards. The FSAP Update will also include an assessment of Canada's compliance against securities regulatory standards and stress tests of the Canadian financial system. The results, which will be made public, will provide an independent review of OSFI's performance in this area.

Also early in 2007, an assessment of Canada's anti-money laundering and anti-terrorist financing regimes will be conducted by the FATF. While there may be some concern that the FSAP Update and FATF review would not be favourable in some aspects, successful IMF and FATF assessments will be an important validation of the strength of OSFI's core risk assessment and intervention work.

Accounting

The Canadian Accounting Standards Board has decided to adopt international financial reporting standards (IFRS) over the next five years. This will have an impact on both OSFI, as it relies on audited financial information, and the institutions it regulates. Key accounting changes will affect insurance, consolidation, business combinations, pensions, revenue recognition and measurement of fair value. As a reliance-based regulator, it is crucial that OSFI understand the implications of financial statements to perform accurate risk assessments of financial institutions.

New accounting standards (financial instruments) allow any asset or liability to be designated at fair value (Fair Value Option). OSFI issued a guideline in 2006 with requirements for use of this option. As accounting standards continue to move to incorporate the use of fair values, OSFI may need to significantly modify reporting to obtain data to assess and monitor the quality of financial results and identify potential prudential concerns.

Minimum Continuing Capital Surplus Requirement (MCCSR)

The International Association of Insurance Supervisors (IAIS) is revising its capital framework to make capital requirements more risk-sensitive. There is a need to develop more advanced risk measurement techniques to be incorporated into the MCCSR, while maintaining the integrity of the existing capital test. At the same time, the current MCCSR should be maintained as a fallback approach for life insurance companies that do not use models, yet be updated to reflect changes in accounting and actuarial standards that affect the measurement of risk and available capital. To date, Canada has been at the forefront of insurance regulation, and the adoption of MCCSR is necessary to ensure that OSFI continues to meet or exceed international standards.

Internal Risks

People Risks

The financial industry is becoming more complex. OSFI must have staff with sufficient skills to regulate and supervise financial institutions and identify significant issues. In addition, there is a need for continuous learning to meet the challenge of a changing environment.

Attracting, motivating, developing and retaining skilled staff is a top priority for OSFI, particularly the ability to attract and retain staff whose skills are in demand in the financial sector. If OSFI does not have the right resources on the right task, it could constrain OSFI's ability to perform accurate risk assessments and perform effective interventions if required. This risk is exacerbated by the increased risk of changes to the economy.

Pensions Systems and Processes

The changing external environment for pensions, which includes increasing complexity of the work and a litigious environment, demands greater skill on the part of OSFI staff. At the same time, OSFI's internal pensions information system is being upgraded and certain elements such as the adequacy of controls may need to be reviewed. OSFI has started to

address both the staff and systems issues, but work in these areas is not complete. The long time lines for approvals have also been shortened, but further work needs to be done to ensure that delays do not result in reputational risk to OSFI.

Priorities for the 2007–2010 Planning Period

Responding to External Risks

OSFI has identified several priorities and projects to respond to the external risks the organization faces in the current planning period.

Readiness Planning – Responding to Shocks to the Economy and Cyclicity in the Industry

To ensure that OSFI is able to respond adequately to shocks to the economy as a result of a crisis or pandemic, it is carrying out table-top exercises on its crisis planning and Business Resumption Plan. OSFI is also planning its own response to a pandemic, as well as reviewing financial institutions' preparedness for a pandemic.

As a result of an increasing risk of potential changes in the economic environment, OSFI must have the resources in place to identify and deal with problem institutions. OSFI will carry out table-top exercises and will emphasize financial institutions' stress-testing capabilities. This is essential to meeting OSFI's key ongoing responsibility of accurate risk assessment and timely, effective intervention.

Basel II Capital Accord

For the first year of the 2007-2010 planning period, OSFI will focus on being able to review and process, with a reasonably high degree of confidence, applications that are submitted for approval under the Basel II Capital Accord. This includes Basel II implementation support, and Basel II and Business Intelligence Monitoring.

Financial Sector Assessment Program (FSAP) / Financial Action Task Force (FATF)

Early in the 2007-2010 planning period, Canada will be the subject of both an FSAP and an FATF review. OSFI will work with the Bank of Canada and Canadian banks to complete appropriate stress tests, and provide the IMF with information to enable it to assess our compliance against four recently revised banking standards. The objective is to receive a successful assessment from the IMF on the financial sector assessment, and be in a position to deal with any feedback that results from the reviews. For the FATF review, OSFI will provide input to a Mutual Evaluation Questionnaire being coordinated by the Department of Finance.

Accounting

Starting in the 2008-2009 year, OSFI will focus on the move to IFRS and, in particular, determine the implications for Canadian financial institutions and supervisors. As a first step, a process for handling changes to accounting standards in OSFI data collection and reporting systems will be developed. This project includes determining the impact of fair value accounting on financial institutions.

Minimum Continuing Capital Surplus Requirement (MCCSR)

Work on MCCSR has begun, and later in the 2007-2010 planning period OSFI will focus more extensively on changes to the MCCSR. This is a five-year project to develop and agree on a capital framework for life insurance companies. One component of the project will be to develop implementation criteria for risk-sensitive methodologies and internal models. Interest rate risk will be addressed first, followed by credit risk, and then other risks.

Responding to Internal Risks

OSFI has identified several priorities to respond to the external, people and systems risks the organization faces in the current planning period.

People Risks – Integration of Human Resources (HR) Planning into Business Planning

Through better long-range, integrated planning, OSFI will enhance its ability to: proactively identify changing human resources requirements; ensure their timely availability; and allocate available resources to identified risks and priorities. This will include continuing enhancements to our business planning process; preparing and implementing a framework for HR development and management in Supervision; continuing the 360-degree feedback of executive leadership; and conducting employee and compensation surveys. These responses to identified HR risks will ensure OSFI has the resources available to fulfill its mandate.

Pensions Systems and Processes

Pensions projects include: continuing to accelerate the pensions approval process; training new employees; upgrading the internal information technology system; and contributing to policy analysis of the *Pension Benefits Standards Act, 1985*. In the human resources area, OSFI will focus on fully integrating additional staff hired over the previous year into the Private Pension Plan Division. OSFI will also focus on monitoring, and determining the implications of, court decisions affecting private pension plans. These activities will enhance OSFI's ability to perform as required in an increasingly complex environment.