2003–2004

ANNUAL REPORT
OSFI 2003-2004

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

Canada

Mandate

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

Under our legislation, our mandate is to:

- Supervise institutions and 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 has due regard to the need to allow institutions to compete effectively and take reasonable risks. Our legislation also 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, which is part of OSFI, provides actuarial services to the Government of Canada.

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Letter of Conveyance

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

Dear Minister:

Pursuant to section 40 of the *Office of the Superintendent of Financial Institutions Act*, I am pleased to submit to you the Annual Report of the Office of the Superintendent of Financial Institutions (OSFI) for the period April 1, 2003, to March 31, 2004.

For the first time this year, in order to streamline OSFI reporting, this report also includes the report on the Administration of the *Pension Benefits Standards Act, 1985* (PBSA), for the period April 1, 2003, to March 31, 2004, pursuant to section 40 of the PBSA.

Yours sincerely,

Nicholas Le Pan
Superintendent

Ottawa, October 1, 2004

Superintendent's Message

Canada is fortunate to possess one of the strongest, most dynamic and successful financial systems in the world. It contributes to the strength and innovation of Canada's economy and protects the savings of Canadians.

Canadian confidence in the safety of money entrusted to financial institutions is high and deservedly so. A world-class prudential regulator and supervisory system is an important ingredient of that success and confidence. Canada's record stands out in today's world and I am proud to say that other countries are now looking to emulate our regulatory framework.

Effective mechanisms for evaluating and managing risk, programs to promote sound business and financial practices and the capacity and willingness to intervene early on to avoid or minimize problems are key ingredients of OSFI's success. These are areas where we exercise leadership in accordance with our mandate and these are among the long-term benefits we provide to Canadians.

We expected that, in 2003-2004, financial institutions and pension plans might continue to face challenges depending on the financial and economic environment in Canada and abroad. Financial institutions generally saw a return to better credit quality and profitability. Many institutions actively managed their affairs to reduce risk. On the other hand, OSFI continued to identify selected situations where risks assumed by institutions were not matched by the required capability to measure, monitor and manage those risks.

Success is a key ingredient of safety and soundness. Discipline to maintain desired risk tolerance will be important as market conditions rebound. The issue of better management of reputational risk received prominence, in part due to OSFI's actions.

The solvency position of defined benefit plans taken as a whole stabilized during the year. OSFI was very proactive in dealing successfully with individual problem cases to protect plan members. However, we must not be complacent. Persistent sustained action by plan sponsors is required going forward to reduce actual or potential problems.

The Office of the Chief Actuary, which is part of OSFI, had a banner year in terms of the scope of its work and the number of actuarial valuations completed. It continues to provide high quality information to decision-makers responsible for public pension and social programs.

In this year's annual report, we are further enhancing our reporting on our performance. While performance reporting is difficult for regulatory agencies because of the nature of their operations, I want OSFI to be a leader in this as well.

OSFI has made a difference, and will continue to do so.

OSFI's direct costs, which are charged to those we regulate, are not large relative to their capacity to pay. We took actions during

The solvency position of defined benefit plans taken as a whole stabilized during the year. OSFI was very proactive in dealing successfully with individual problem cases to protect plan members.

the year to manage our costs efficiently, and to enhance our internal efficiency and effectiveness. More importantly, we acted to reduce compliance costs for those we regulate in a number of areas, which is equally if not more important to an efficient regulatory system.

In the March 2004 federal budget, the government indicated it wished to explore reducing any overlap and duplication that may exist between CDIC and OSFI, specifically in functions and support services. I personally believe this is an opportunity to enhance the efficiency and effectiveness of the regulatory and supervisory system, to clarify accountability, and to reduce compliance costs to deposit-taking institutions. OSFI has provided a response to the Minister of Finance and will actively participate in any ongoing discussions.

In addition to enhanced performance reporting, this year's annual report includes the annual report on the Administration of the *Pension Benefits Standards Act, 1985* (PBSA).

We are, in my view, one of the top prudential regulators in the world and we will continue to improve to keep it that way.

Nicholas Le Pan
Superintendent

Performance Highlights

In OSFI's last Annual Report, we outlined our priorities for the coming year. In this section we report back on our accomplishments against those priorities. In brief, here is what we said we were going to do in 2003-2004, and here are some highlights that illustrate what we accomplished.

Priority

Effectively identify the risks faced by federally regulated financial institutions and federally regulated private pension plans and intervene as appropriate.

Steps Taken

Financial Institutions

- Tracked a drop in institutions with a risk to financial viability or solvency (stage 2) from 10 to 4 over the year, in part through OSFI's intervention. Total staged institutions increased slightly year over year; however the majority were in the early warning category (stage 1) (92% versus the previous year at 79%). The majority of staged institutions were property and casualty (P&C) insurance companies.

- Stressed the need for financial institutions to have appropriate controls in place to manage the legal and reputational risks of their operations, stepped up monitoring of how larger institutions manage these risks, and intervened when institutional approaches were insufficient.

Pension Plans

- Posted a slight decline in the number of pension plans on OSFI's watchlist during 2003-2004, from a high of 96 to 83 (62 defined benefit and 21 defined contribution plans). Some plans remedied their problems and were removed from the list, in part through OSFI's actions.

- Identified plans that posed higher levels of risk and ensured plan administrators took prompt corrective action. Contacted 16 plans that might warrant an early valuation report to anticipate if increased funding is required.

- Identified plans taking contribution holidays when they might no longer be in a surplus position. Following our enquiries and recommendation, these plans resumed their contributions.

- Conducted reviews of the adequacy of disclosure to members and pushed for better disclosure where necessary to meet responsibilities under legislation.

Priority

Improve OSFI's readiness to deal effectively with problem federally regulated financial institutions and federally regulated private pension plans.

Steps Taken

- Shifted resources and improved processes, e.g. enhanced early warning tests and increased solvency testing, focused especially on property and casualty insurance companies and pension plans.
- Widely promoted the need for responsible pension plan governance, including increased awareness by pension stakeholders of the issues, the risks and how to deal with them.
- Prepared a report on the property and casualty insurance industry, looking at trends in revenues, expenses and profitability, and reviewing the regulatory framework for investment as well as industry practices. The report, which was sent to federal and provincial governments, concluded the regulatory system is sound and urged that any actions to control insurance premiums be matched by actions to reduce claims expenses so as to avoid solvency problems.
- Rolled out OSFI's Business Resumption Plan (BRP) and tested crisis management scenarios. Remained open and dealt successfully with OSFI's responsibilities during the blackout of August 2003.

Priority

Ensure that the framework of OSFI guidance and rules applying to federally regulated financial institutions and federally regulated private pension plans remains relevant and meets international minimums.

Steps Taken

- Modernized the guideline for effective outsourcing by financial institutions, to address the risks of reliance on third party service providers through better management and control.
- Finalized a new guideline for the duties of an appointed actuary, including expectations for an external review process for reports, to narrow the range of actuarial practice and strengthen confidence in the work of the appointed actuary.
- Updated the Minimum Continuing Capital and Surplus Requirements (MCCSR) Guideline for Lapse and Mortality Risk Capital Requirements to more accurately reflect risk and provide a better basis for comparison between Canadian life insurance companies.
- Through a joint effort with provincial regulators, produced a harmonized test of capital adequacy for P&C companies, and replaced the Minimum Asset Test (MAT) with the Minimum Capital Test (MCT), resulting in reduced capital requirements for the majority of P&C companies. Met with companies to review the new MCT test and ensure they set appropriate targets.
- Worked with the Canadian Institute of Actuaries (CIA) to develop a model for disclosure of annual gains and losses by source for life insurance companies.

Air Canada Pension Plans

Throughout 2003-2004, OSFI took a number of actions to protect the rights and interests of the over 55,000 members of Air Canada's pension plans.

Prior to the airline entering protection under the *Companies' Creditors Arrangement Act* (CCAA), OSFI raised a number of pension issues with Air Canada and established a strong claim for the pension plans on outstanding payments. OSFI worked with representatives from the airline, unions, beneficiaries, investors and the court-appointed Monitor to develop a funding relief proposal that would provide appropriate safeguards for pension plan beneficiaries, while balancing Air Canada's need to emerge from CCAA protection. OSFI insisted on adequate funding and a buy-in process in which beneficiaries were adequately informed and represented. These efforts ultimately led to a funding relief proposal that was put forward to plan representatives for their consideration.

- Continued our commitment to the work of the Basel Committee on Banking Supervision (BCBS) and made significant efforts to be ready for the implementation of the new capital adequacy framework (Basel II). The Superintendent served as Vice-Chairman of the BCBS and Chairman of the Accord Implementation Group.
- Collaborated with standard setters and financial institutions so new standards on accounting for fair values of assets and liabilities, insurance enterprises, special purpose entities, and liabilities and equities better reflect the operations of financial institutions.

Priority

Analyze the implementation of policy frameworks and adapt regulatory and supervisory approaches as required.

Steps Taken

- Assigned a low or moderate rating to 83% of those institutions that were provided Composite Risk (CR) ratings as at March 31, 2004 (versus 75% the previous year); assessed less than 0.3% as high risk (versus 1.5% the previous year). To increase transparency, OSFI has shared assessment criteria and CR ratings with 320 institutions to date.
- Participated with the Canadian Association of Pension Supervisory Authorities (CAPSA) in the development of principles for sound governance of pension plans. CAPSA tested a self-assessment questionnaire for plan administrators, and the results will help shape CAPSA guidance on plan governance.
- Continued with a program of assessments to determine the progress federally regulated financial institutions have made in developing anti-money laundering and anti-terrorist financing programs. Assessments completed by

March 2004 covered 63% of industry total assets for deposit-taking institutions and life insurance companies. By June 2004, that rose to 90%.

- Accelerated assessments of banks to determine their readiness to implement the new capital adequacy framework (Basel II). All major banks completed a gap analysis and identified areas where improvements were needed.

Priority

Maintain the resources and infrastructure necessary to support supervisory and regulatory activities.

Steps Taken

- Made further progress in applying best industry practices to OSFI and adopt Enterprise-wide Risk Management (ERM), so OSFI can be more rigorous in prioritizing internal issues requiring strategic action. Began to formally incorporate risk mitigation strategies into the corporate planning.

- Met milestones for the Business Systems Integration Initiative (BSII), which is re-engineering core supervision processes and will allow us to better allocate resources to high-risk situations and implement associated technologies, such as document management and workflow.

- Reviewed data requirements for the life and P&C insurance industry. Along with other data rationalization activities, this resulted in a net reduction of up to 50% in the number of mandatory data points to be filed by most life and P&C companies.

- Integrated behavioural competencies into the performance management process, to better assess how well assigned work is being performed.

- Responded to the latest employee survey by strengthening internal communications, by providing improved inquiry channels, information sessions on key internal initiatives, and increased employee contact with senior management.

Priority

Respond in a focused and selective way to the increasing demands for OSFI's technical assistance, funded by CIDA, and further develop OSFI's program of hands-on training.

Steps Taken

- Expanded the geographic focus of our technical assistance program to include Eastern Europe, at the request of the World Bank, to meet an urgent need for technical assistance in this region, beginning with insurance regulation in the Ukraine.

- Provided hands-on technical advice and consulting services to rectify shortcomings in jurisdictions identified in the International Monetary Fund (IMF) / World Bank Financial Sector Assessment Program (FSAP), to achieve compliance with the Basel Core Principles and the International Association of Insurance Supervisors (IAIS) Core Principles. Work included market risk guidance, the initiation of on-site examination programs and legislative drafting.

Priority

Provide expert and timely advice to the Government of Canada on the Canada Pension Plan (CPP) and other programs reviewed by the Office of the Chief Actuary (OCA).

Steps Taken

- Tabled in Parliament the 20th Actuarial Report on the Canada Pension Plan, confirming the long-term viability and financial sustainability of the CPP.
- Released the third actuarial study, the "Canada Pension Plan Mortality Study", presenting the results of a mortality study of CPP retirement and survivor beneficiaries.
- Completed the second actuarial review of the Canada Student Loans Program.
- Tabled in Parliament a number of other reports, including actuarial reports on the Public Service Pension Plan, the RCMP Pension Plan, the Canadian Forces Pension Plan, the Public Service Death Benefit and the Regular Forces Death Benefit.
- Hosted the third seminar on "Demographic, Economic and Investment Perspectives of Canada, Years 2003-2050", for experts to discuss assumptions to be used in actuarial reports.
- Provided actuarial advice to client government departments on the design, funding and administration of public pension plans, including Social Development, Finance, Treasury Board, Human Resources and Skills Development, Public Works and Government Services, National Defense, Veterans Affairs, the RCMP and Justice Canada.
- Conducted peer reviews as part of an internal quality control process, as well as ensuring that statutory actuarial reports were prepared by the OCA Fellows of the Canadian Institute of Actuaries (CIA) and co-signed by the Chief Actuary.

Priorities Going Forward

The coming year is not expected to bring any material changes in OSFI's strategic focus. The environment will influence the relative importance of specific initiatives or objectives, but the underlying priority will be to remain vigilant to the challenges faced by federally regulated financial institutions and federally regulated private pension plans.

In 2004-2005, OSFI will continue to:

Effectively identify the current and potential future risks faced by federally regulated financial institutions and federally regulated private pension plans, and ensure timely intervention to deal with problems, including:

- Continuing the practice of effective comprehensive consolidated supervision;
- Identifying problem situations in a timely fashion to allow for constructive intervention;
- Reviewing selected supervisory practices in light of globalization and the fact that a number of financial institutions are increasing their operations outside of Canada;
- Putting in place enhancements to our risk-based supervision approach, including more clearly identifying our risk tolerance and linking it to resources used on supervision and approvals;
- Reviewing core supervisory and regulatory processes as they relate to federally regulated private pension plans to ensure the efficient allocation of resources to priority work.

Make targeted adjustments to OSFI guidance and rules applying to federally regulated financial institutions and federally regulated private pension plans, including:

- Assessing the costs and benefits of prospective rule changes, effective implementation, and the selective review of new rules to ensure intended outcomes are being attained;
- Providing guidance on implementation policy and supervisory and reporting expectations in respect of the new bank capital adequacy framework (Basel II);
- Continuing to influence the development of international prudential standards, to take account of Canadian circumstances;
- Developing an appropriate capital adequacy framework for regulated insurance holding companies;
- Developing and proposing strengthened regulations governing pension funding;

- Providing guidance on managing reputational risk, if required based on a review of financial institution practices;
- Furthering the education of all parties in the pension domain for the need for improved governance and accountability surrounding pension plans;
- Providing timely, high quality responses to requests for approvals.

Implement material upgrades in the quality of internal governance and related reporting, including:

- Integrating Enterprise-wide Risk Management (ERM) more effectively into corporate planning processes;
- Enhancing OSFI's internal audit function, further developing OSFI's performance indicators, and improving reporting on activities and outcomes.

Achieve the benefits of OSFI's ongoing initiatives to enhance information management and information technology (IM/IT) infrastructure and processes, including:

- Implementing the IM/IT infrastructure and process improvement initiatives that are under development;
- Implementing the Business Systems Integration Initiative (BSII), to reengineer core supervision processes and better allocate resources to high-risk situations;
- Reviewing, rationalizing and improving the efficiency of data collection from deposit-taking institutions.

Ensure that OSFI maintains the appropriate skills to support its mandate, including:

- Making continual upgrades to human resources, identifying alternative resource strategies, and enhancing the succession planning process.

Provide expert and timely advice to the stewards of the Canada Pension Plan (CPP) and to the Government of Canada and other stakeholders about other programs reviewed by the Office of the Chief Actuary (OCA), including:

- Developing more sophisticated valuation techniques;
- Implementing recommendations from independent actuaries who review the OCA's or public sector actuarial reports;
- Organizing seminars to broaden OCA's sources of advice concerning assumptions made in actuarial reports;
- Collaborating in government initiatives related to the aging of the Canadian population;
- Participating actively in the technical committee of the International Social Security Association (ISSA);
- Promoting awareness and understanding of issues in the OCA's actuarial reports through parliamentary committees;
- Completing the next triennial actuarial report on the CPP by the end of year 2004.

Role and Responsibilities

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

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

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

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

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

OSFI comprises the Supervision, Regulation and Corporate Services sectors, as well as the Office of the Chief Actuary, employing some 450 people in offices located in Ottawa, Montreal, Toronto and Vancouver.

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

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 1,699 organizations managed a total of $2,531 billion of assets (as at March 31, 2004). OSFI also undertakes supervision of provincially incorporated financial institutions on a cost recovery basis under contract arrangements with some provinces.

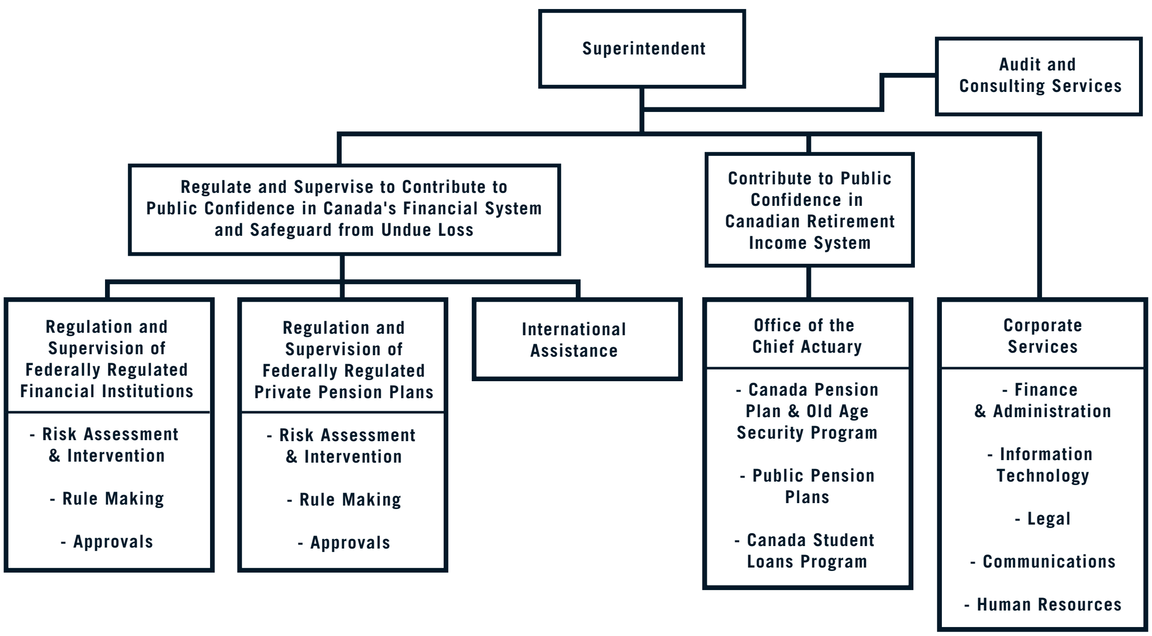
How We Meet Our Mandate

OSFI's mandate is set out on the inside cover of this report. From our mandate, we have identified two strategic objectives:

1. **To regulate and supervise financial institutions so as to contribute to public confidence.**
   For federally regulated financial institutions and pension plans, OSFI does this by enhancing their safety and soundness, therefore protecting policyholders, depositors, creditors and pension plan members from undue loss.

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

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



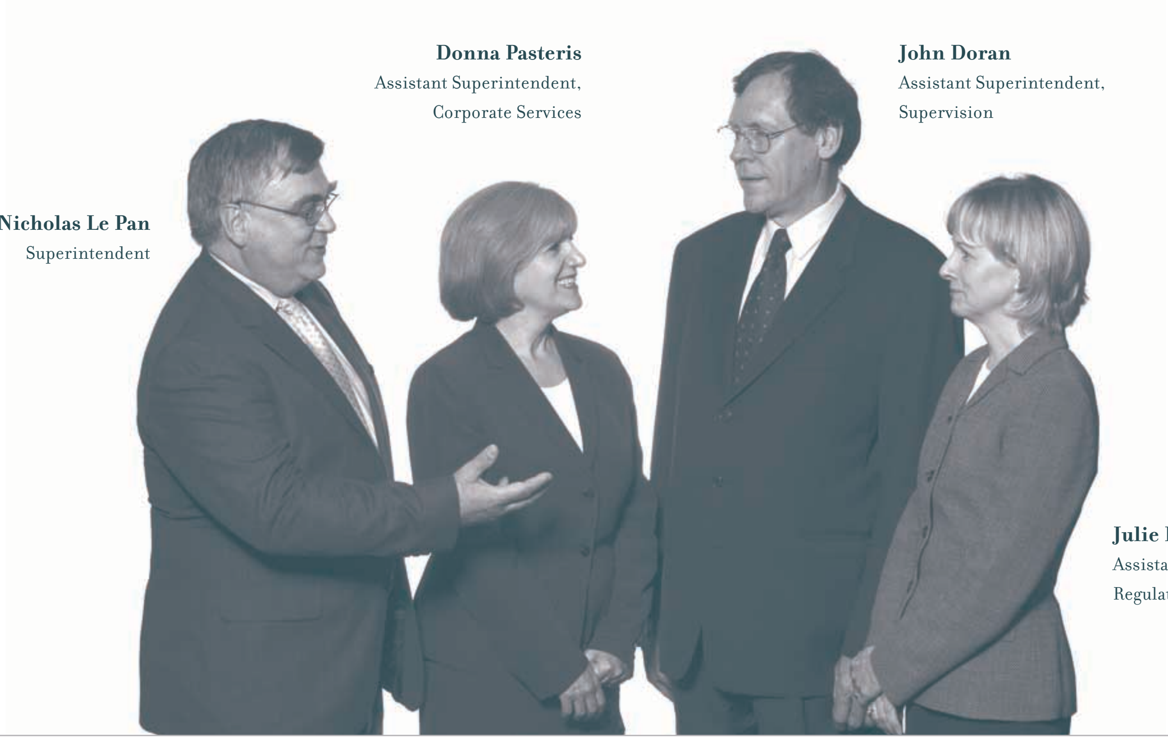
as at March 31, 2004

Organization of the Report

This report is organized according to the five main external outputs that support the achievement of OSFI's mandate.

- *Risk assessment and intervention* includes OSFI's activities to monitor and supervise financial institutions and pension plans; monitor the financial and economic environment to identify emerging issues; and intervene in a timely way to protect depositors, policyholders and pension plan members, while recognizing that all failures cannot be prevented.
- *Rule making* encompasses the issuance of guidance and regulations; our input into federal legislation affecting financial institutions; our contribution to accounting, auditing and actuarial standards; and our involvement in a number of international rule-making activities.
- OSFI's *approvals* function covers approvals required under the legislation applying to financial institutions and pension plans, as well as supervisory approvals.
- The *international assistance* operations of OSFI help other countries that are building their supervisory and regulatory capacity.
- The *Office of the Chief Actuary* provides a range of actuarial services under legislation to the Canada Pension Plan (CPP) and federal government departments.

These external functions are supported by *corporate initiatives* undertaken by the Corporate Services Sector, which contributes to our effectiveness and efficiency.



Nicholas Le Pan
Superintendent

Donna Pasteris
Assistant Superintendent, Corporate Services

John Doran
Assistant Superintendent, Supervision

Julie Dickson
Assistant Superintendent, Regulation

Supported by a generally positive economic environment and a focus on expense management, Canadian financial institutions performed well during 2003-2004.

Risk Assessment and Intervention

OSFI's mandate falls from the *Office of the Superintendent of Financial Institutions Act*.

Federally Regulated Financial Institutions

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

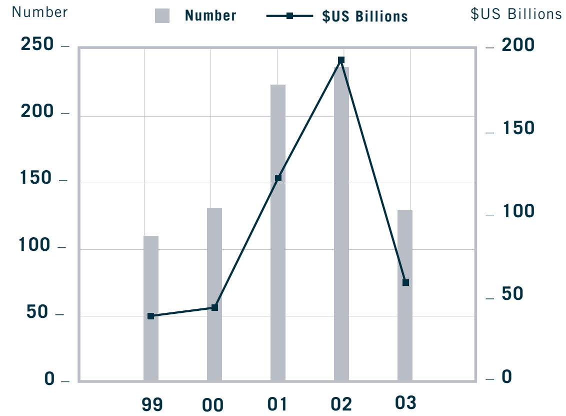
Federally Regulated Private Pension Plans

OSFI's mandate is "*to supervise pension plans in order to determine whether they meet the minimum funding requirements and are complying with the other requirements of the Pension Benefits Standards Act, 1985 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.*"

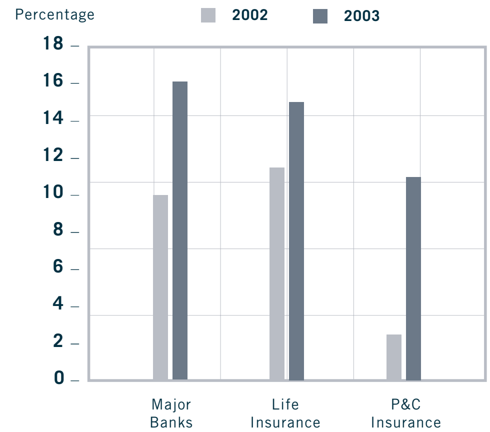
FINANCIAL ENVIRONMENT

Economic, political and industry conditions in Canada and abroad significantly affect the performance, and consequently the safety and soundness, of financial institutions and pension plans.

Global economic conditions improved substantially during the second half of 2003, led by a pickup in the U.S. economy and stronger-than-expected growth in Japan. Canada's economy was weaker than expected, as a sharp inventory reduction, Severe Acute Respiratory Syndrome (SARS), "mad cow disease" (BSE) and a stronger Canadian dollar each had a dampening effect. However, Canadian



Global Corporate Defaults
Source: Standard & Poor's



Return on Equity

financial institutions weathered these events well and reported improved financial results in 2003.

Improved global economic conditions helped institutions with international exposures, although the appreciation in the Canadian dollar somewhat offset these gains. The relative strength of the Canadian household sector was also a source of support. The growth of personal credit has been persistently strong in recent years, stimulated by low interest rates, an improved economic outlook, and continuing growth in personal income.

The strong comeback in equity markets in 2003, triggered by higher corporate profits and greater investor confidence, improved financial institutions' earnings from their capital markets and wealth management businesses.

Diminishing default rates and credit rating downgrades on corporate debt have allowed Canadian banks to reduce their loan-loss provisions and improve their profitability.

Supported by a generally positive economic environment and a focus on expense management, Canadian financial institutions performed well during the period under review. The property and casualty (P&C) insurance industry had encouraging results, achieving a substantial increase in aggregate profit after a number of years of poor performance. However, there is still some uncertainty about the sustainability of those results. Prospects for the auto insurance sector in a number of provincial jurisdictions also remain uncertain due to provincial regulatory initiatives in product design and pricing.

The overall condition of Canadian pension plans improved slightly during 2003-2004. Strong performance in equity markets helped the plans' funding situation; however, lower interest rates resulted in a substantial increase in plan liabilities. The net result, based on solvency testing conducted by OSFI as at December 2003, was an overall average improvement of about 2% in solvency ratios over the previous year. Despite this positive development, many pension plans, due to poor market performance over the last few years, have little in the way of a funding cushion, rendering them vulnerable to potential adverse changes in economic conditions affecting their sponsor or financial markets.

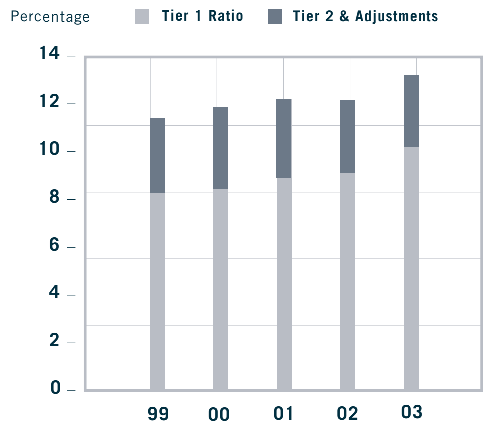
MAJOR CANADIAN BANKS

The profitability of the major domestic banks improved significantly in 2003 compared to the previous year, aided by declining provisions for corporate loan losses and good expense control. Earnings for the first quarter of 2004 showed continued strength.

There has been broad-based improvement in the earnings of the large banks, with most lines of business showing positive results. Capital market and wealth management businesses improved significantly in 2003 as a result of rising equity prices. After two years of sharply increasing loan-loss provisions, new provisions fell substantially in 2003 as exposures to sectors that had experienced significant financial problems, such as telecommunications, cable, and power generation, were substantially reduced.

Asset quality and capital ratios continued to improve. The average ratio of capital to risk-adjusted assets increased to over 13% at the end of 2003. This ratio was considerably higher than the Bank for International Settlements (BIS) 8% minimum threshold or OSFI's 10% target.

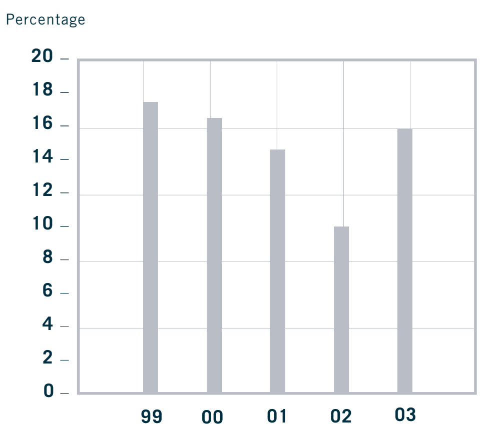
Retail banking has been a relatively stable source of revenue over the past few years. As a result, a number of banks have increased their emphasis on retail and wealth management operations, while selectively reducing their corporate exposures.



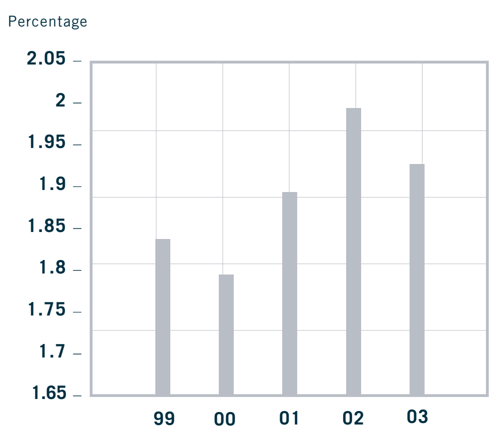
Major Banks: Risk-Weighted Capital Ratios

However, despite the progress made over the past year or so, banks continue to face some challenges. A lack of top line growth in their core businesses remains a concern. As a result of low interest rates, the industry continues to experience declining net interest margins. Also, growth in the retail sector is expected to slow and provisions increase, as consumer credit reaches record high levels.

The strength in the Canadian dollar has been a drag on international earnings and raises the



Major Banks: Return on Equity



Major Banks: Spread
Interest Income Less Interest Expense / Average Total Assets

As the major Canadian banks continued to face heightened legal and reputational risks in their operations, OSFI began stressing the need for them to have appropriate controls in place and stepped up monitoring of how larger institutions manage these risks.

possibility of deteriorating financial conditions in certain domestic industries with a net-export orientation.

U.S. strategies are being reassessed due to integration and competitive challenges while domestic mergers are on hold as the banks await the release of the government's updated merger guidelines.

Overall, OSFI is satisfied with the risk management practices of the major Canadian banks and with their improved performance. However, as the major banks continued to face heightened legal and reputational risks in their operations, OSFI began stressing the need for them to have appropriate controls in place and stepped up monitoring of how larger institutions manage these risks.

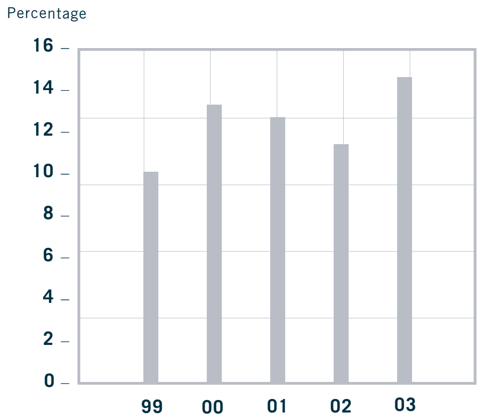
OTHER DEPOSIT-TAKING INSTITUTIONS

As at the end of March 2004, there were 40 smaller Canadian deposit-taking institutions supervised by OSFI, including 8 banks, 25 trust and loan companies (excluding bank-owned trust and loan companies), and 7 credit union centrals. OSFI also supervised 25 foreign bank subsidiaries, 22 branches of foreign banks and 28 foreign banks with representative offices.

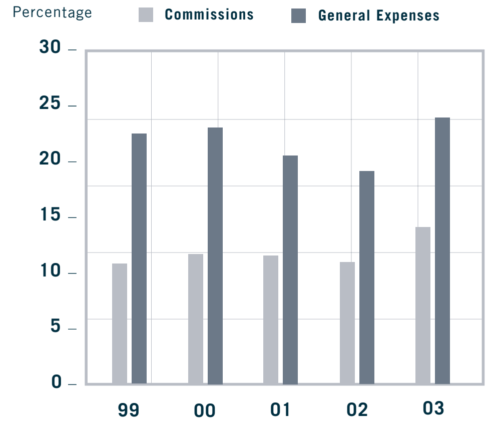
Smaller domestic deposit-taking institutions and foreign banks have adopted a wide range of business strategies. Accordingly, the factors affecting these institutions are varied and the risks more specific to individual institutions.

The performance of the smaller deposit-taking institutions showed some improvement in 2003 compared to the previous year, as fewer reported a loss. Capital positions remained at healthy levels for most institutions. Improvements in the Canadian economy and in retail and commercial banking have been particularly important to the health of a number of these institutions.

With the growth experienced by several institutions in the smaller deposit-taking sector came a need for enhanced risk mitigation activities. OSFI took action under its supervisory framework in several cases in which risk management and control practices were inadequate relative to the risks being assumed.



Life Insurance Companies: Return on Equity



Life Insurance Companies: Expenses as a % of Premiums*

*2002 results exclude reinsurers

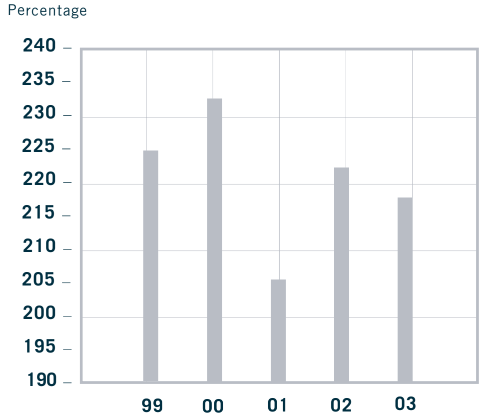
LIFE INSURANCE COMPANIES

Canadian life insurance companies continued to demonstrate earnings resiliency in 2003 despite the low interest rate environment and rising Canadian dollar. The conglomerate insurers improved their year-over-year earnings significantly while the smaller companies and branches, as a whole, recorded an even larger increase.

Factors contributing to this positive performance include improved equity markets, good expense management, stable earnings from protection business and favourable claims experience. The life companies are currently well capitalized and have good asset quality.

Aided by an improving global economy, net income from conglomerates operations in Canada increased by about one third and net income from Asia (excluding Japan) almost doubled. However, revenues were down in the U.S. and U.K. regions, due to a number of factors. The proportion of the sector's income originating from foreign operations declined slightly in 2003, to just under half.

Canadian life insurance companies continued to demonstrate earnings resiliency in 2003-2004, due in part to improved equity markets, good expense management, stable earnings from protection business, and favourable claims experience.



Life Insurance Companies: MCCSR Ratios

OSFI establishes Minimum Continuing Capital and Surplus Requirements (MCCSR) for life insurance companies based on their business and investment risks. The ratio of a company's actual capital relative to the minimum requirement (the MCCSR ratio) is an indicator of how well that company is capitalized. MCCSR ratios for Canadian life insurance companies declined slightly in 2003 from the previous year's very strong levels. However, they continue to be well above their regulatory target capital level of 150%.

Consolidation in the industry continued into early 2004 with the completion of a significant U.S. acquisition by one of Canada's major life insurers. This and other recent acquisitions by the major players over the past few years should sustain the strong earnings trend into the future.

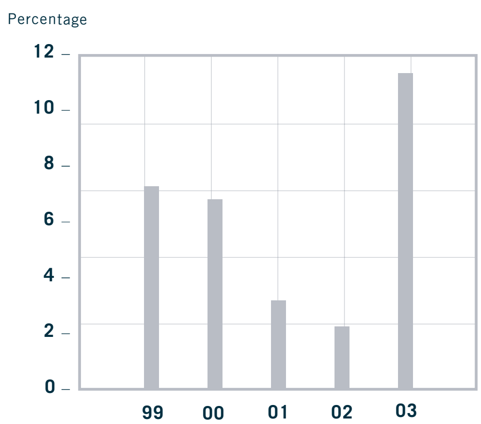
Challenges for the conglomerates include the need to integrate their newly merged operations, and dealing with moderate top line revenue growth.

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

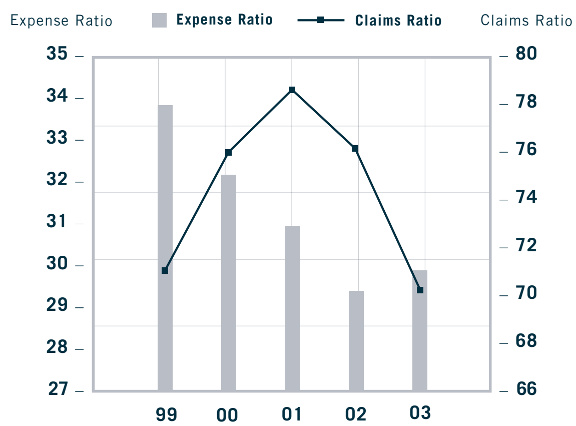
As with the major banks, OSFI is actively reviewing the policies and practices used by the larger life insurers for managing reputational risk.

PROPERTY AND CASUALTY (P&C) INSURANCE SECTOR

After five years of deteriorating results, the Canadian P&C industry turned the corner in 2003. This was despite a challenging year during which some provincial governments introduced product



P&C Insurance: Return on Equity



P&C Insurance: Expense and Claims Ratios (%)

In 2003, the Canadian property and casualty industry's return on equity improved significantly, to 11.4%. OSFI continued to devote considerable supervisory resources to the industry, as some companies struggled to achieve profitability in certain sub-markets.

changes and premium rollbacks or rate freezes on automobile business, forest fires ravaged British Columbia, and Hurricane Juan caused extensive damage to communities in Atlantic Canada. In addition, the residual automobile insurance market reported a loss of approximately $550 million, which is paid for by companies.

In 2003, the industry's return on equity improved significantly, to 11.4%, primarily due to substantially better underwriting results. The industry-wide combined ratio (ratio of claims and expenses to earned premium) dropped below 100% for the first time in two decades due in part to substantial increases in insurance premiums. Better investment returns also contributed to the improved performance. Although discounting of claims liabilities was introduced in 2003, the impact on profitability was minimal.

Performance improvement was not uniform, however. Companies that underwrote mainly commercial property or specialty lines business, or were well diversified geographically, outperformed those that wrote mainly automobile business, especially Ontario automobile business.

The industry's capital base also grew in 2003, due mainly to the improvement in earnings, reversing the downward trend that began six years ago. In 2003, the Minimum Asset Test (MAT) was replaced by the Minimum Capital Test (MCT), a risk-based capital adequacy framework that better reflects the riskiness of individual P&C insurers and is more consistent with the approaches used in the life insurance and deposit-taking sectors.

During the year, OSFI met with a number of companies to review the new Minimum Capital Test and to ensure that they set appropriate targets for their institutions. The industry's MCT ratio for 2003 was well above OSFI's supervisory target of 150%, and better than the ratio for the previous year.

OSFI continued to devote considerable supervisory resources to the P&C industry, as companies are still struggling to achieve profitability in certain sub-markets. Sustainable profitability at reasonable rates of return is important to the health of the industry. OSFI prepared a report on the P&C industry for the Secretary of State (International Financial Institutions), looking at trends in revenues, expenses and profitability, and reviewing the regulatory framework for investment as well as industry practices. The report, which was sent to federal and provincial governments, concluded the regulatory system is sound and urged that any actions to control insurance premiums be matched by actions to reduce claims expenses so as to avoid solvency problems.

PENSION PLANS

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

Also falling under federal jurisdiction is any work, undertaking or business declared by the Parliament of Canada to be for the general

	Y-E 2003-04	Y-E 2002-03	Y-E 2001-02
Total Plans	1256	1205	1195
Defined Benefit	336	346	352
Combination	84	70	70
Defined Contribution	836	789	773
Total Membership	547,000	579,000	557,000
Defined Benefit	367,000	397,000	389,000
Combination	96,000	88,000	88,000
Defined Contribution	84,000	94,000	80,000
Total Assets	$91 Billion	$85 Billion	$91 Billion
Defined Benefit	$78 Billion	$70 Billion	$75 Billion
Combination	$11 Billion	$13 Billion	$14 Billion
Defined Contribution	$2 Billion	$2 Billion	$2 Billion

Pension Plans by Type (last 3 years)

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

Close to 25% of the plans that offer defined benefits reported increases in pensions being paid out, i.e. retirees' pensions, a slight reduction from the 30% of the past few years. Of these plans, 31% also increased deferred pensions.

Increases were based on full Consumer Price Index (CPI) in 36% of cases, 34% on partial CPI and 30% using other formulae, such as excess interest, a flat dollar amount, or a percentage of pension payment. In 77% of cases (78% in 2002-2003), 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 2003-2004, 38% of the plans that made adjustments to pensions did so using surplus funds or gains. The remainder used sources outside the pension fund, created unfunded liabilities, or used some combination of options to improve pensions.

In 61% of cases, plans used surplus/gains to improve benefits, while in 59% of the cases the employer reduced contributions through using surplus/gains. This is a change from 2002-2003, when 52% used surplus/gains to improve benefits and 80% reduced contributions. The remaining defined benefit plans either did not have surplus/gains or chose to let their surplus/gains accumulate.

> Given the impact of potential future adverse changes in economic conditions or financial markets, OSFI continues to actively monitor and intervene where warranted in order to protect pension plan members' benefits.

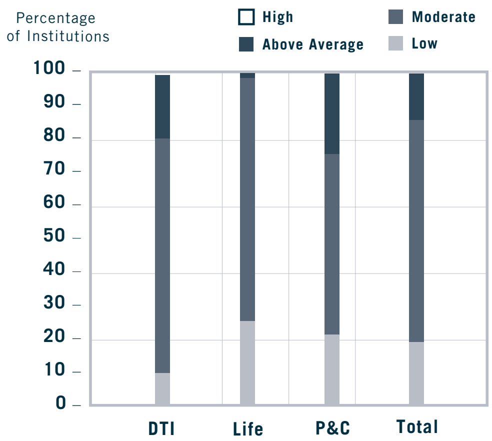
advantage of Canada or for the advantage of two or more provinces. Uranium mining is an example of an undertaking that falls into this category. All other private pension plans are governed by the pension legislation of the provinces in which their members are employed (with the exception of Prince Edward Island, which does not have private pension plan legislation).

As at March 31, 2004, there were 1,256 pension plans registered under the *Pension Benefits Standards Act, 1985,* covering nearly 547,000 employees. In 2003-2004, plan assets increased by 7%, to a value of approximately $91 billion. Of the plans that OSFI regulates, defined benefit plans have the great majority of members and assets. Over the past five years, there has been a small but steady increase in the proportion of defined contribution plans relative to the total number of plans.

The most recent pension plan financial statements filed during the 12-month period ending March 31, 2004, report that 56% of pension funds are invested in equities, 39% 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 2002-2003.

Overall, the strong performance of equity markets in 2003 has improved the outlook for pension plans. However, the continuing decline in interest rates has in large measure offset these improvements. The average estimated solvency ratio (the ratio of the value of assets to liabilities assuming plan termination) for all plans improved by about 2% since mid 2003.

Estimated solvency ratios calculated by OSFI as at December 31, 2003, showed that approximately 53% of all defined benefit plans supervised by OSFI were under funded (solvency ratio less than one), meaning their estimated solvency liabilities exceeded assets, compared to 47% as at December 31, 2002. Over half of these were under funded by more than 10%. Given the impact of potential future adverse changes in economic conditions or financial markets, OSFI continues to actively monitor and intervene where warranted in order to protect pension plan members' benefits.



Composite Risk Rating by Sector

SUPERVISORY POLICIES

FINANCIAL INSTITUTIONS

OSFI's risk-based supervisory framework enhances its ability to identify and intervene on a timely basis when a financial institution's practices are imprudent or unsafe. The methodology outlined in the framework involves assessing an institution's inherent business risks, risk management processes, and financial condition. In arriving at these assessments, OSFI relies on, where appropriate, the work of an institution's oversight functions to ensure suitable risk management practices and processes are in place and being followed at the operational level. This allows OSFI to focus its resources on reviewing areas of an institution that are likely to have a material impact on its safety and soundness.

OSFI's methodology is applied by teams responsible for the supervision of one or more institutions. Supervisory work consists of periodic on-site reviews and/or monitoring of the financial condition and affairs of institutions. In line with OSFI's early intervention mandate, problem companies are subjected to a higher level of review.

Composite Risk (CR) Ratings

In 2002, OSFI published the assessment criteria that guide the development of supervisory ratings under the framework. The assessment criteria were developed in consultation with the industry. The Composite Risk (CR) rating represents OSFI's overall assessment of an institution's safety and soundness. There are four ratings for Composite Risk: "low", "moderate", "above average" and "high". Confidentiality of these ratings is protected by regulations.

Sharing the assessment criteria and CR ratings with institutions will increase the transparency of OSFI's assessments and help institutions better understand the basis of the assessment and the significance of the assigned ratings. OSFI started

To enhance transparency and improve understanding, OSFI shared its assessment criteria and composite risk ratings with 320 financial institutions.

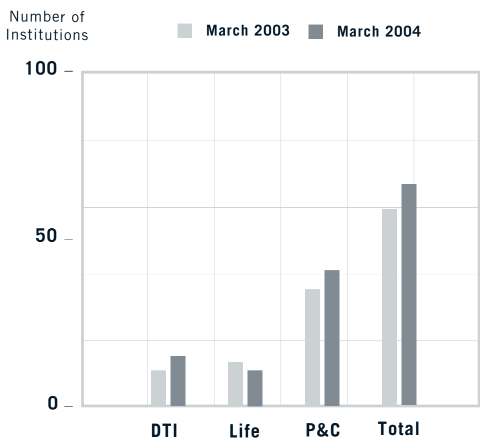
sharing CR ratings with institutions in 2002-2003. To date, CR ratings have been provided to 320 institutions and these are updated as conditions warrant.

At the end of March 2004, 83% of all institutions provided ratings were assigned a low or moderate risk rating, and 0.3% were assessed as high risk. This is an improvement over the previous year, when approximately 75% of all institutions were assigned a low or moderate risk rating and 1.5% were assessed as high risk.

Intervention Ratings

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

The number of staged institutions increased in 2003-2004, mainly as a result of a continued increase in the number of problem P&C companies.



Number of Staged Institutions

However, the number of P&C companies rated as stage 2 decreased, as some of these companies demonstrated a return to profitability and were able to maintain target capital levels. The vast majority of staged institutions were in the early warning (stage 1) category.

Due to the issuance of the U.S. liquidation order against Home Insurance, OSFI wound up the Canadian branch of the U.S.-based P&C company in order to protect policyholders and creditors in Canada. In 1997, OSFI had restricted the Canadian branch's activities and frozen the vested assets held in Canada to cover Canadian liabilities because of the financial difficulties the U.S.-based company was experiencing at the time.

In line with OSFI's early intervention mandate, problem companies were subjected to a higher level of review.

PENSION PLANS

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

To address the challenges facing plans from potential adverse changes in economic conditions or financial markets, OSFI stepped up its efforts to more proactively identify plans that pose higher levels of risk and ensure plan administrators take prompt corrective action where needed.

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

Early Warning Tests

OSFI has developed a series of early warning tests based upon information submitted as part of required filings. An initial series of these tests is

Solvency testing of pension plans is critical to OSFI's intervention strategy because it is effective in the early identification of potential problems and risks.

run in an automated fashion, highlighting plans that OSFI considers to be riskier. Plans highlighted as a result of these tests are then subjected to a more detailed analysis by pension plan supervisors to assess whether further action should be taken.

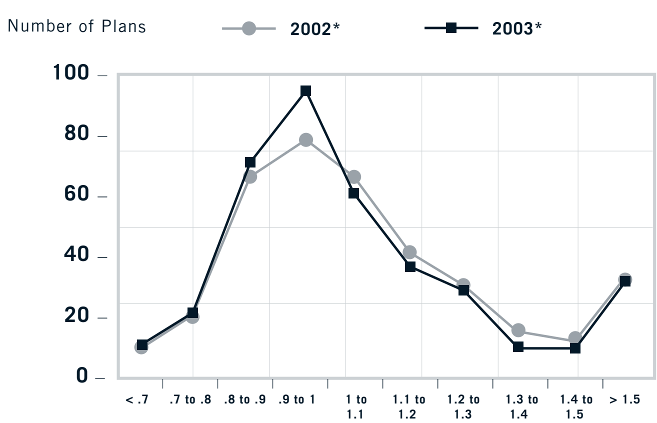
Solvency Testing

Early detection of solvency and funding problems is a key element in safeguarding plan members' benefits. In 2002, OSFI developed a model to estimate the solvency of a plan between its reporting periods. Solvency testing is critical to OSFI's intervention strategy because it is effective in the early identification of potential problems and risks.

On a semi-annual basis, starting in December 2002, OSFI began estimating solvency ratios (the ratio of the value of assets to liabilities) for all defined benefit pension plans and identified the plans most at risk on a solvency basis. Depending on the results, plan administrators were contacted and asked to provide more accurate estimates and/or information on their pension plans. If the estimated solvency ratio was close to or less than 1, or if the plan's risk profile fell in the high range, various interventions were selected, including early filing of valuation reports. This triggers a request for the plan to accelerate funding.

On-Site Examination

OSFI's risk-based approach to supervision includes making on-site examinations of selected pension plans. As with other pension supervisors, on-site examination is used less often than in the case of the supervision of financial institutions. Plans are selected for on-site examination based on a number of factors, including plan size and the assessed risk to beneficiaries. On-site examinations enable OSFI to enhance assessment of the financial situation and quality of the administration of plans. They also provide OSFI with the opportunity to meet the



Defined Benefit Plans, Solvency Testing Results

*as at December 31

individuals involved in plan administration, thereby improving communication between administrators and the Office. In 2003-2004, OSFI performed 13 on-site examinations, with continued focus on governance, along with emphasis on disclosure to members and review of investments.

Watch List

In deciding whether and how to intervene, OSFI takes into account the size of any deficit and the sponsor's capacity to fund it. Pension plans that give rise to serious concern, due to their financial condition or other reasons, are placed on a watch list, and OSFI management actively monitors these plans. The number of pension plans on the watch list declined slightly during 2003-2004 from a high of 96 to 83. Of these, 62 were defined benefit plans and 21 were defined contribution plans.

In addition, some under-funded pension plans continued to take contribution holidays (the plan sponsor stops contributing to the pension plan) in 2003-2004, which, in OSFI's view, was not prudent in some circumstances. OSFI took action, ranging from recommending plan sponsors cease contribution holidays to requiring enhanced notification to OSFI and members.

John Doran
Assistant Superintendent,
Supervision

Rule making initiatives during 2003-2004 focused on ensuring that OSFI's rules promote prudent practices, while allowing financial institutions to compete effectively in today's financial environments.

Rule Making

OSFI's mandate is "*to promote the adoption by management and boards of directors of financial institutions of policies and procedures designed to control and manage risk.*"

Office of the Superintendent of Financial Institutions Act

Rule making, which includes contributing to legislative changes, drafting regulations and guidelines, and working with various standard-setting agencies (domestic and international), plays a key role in OSFI's ability to achieve its mandate.

DOMESTIC RULE MAKING

Collaboration with Standard Setters

OSFI continued to promote the strengthening of governance practices at financial institutions through active participation in a variety of initiatives undertaken in collaboration with other regulators and standard setters.

OSFI was active as a member of the Council of Governors of the Canadian Public Accountability Board (CPAB), whose mission is to contribute to public confidence in the integrity of financial reporting of Canadian public companies by promoting high-quality and independent auditing. In 2004, the Board began its work to review the practices of registered audit firms.

OSFI is a member of the Accounting Standards Oversight Council (AcSOC), which oversees the activities of the Accounting Standards Board. AcSOC's contributions during 2003-2004 included working on issues that have arisen as new, more complex standards were introduced, as well as providing input to the development of the Board's five-year strategic plan. During the year, OSFI became a member of the recently created Auditing and Assurance Standards Oversight Council (AASOC). This group supports the Auditing and Assurance Standards Board in setting auditing and assurance standards in Canada and contributing to the development of internationally accepted assurance standards.

Capital Adequacy

Given the importance of adequate capital to the safety and soundness of financial institutions, OSFI continued to devote significant effort to developing or enhancing the various regimes for capital adequacy.

As noted in further detail under the International Rule Making section that starts on page 35, OSFI continued to be closely involved in the development and implementation of "Basel II", a modernized capital adequacy framework for internationally active banks. During the year, OSFI undertook consultations with the industry, including quantitative impact studies, to determine the potential effect of the new framework, and made material contributions to the development of the rules. The consultative process will continue, including the issuance of policy papers related to OSFI's implementation of Basel II in Canada.

The Minimum Capital Test (MCT), which established a harmonized risk-based capital adequacy test for Canadian P&C companies across Canada, was introduced in 2003. The Branch Adequacy of Assets Test (BAAT), a similar risk-based test for branches of foreign companies operating in Canada, was also introduced. The majority of federally regulated P&C insurers have experienced a reduction in their capital requirements as a result of the risk sensitivity of the tests.

While requirements for some insurers have risen, the MCT and BAAT have reduced capital requirements for the federal P&C industry by 14% overall, or approximately $1.3 billion. During the year, OSFI provided additional information to the industry regarding its expectations with respect to internal capital target levels that federally regulated P&C insurers are required to set. To date, insurers have made good progress in establishing their target levels.

OSFI continued to enhance the Minimum Continuing Capital and Surplus Requirements (MCCSR) guideline. The key changes dealt with the use of participating factors and modifications to the treatment of negative reserves and lapse risk. MCCSR recognizes the risk pass-through nature of participating policies by applying lower factors to the risk components associated with participating policies.

In response to a proposal made by the Canadian Institute of Actuaries, the treatment of negative reserves and lapse risk were revised to remove limits on the amount of negative reserves that may be included in Tier 2C capital and expand the lapse risk component. The change is being phased in over three years and is expected to have a neutral impact on industry-wide capital.

OSFI issued three Capital Advisories to clarify Tier 1 capital issues and address revisions to accounting, and will continue its work in this area.

Other Guidance

To strengthen industry and public confidence in the work of the appointed actuary, OSFI finalized guidance (E-15) to clarify the duties of appointed actuaries in September 2003. The guideline also paves the way for an external review process for reports produced by the appointed actuaries of federally regulated financial institutions. In February 2004, OSFI issued guidance (E-14) that sets out the independent actuary's responsibilities in preparing certain reports as required by the *Insurance Companies Act* or by OSFI. At OSFI's instigation, industry standard setters commenced a review of the reliance by auditors on actuarial valuation.

OSFI was involved at both the domestic and international levels in the development of standards relating to the accounting for fair values of assets and liabilities, insurance enterprises, special purpose entities and liabilities and equities, so that these standards better reflect the operations of financial institutions.

Increasingly, financial institutions are using risk transfer mechanisms, like securitization, to reduce their risk exposure and manage capital.

Improper recognition of which risks have been laid off can create significant problems for institutions. To clarify expectations, OSFI released a draft Asset Securitization guideline (B-5) for comment. In particular, the guideline introduces a more flexible approach in the capital treatment of securitization transactions and adopts aspects of rules already in place in other countries that are consistent with the Basel II capital adequacy framework.

Financial crime, such as money laundering or terrorist financing, can pose a significant risk to the reputation and integrity of financial institutions. In April 2003, OSFI re-issued its guideline (B-8) on Deterring and Detecting Money Laundering to reflect the establishment of the Financial Transactions and Reports Analysis Centre of Canada (FINTRAC), and more clearly enunciate OSFI's expectations for the establishment and implementation of anti-money laundering policies and procedures by financial institutions. Part of this update was based on OSFI's experience in conducting reviews of institutions' anti-money laundering and anti-terrorist financing practices.

In concert with the issuance of the guideline, OSFI continued with a program of assessments to determine the progress federally regulated financial institutions have made in developing anti-money laundering and anti-terrorist financing programs. Institutions are devoting considerable resources to the implementation of compliance regimes and OSFI has identified a number of areas where financial institutions could take steps to improve their ability to deter and detect money laundering and terrorist financing activity. Assessments completed by March 2004 covered 63% of industry total assets for deposit-taking institutions and life insurance companies. By June 2004, that rose to 90%.

The increasing reliance by financial institutions on third party service providers led OSFI to update and strengthen the guideline (B-10) on Outsourcing of Business Activities, Functions and Processes. The revised guideline sets out a more robust definition of "material" outsourcing arrangements, but also provides more flexibility to institutions to manage arrangements with related parties in a more streamlined manner.

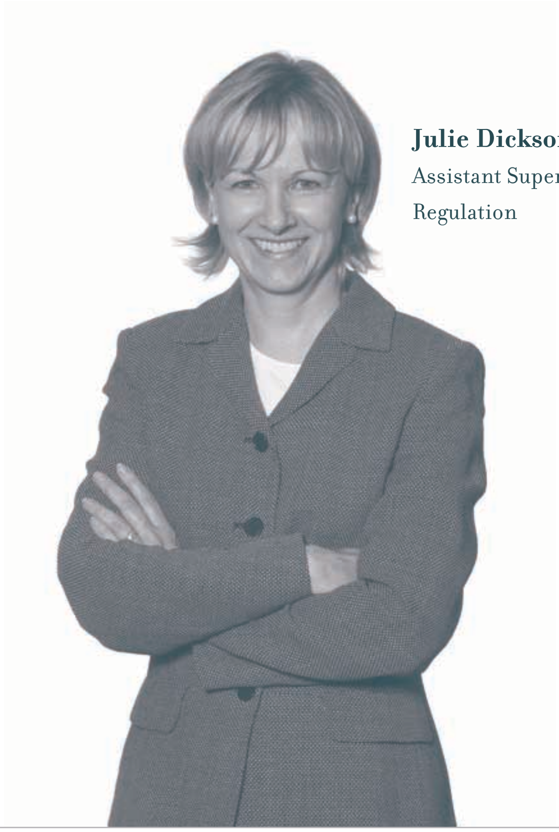
The importance of auditor independence is underscored by clarifying that *all* financial institutions should ensure their external auditor is in compliance with Canadian Institute of Chartered Accountants auditor independence principles relating to internal audit and actuarial work. Finally, consistent with OSFI's increased focus on sound Business Continuity Planning (BCP) since the events of September 11, 2001, the guideline sets out higher expectations in terms of centralized control over outsourcing and BCP.

Given the importance of adequate capital to the safety and soundness of financial institutions, OSFI devoted significant effort to developing or enhancing regimes for capital adequacy.

PENSION PLANS

As a member of the Canadian Association of Pension Supervisory Authorities (CAPSA), OSFI has been active in the development of principles for sound governance of pension plans. CAPSA was established in 1974 as a federal-provincial forum to discuss common issues faced by federal and provincial pension plan supervisory authorities. In 2003-2004, CAPSA tested a self-assessment questionnaire for plan administrators to support improved governance of pension plans. The results will help shape CAPSA guidance on plan governance.

OSFI continued to stress the benefits of good governance by participating in educational programs, delivering speeches and co-operating with associations to promote good governance. These groups included the Association of Canadian Pension Management, the Canadian Pension & Benefits Institute, and several employee benefit foundations and educational institutions.



Julie Dickson
Assistant Superintendent, Regulation

OSFI is developing a number of regulatory changes to strengthen the current pension plan funding rules. Under review are potential changes related to minimum funding, including a provision for full funding on plan termination, application of actuarial gains and other minor amendments. During the year, OSFI reviewed and analyzed the comments received during consultation with the pension industry on these matters. In light of the significant changes in the pension environment, additional consultation will be required. As well, discussion of other funding proposals continues with provincial regulators in an effort to harmonize pension plan funding across Canada. In addition, work is underway to draft and implement regulations authorizing the Superintendent to place restrictions on any benefit improvements that would cause the solvency ratio of a plan to fall below a prescribed level.

Air Canada Pension Plans

Prior to and following Air Canada's filing under the *Companies' Creditors Arrangement Act* (CCAA), OSFI took action to protect the rights and interests of the over 55,000 members of Air Canada's pension plans.

OSFI's actions prior to the company filing under CCAA created protection for plan members should the restructuring not succeed. At that time, the aggregated solvency deficiency in the plans was estimated at $1.3 billion, which overall amounted to approximately 13% of liabilities. The company's ability to fund this deficiency was undercut by adverse developments in the airline industry and Air Canada's business. As part of its restructuring, Air Canada sought a change in federal pension regulations to allow it to fund its solvency deficiencies over 10 years rather than the maximum five years permitted by the regulations. This change would potentially apply to other companies in similar restructuring circumstances who sponsor federally registered defined benefit pension plans.

Throughout the CCAA process, OSFI pushed hard for adequate representation of all beneficiaries, including retirees. While authority to change the regulations rests with the federal government, OSFI set out principles to guide the development of a proposal for funding relief that would provide appropriate safeguards for plan beneficiaries. OSFI insisted on a reasonable minimum funding level and, among other things, that there be a buy-in process during which beneficiaries were adequately informed and represented. These efforts ultimately led to a proposal that was put forward to plan representatives for their consideration.

INTERNATIONAL RULE MAKING

Given the highly globalized and competitive nature of the financial services sector, OSFI participates in a number of international initiatives of importance to Canadian financial institutions.

Basel Committee on Banking Supervision

The Basel Committee on Banking Supervision (BCBS) is the prime body bringing together supervisors and regulators of international banks from G-10 countries. It has taken a leadership role over a number of years in rule setting. The BCBS has recently made significant progress towards concluding a modernized capital adequacy framework that will better relate capital requirements for international banks to the risks they assume.

OSFI believes new risk-based capital rules for banks are desirable and participates in the work of the BCBS through its vice-chairmanship and committee membership. The Superintendent chairs the Accord Implementation Group, an ad hoc committee created by the BCBS to share information on approaches to implementation and promote consistency. OSFI also participates in the work of technical subcommittees responsible for different parts of the new Basel framework.

During the development of the new capital adequacy framework (Basel II), OSFI sought the input of Canadian banks and shared with BCBS members Canada's expertise in retail lending and asset securitization. Supported by quantitative impact information provided by major banks, Canada made a significant contribution during the year in the development of a BCBS consensus on an appropriate capital treatment of credit card loans and securitization of these loans.

During the year OSFI reviewed Canadian banks' self-assessments against the most technically sophisticated proposals for credit risk in Basel II. This allowed banks to more clearly identify implementation issues and plan for their redress. All major banks completed a gap analysis and identified areas where improvements were needed.

International Association of Insurance Supervisors

OSFI also plays an important role in the work of the International Association of Insurance Supervisors (IAIS), which has been increasingly active in its role as a standard-setter for life and property and casualty insurance supervision. OSFI contributed to the revision of the insurance core principles (approved in October 2003), which provide a globally accepted framework for the regulation and supervision of the insurance sector. OSFI participates as a member of the Executive of the IAIS as well as technical committees and sub-committees.

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

As part of an ongoing effort to make the approval process more transparent and more efficient, OSFI centralized its approval activities, and reviewed and clarified its instruction guides for applications.

Approvals

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

Office of the Superintendent of Financial Institutions Act

FINANCIAL INSTITUTIONS

Federally regulated financial institutions and other applicants are required to seek regulatory consent for certain types of transactions, including incorporations, orders authorizing the carrying on of business activities in Canada, corporate restructurings and ownership changes. To build on past legislative initiatives, which reduced the requirements for Ministerial as well as for Superintendent approvals, other changes were introduced to streamline the approval process.

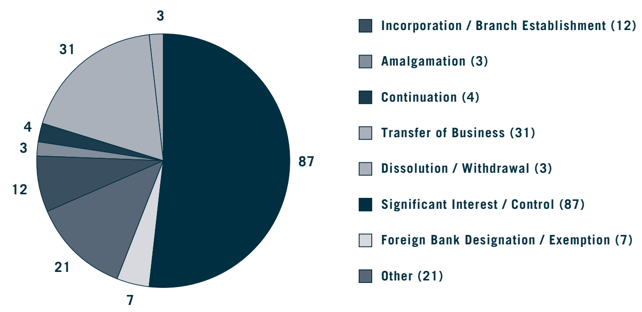
Following publication of an OSFI guideline in May 2003, the legislative provision amending the security interests sections of the financial institution statutes was proclaimed into force in January 2004, eliminating the need for financial institutions to obtain regulatory approval prior to the creation of security interests in their property.

Applications and Opinions

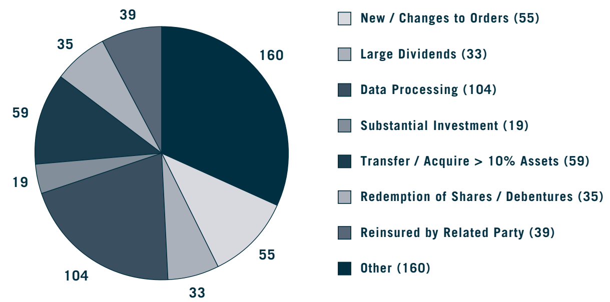
OSFI processed 672 applications for approvals in 2003-2004, a decline of 8% from the previous year. Close to 50% of these applications were subject to the statutory "deemed approval" regime (i.e. automatically approved 30 days after receipt of application unless the Superintendent raised a concern), and approximately 65% of them were in fact processed within 30 days. Incomplete applications accounted for a large majority of the approvals that extended beyond the prescribed period.

Ministerial approvals accounted for 25% of those approvals processed by OSFI during 2003-2004. Although there were fewer Ministerial approvals, these applications generally took longer to evaluate because they were more complex and often involved public policy 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 12 such opinions



Major Types of Ministerial Approvals (168)



Major Types of OSFI Approvals (504)

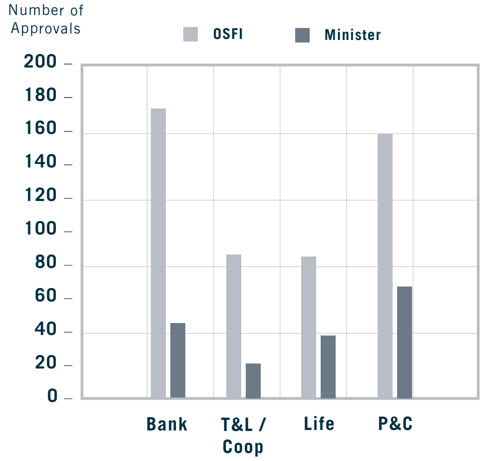
and validations were provided during 2003-2004.

During the year, several interested parties approached OSFI to discuss the incorporation of new closely held banks, as permitted pursuant to Bill C-8 passed in 2001. Some of these discussions led to formal applications, which are at various stages of review. Two applications resulted in the establishment of new closely held domestic banks during this period: Canadian Tire Bank and Sears Canada Bank.

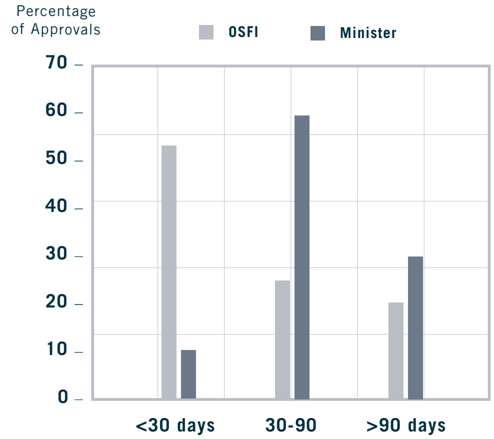
In 2003-2004, The Great-West Life Assurance Company, a domestic insurer, received approval from both the Superintendent and the Minister to acquire The Canada Life Assurance Company. OSFI also dealt with the acquisition by Manulife Financial Corporation of Boston-based John Hancock Financial Services, Inc. This transaction, which closed in April 2004, required approvals from both the Superintendent and the Minister and resulted in a Canadian insurance company that is, on a consolidated basis, the second largest in North America and the fifth largest in the world.

Guidance and Education

OSFI continued efforts to make the approval process more transparent to financial institutions. Since 2002, a total of 45 Instruction Guides have



Approvals by Industry Sector



Approvals Processing Time

been published, setting out key information requirements for applications requiring regulatory consent. In 2003-2004, a review of these Instruction Guides was initiated, with the objective of updating and clarifying information requirements and providing more administrative guidance. Seven revised Instruction Guides were posted on OSFI's Web site early in 2004.

In keeping with OSFI's objectives to enhance the transparency of its statutory approvals process, OSFI develops Advisories and Rulings. These promote a better understanding of OSFI's application process and interpretation of the federal financial institution statutes, and provide insight into OSFI's position on precedent-setting situations and policy issues. In 2003-2004, OSFI published six Advisories and four Rulings on its Web site.

During the period under review, OSFI merged its Registration and Approvals Division with its Legislation and Precedents Division in an effort to clarify accountabilities, deal with precedent-setting applications more effectively and expedite decision-making. This resulted in greater centralization of approval activities and decision-making and a more efficient approvals process. The merged division was named Legislation and Approvals Division.

Repeating an initiative started in 2002, OSFI hosted a Legislation and Approvals Division Seminar for financial institutions and their advisors in October 2003. Eighty participants attended the seminar in Toronto, which focused on providing greater insight into OSFI's approval process as well as promoting a better understanding of ongoing guidance initiatives. The seminar was extremely well received by participants and will be repeated in future years.

INDUSTRY FEEDBACK

Here is what representatives from financial institutions had to say about the seminar hosted by OSFI's Legislation and Approvals Division in October 2003:

"I found it useful to hear OSFI's interpretation and some of the subtleties in applying the rules. It was an opportunity for guidance."

"We appreciated the attempt to make OSFI's internal workings transparent. The in-progress items were useful."

"It is important to financial institutions to learn what OSFI is working on, for example the information about upcoming rulings publication, and what is important in the evaluation of applications."

PENSION PLANS

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 transfer, plan termination, partial plan termination, plan merger, refund of surplus, or a reduction of benefits.

During 2003-2004, 59 new plans were registered with OSFI. Of these, 10 were defined benefit plans. Eight registered plans, affecting some 410 members, informed OSFI that they were terminating or consolidating with other plans. In addition, two new applications for refunds of surplus to employers were received. No refunds were approved during 2003-2004.

OSFI's technical assistance program helps upgrade the supervisory capacity of emerging-market regulatory bodies, supporting Canada's role in enhancing the stability of the global financial system.

International Assistance

Canada and other G8 governments have recognized that upgrading the supervisory capacity of emerging-market regulatory bodies can help to enhance the stability of the global financial system. Canada has chosen to play a role in this regard, both directly and indirectly, through OSFI's technical assistance program, which is designed to help emerging-market economies improve their financial institutions' supervisory systems. During 2003–2004, OSFI continued to expand and grow its technical assistance program, funded in the main by the Canadian International Development Agency.

International Advisory Group

Since its inception in 2001, OSFI's International Advisory Group (IAG) has administered and operated its technical assistance program by conducting needs assessments and providing hands-on technical advice, training, workshops and seminars, primarily to supervisors in the Caribbean, Asia and Latin America.

In 2003, the IAG expanded its geographic focus to include Eastern Europe. This was undertaken by OSFI at the request of the World Bank, to meet an urgent and underserved need for technical assistance in this region. The IAG's first major project in Eastern Europe was with the State Commission for Regulation of Financial Services Markets in Ukraine, which was established in December 2002. Ukraine has seen its private insurance market continue to develop since gaining independence in 1991, and insurance regulation is one of the key responsibilities of the State Commission.

OSFI offers unique in-house programs that allow foreign bank and insurance company supervisors the opportunity to visit and learn at OSFI. During 2003-2004, the IAG hosted close to 100 supervisory personnel from across the world.

The IAG offers a variety of regional training programs and provides technical assistance, with or without technical assistance partners, in various locations outside Canada. This training often extends beyond the typical classroom setting and is developed according to the needs of the specific

With OSFI's help, one emerging-market supervisory agency completed its first ever on-site examination, another closed a number of unsafe and unsound banks, and a third implemented a system of risk-based supervision.

jurisdiction. It includes the provision of hands-on technical advice, consulting services and follow-up as necessary.

During 2003-2004, the IAG provided diverse forms of technical assistance, including that necessary to rectify shortcomings in jurisdictions identified in the IMF/World Bank Financial Sector Assessment Program (FSAP). Specifically, OSFI assisted selected bank supervisory agencies in achieving compliance with the Basel Core Principles and insurance company supervisors in complying with the International Association of Insurance Supervisors Core Principles. The Core Principles of each of these standard setters need to be in place for a supervisory system to be effective, and compliance is a significant step in the process of improving financial stability.

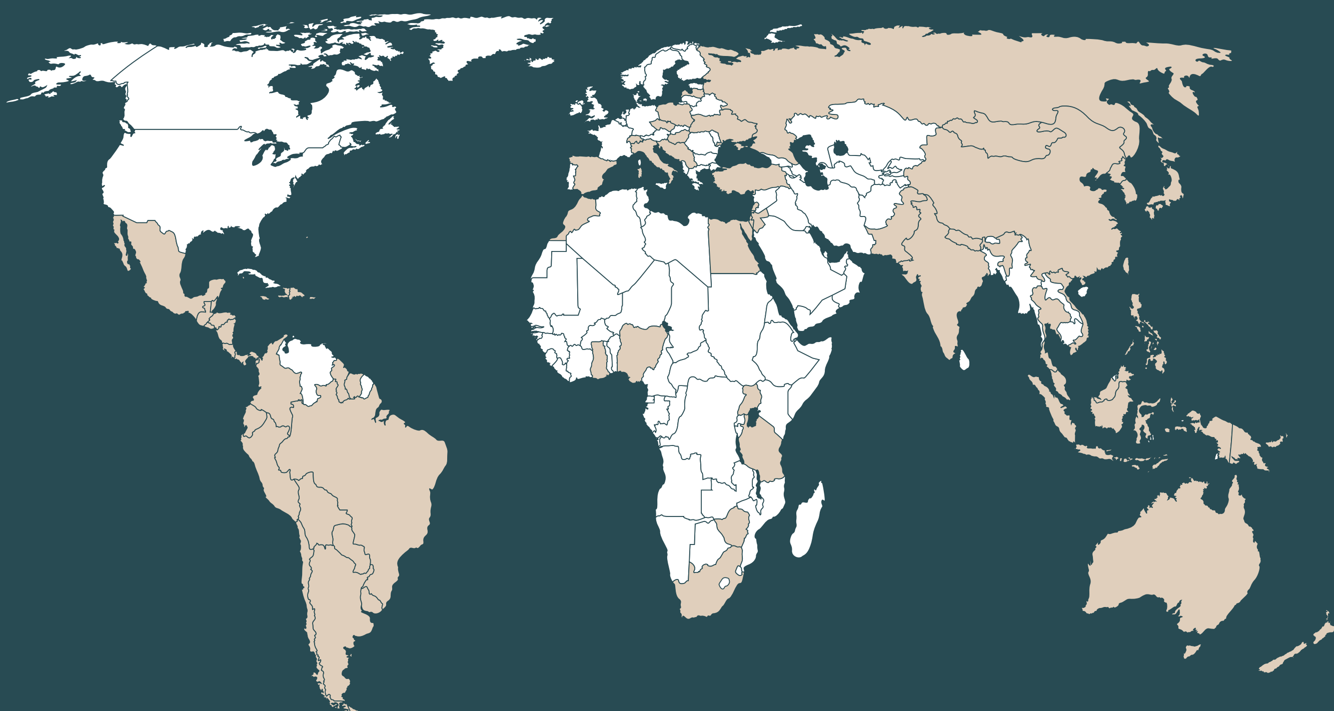
The IAG provided legislative drafting expertise, participated in on-site examinations, assisted in the FSAP self-assessment process, played a key role in the selection process for senior level supervisory staff in some organizations, and addressed industry participants and regulators on a variety of topics. In one country, the IAG was involved in a major project to develop the organizational structure and work processes of a new supervisory authority.

Toronto International Leadership Centre

OSFI continued to support the Toronto International Leadership Centre for Financial Sector Supervision through its role on the Board of Directors, the Executive Committee and the Banking Program Advisory Board. In addition, the IAG contributed resources to the Toronto Centre in the form of program leaders, and developed and delivered presentation materials. Founded in 1998, the Toronto Centre helps supervisors from around the world acquire the knowledge and leadership skills to build effective supervisory regimes in their countries.

The benefit and effect of any technical assistance program is typically long term and difficult to measure. However, with OSFI's help, one emerging-market supervisory agency completed its first ever on-site examination, another closed a number of unsafe and unsound banks, and a third implemented a system of risk-based supervision.

Since its inception in 2002, OSFI's International Advisory Group has provided technical assistance or training to financial supervisors from numerous countries.



Albania
Anguilla
Antigua
Argentina
Australia
Bahamas
Barbados
Belize
Bermuda
Bolivia
Bosnia
Brazil
British Virgin Islands
Brunei
Cayman Islands
Chile
China
Columbia
Cook Island
Costa Rica
Croatia
Czech Republic
Dominican Republic
Egypt
El Salvador
Ecuador
Fiji
Ghana
Grenada
Guatemala
Guyana
Haiti
Honduras
Hungary
India
Indonesia
Israel
Italy
Jamaica
Japan
Jordan
Korea
Latvia
Lebanon
Malaysia
Marshall Islands
Mexico
Micronesia
Mongolia
Morocco
Nepal
New Zealand
Nicaragua
Netherlands Antilles
Nigeria
Niue
Pakistan
Palau
Panama
Papua New Guinea
Paraguay
Peru
Philippines
Poland
Russia
Samoa
Singapore
Solomon Islands
South Africa
Spain
St. Lucia
St. Vincent & Grenadines
Suriname
Switzerland
Taiwan
Tanzania
Thailand
Tonga
Trinidad
Turkey
Tuvalu
Uganda
Ukraine
Uruguay
Vanuatu
Vietnam
Zimbabwe

OSFI made progress on several fronts in its efforts to streamline and harmonize the collection of data from financial institutions.

Corporate Initiatives

Regulatory Information
A joint effort by OSFI and provincial regulators produced a harmonized test of capital adequacy for property and casualty insurance companies which, when adopted by all provinces, and in conjunction with changes to other data requirements, will result in a net reduction of up to one half of the amount of data filed annually with OSFI by most federally regulated property and casualty insurance companies.

A second initiative, in partnership with the Quebec regulatory authority and the Canadian Life and Health Insurance Compensation Corporation (CompCorp), is aimed at developing a harmonized, more streamlined return for use by both federal and provincial life insurance companies. A federal life insurance company will file significantly less data (net) with OSFI in the future.

An initiative by OSFI, the Bank of Canada, the Canada Deposit Insurance Corporation, the Department of Finance and Statistics Canada is underway to similarly assess the usefulness of data filed by deposit-taking institutions and explore ways to streamline the collection of data by these government agencies.

Finally, the Private Pension Plans Division is moving towards the implementation of electronic filing of regulatory returns for the pension plans that OSFI supervises, as a first step in easing the regulatory burden through the use of technology.

Information Management and Technologies
OSFI continued with its multi-year plan to enhance its information systems and to assist in the improvement of its overall efficiency and effectiveness. OSFI met its 2003-2004 milestones for the Business Systems Integration Initiative (BSII). This significant internal project is re-engineering core supervision processes and will allow OSFI to better allocate resources to high-risk situations.

OSFI completed Phase 1 of its implementation of an office-wide electronic document management system (EDMS), with a view to moving toward a fully electronic corporate record system over the next four years. EDMS allows OSFI employees to manage all electronic corporate documents in a single shared repository, improving individual employee productivity and ensuring that OSFI meets legislative requirements for document and record management. Phase 1 included deployment of new electronic document management technologies on every employee's desktop. Records from several groups were migrated into the system, and as at March 31, 2004, more than 850,000 files were being managed in EDMS.

Management Practices

OSFI made further progress in applying industry best practices and adopting Enterprise-wide Risk Management (ERM). ERM is a contemporary management tool that provides organizations with a comprehensive and integrated approach to identifying risks in their operations and assessing the quality of risk mitigants. OSFI incorporated ERM concepts in its corporate planning process and, as a consequence, was more rigorous in identifying and prioritizing risks and issues requiring action at a strategic level.

OSFI rolled out its updated Business Resumption Plan (BRP) and conducted crisis management scenario testing. The BRP was successfully put into effect during the Ontario power blackout in August 2003, during which time OSFI was able to remain open and deal with its responsibilities.

Human Resources

OSFI introduced a new performance management process in 2003-2004, which integrated behavioural competencies. This process establishes expectations of *what* will be done by staff in meeting their key responsibilities as well as requiring ongoing observation and assessment of *how* assigned work is delivered. Linking competencies directly into performance management and remuneration reinforces OSFI's belief that demonstrating behavioural competencies will significantly leverage our technical skills.

In May 2003, OSFI reorganized its divisions into three sectors to better align them with OSFI's main activities: Supervision, with responsibility for risk assessment and intervention; Regulation, with responsibility for rule making and approvals; and Corporate Services, which supports them. This restructuring, which eliminated one Assistant Superintendent position, was designed to improve cohesiveness and simplify communication with federally regulated financial institutions.

A QUALIFIED WORKFORCE

In 2003-2004, OSFI continued to attract, retain and train a qualified workforce:

- 85% of employment offers were accepted
- 3.5% was the voluntary turnover rate
- 7.1 days were spent per employee on training

Donna Pasteris
Assistant Superintendent,
Corporate Services

OSFI finalized and rolled out its Business Resumption Plan (BRP) and conducted crisis management scenario testing. The BRP was successfully put into effect during the Ontario power blackout in August 2003, during which time OSFI was able to remain open and deal with its responsibilities.

Communications

OSFI reviewed and restructured the Communications and Public Affairs Division to better support the needs of the organization. OSFI responded to the latest employee survey by strengthening internal communications, providing improved inquiry channels, offering information sessions on key internal initiatives, and increasing employee contact with senior management.

To improve service and ensure that any internal infrastructure outage would not affect our stakeholders, OSFI outsourced its external Web site to a third party service provider. OSFI added additional key information to the Web site about financial institutions for which it is responsible.

PUBLIC LIAISON

Throughout 2003-2004, OSFI shared its expertise with interested Canadians, including members of the general public, industry, regulators and legislators:

- Handled 14,284 public inquiries (an increase of 36% from last year)
- Issued 2,110 items of correspondence
- Responded to 168 inquiries from Members of Parliament
- Served over 700,000 visitors to OSFI's Internet Web site
- Delivered 33 speeches and presentations to industry and regulatory forums

The Office of the Chief Actuary provides vital information on future costs to those responsible for the different pension plans the OCA is mandated to review.

Office of the Chief Actuary

The Office of the Chief Actuary (OCA) has different responsibilities from other sectors within OSFI. Rather than fulfilling a regulatory or supervisory function, the OCA was created to provide actuarial and other services to the Government of Canada and provincial governments that 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 reflected in reports prepared by the OCA.

The current environment for the retirement income system puts an additional premium on being, and being seen to be, fully accountable and professionally independent. The quality of the OCA's work is of utmost importance. In 2003-2004 and ongoing, the OCA maintained credibility by adhering strictly to professional actuarial standards. Peer reviews were conducted as part of an internal quality-control process. The statutory actuarial reports were prepared by OCA Fellows of the Canadian Institute of Actuaries and were co-signed by the Chief Actuary to enhance the internal quality-control process.

ROLE AND RESPONSIBILITIES

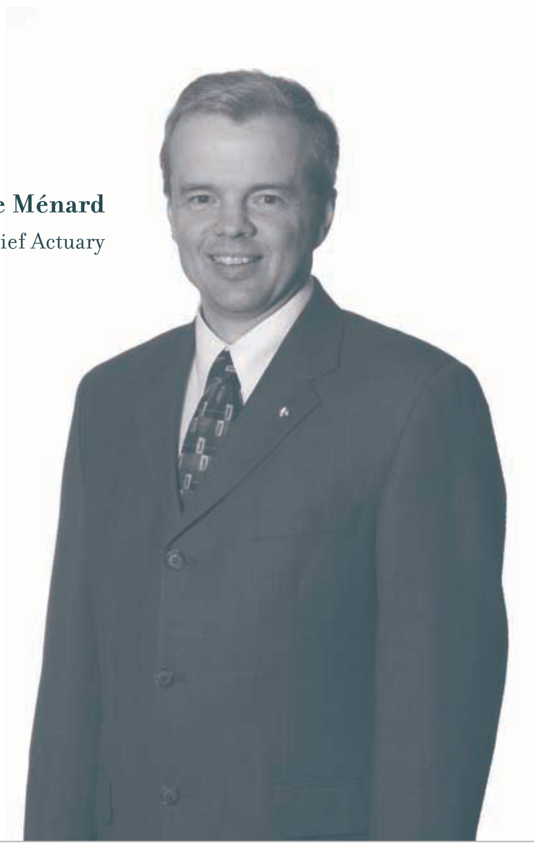
The federal government and the provinces, through the Canada Pension Plan, public sector pension arrangements and other social programs, have made commitments to Canadians and taken on responsibility for the financing of these commitments. Some are long-term and it is important that decision-makers, Parliamentarians and the public understand these and the inherent risks. The OCA provides vital information on future costs to those responsible for the different pension plans the OCA is mandated to review.

The Office of the Chief Actuary conducts statutory actuarial valuations of the CPP, Old Age Security program and pension and benefit plans covering the federal Public Service, the Canadian Forces, the Royal Canadian Mounted Police, the federally appointed judges, and Members of

Parliament. Since 2001, the OCA has also been responsible for undertaking the actuarial review of the Canada Student Loans Program.

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

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



Jean-Claude Ménard
Chief Actuary

DEVELOPMENTS

In a past Federal-Provincial Review of the Canada Pension Plan by the Ministers of Finance, they endorsed plans to establish regular peer reviews of future actuarial reports on the CPP, and to consult regularly with experts on assumptions to be used in actuarial reports. As part of this consultation process, on May 2, 2003, the OCA hosted the third seminar on "Demographic, Economic and Investment Perspectives of Canada, Years 2003-2050". The daylong seminar, which focused on the work force, featured four guest speakers who addressed some 100 participants invited from across the country and from various provincial and federal government organizations. In his remarks, the Chief Actuary stressed the need to discuss, reflect on and question key assumptions.

The 20th Actuarial Report on the Canada Pension Plan was completed and tabled in Parliament in April 2004. This actuarial report was prepared to show the effect of Part 4 of Bill C-30, which amends the rules governing employer and employee contributions in the event of a business restructuring and more generally clarifies these rules and those governing refunds of employers' contributions. Part 4 of Bill C-30 also allows reinstatement of a CPP disability pension and/or benefits to children in specific circumstances. The report confirms that these changes do not alter the viability and sustainability of the legislated 9.9% combined employer-employee contribution rate.

The OCA completed a number of other reports in 2003-2004, including actuarial reports on the Public Service Pension Plan, the RCMP Pension Plan, the Canadian Forces Pension Plan, the Public Service Death Benefit and the Regular Forces Death Benefit. These reports were subsequently tabled before Parliament. The OCA also completed its second actuarial review of the Canada Student Loans Program, and released its third actuarial study, the "Canada Pension Plan

Mortality Study", which presents the results of a mortality study of CPP retirement and survivor beneficiaries.

Other services by the OCA during the year included providing:

- An expert witness report by the Chief Actuary on CPP same-sex survivor benefits before the Ontario Superior Court of Justice in July 2003;
- 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 worker's compensation actuarial liability for implementation of government accounting policies on retirement and post-employment benefits;
- Public Accounts actuarial report on Pension Act related post-employment benefits for the Canadian Forces including wars 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 Treasury Board on group insurance plans covering federal government employees, Canadian forces and members of the RCMP; and
- Ongoing advice and support given to the Public Sector Pension Investment Board and the Pension Advisory Committees of the Public Service, the Canadian Forces and the RCMP.

The current environment for the retirement income system puts an additional premium on the Office of the Chief Actuary being, and being seen to be, fully accountable and professionally independent.

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.

- OSFI met its target of keeping the overall increase in assessment fees under 8%. Total assessments of financial institutions were in fact 2.7% lower than the estimates that had been communicated to industry.

- Assessments are differentiated to reflect the costs incurred by each industry group. General assessments on the P&C insurance sector rose materially from the prior year (14.3%) to reflect OSFI's increased activity in that sector. General assessments in the deposit-taking sector went down by 1.1%, and in the life insurance sector went up by 5.4%.

- OSFI attributes part of its costs to specific "users" rather than to general assessments. Surcharges to problem institutions were approximately 38% higher than estimates due to a greater number of staged institutions and longer periods of staging. A 30% increase in fees for applications for approval was implemented effective August 2003 (the first of a 2-year phase-in; in August 2004, fees will increase by a further 23%).

- Actual expenses were 0.5% below budget. Changes in timing of capital projects resulted in higher than planned information management/technology costs, and the Air Canada Pension Plans issues required greater than expected professional services costs. Lower travel costs and savings in professional development expenses due to more in-house delivery offset these increases.

- OSFI limited its maximum headcount to 495 in 2002. OSFI is undergoing business process re-engineering to become more effective and efficient, with the expectation that not all vacancies will need to be filled. This resulted in a year-end headcount of 457.

- OSFI reduced its office leasing requirements effective 2004-2005. A reduction in the Ottawa footprint of 930 square meters or 14% will lead to an annual saving of $0.4 million. OSFI also reduced its footprint in the Toronto office, and exercised an option in the original lease for the next 5 years at 38% below current market rates.

Financial Highlights

BACKGROUND

OSFI recovers its costs from several revenue sources. Costs for risk assessment and intervention (supervision), approvals and rule making are charged to the financial institutions and private pension plans that OSFI regulates and supervises.

The amount charged to individual institutions for OSFI's main activities of supervision, approvals and rule making is determined in several ways. In general, the system is designed to allocate costs based on the approximate amount of time spent supervising and regulating the industry. As a result, well-managed, lower-risk institutions and those with fewer approvals bear a smaller share of OSFI's costs.

Specific user fees cover costs for certain approvals. Problem (staged) institutions are assessed a surcharge approximating the extra supervision resources required.

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".

The remainder of costs of risk assessment and intervention, approvals and rule making are recovered through base assessments against institutions and pension plans fees according to various formulae. In 2003-2004, OSFI also received a non-recurring parliamentary appropriation that was applied to activities consistent with the government-wide Modern Comptrollership initiative. Overall, OSFI fully recovered all its expenses for the fiscal year 2003-2004.

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

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

FEDERALLY REGULATED FINANCIAL INSTITUTIONS

Revenues

Base assessments to industry rose $1.7 million, or 3%, for the year ended March 31, 2004. Revenue from user fees and charges and cost-recovered services increased considerably from the previous year. Surcharges to problem institutions rose by $1.9 million, or almost doubled, from the prior year. This was due to the combined effect of a greater number of staged institutions in the year and longer periods of staging.

User fees from approvals were slightly lower than expected due to a decline in the number of approvals; this drop was partially offset by the coming into force, in August 2003, of the first of a two-year fee increase of 30% per year, not compounded. These increases were implemented so as to better account for the actual cost of providing approvals and to apply a more equitable method of recovering costs.

Cost-recovered services revenue related to implementing the internal ratings-based approach of the New Basel Capital Accord was $2.5 million, up from $2.2 million in the prior year. Other service charges rose by slightly more than $0.4 million.

Expenses

Total expenses were $69.1 million, an 8% increase from the previous year.

OSFI continued to recruit and hire the highly skilled, experienced professional resources that it needs to successfully deliver its mandate. In 2002-2003, OSFI established its maximum headcount at 495. The 2003-2004 fiscal year ended with a headcount of 457. The expected result of re-engineering is that not all of the current vacancies will need to be filled.

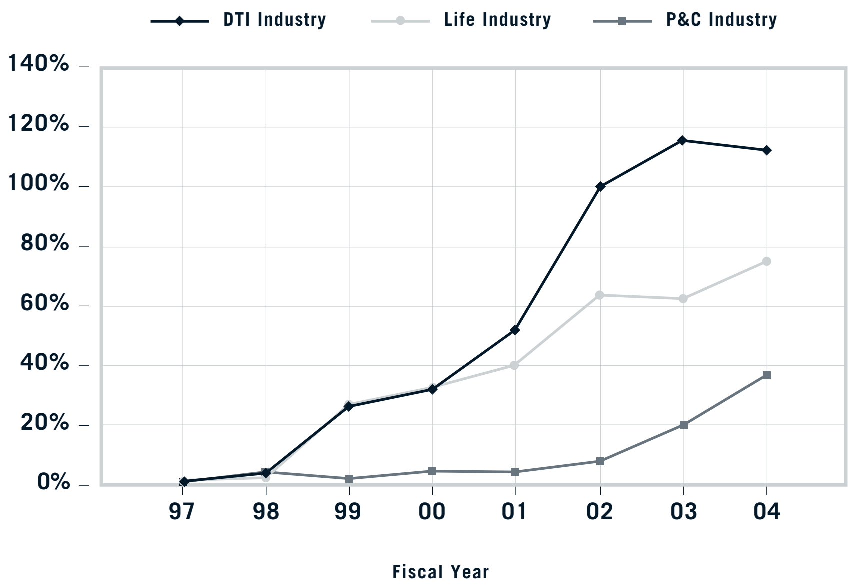
The increase in human resources costs, the main driver of OSFI expenses, was the result of non-recurring restructuring costs and planned growth in employee compensation to more closely reflect market levels. OSFI used its legislated authority to put in place a compensation system that is part of a strategy to ensure OSFI attracts and retains the people it needs, with the requisite range of experience and skills to meet its mandate. During the year OSFI also increased its performance-related pay, which is available to employees at all levels within the organization.

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

Financial Institution Assessments by Industry

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

GENERAL 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, 2004, were $3.5 million, up from $3.3 million a year earlier. The increase in fees assessed reflects a higher fee rate in 2003-2004.

The fee rate is established based on OSFI's estimate of costs to supervise pension plans, adjusted for any excess or shortfall of fees in the preceding years, divided by an estimate of the fee base, i.e. assessable membership.

The rate established for fiscal year 2003-2004 was $11 per assessable member, a rate that reflects anticipated increases in OSFI's monitoring and intervention activities.

Expenses

The cost of administering the PBSA for fiscal year 2003-2004 was $4.3 million, up from $3.2 million the previous year. This increase is largely due to the significant expenses incurred by OSFI in dealing with Air Canada's pension plans. OSFI also staffed vacant positions during the period to deal with the increased risk prevalent in the industry.

Fees Assessed and Expenses
For Fiscal Years 1998-1999 to 2003-2004
($000, except Basic Fee Rate)

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

OFFICE OF THE CHIEF ACTUARY

The increase from the prior year in the expenses of the Office of the Chief Actuary is mainly attributed to planned growth in employee compensation.

[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 basic fee rate by 20 and 10,000 respectively. With a basic fee rate of $11.00 per member, the minimum annual assessment is $220 and the maximum is $110,000.

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.

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

Nicholas Le Pan
Superintendent

Donna Pasteris
Assistant Superintendent
Corporate Services

Ottawa, Canada
May 28, 2004

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, 2004 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, 2004 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 28, 2004

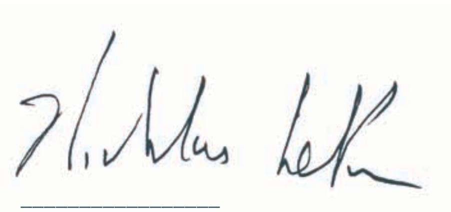
STATEMENT OF FINANCIAL POSITION

As at March 31, 2004, with comparative figures for the year ended March 31, 2003
(in thousands of dollars)

	2004	2003
ASSETS		
Assets		
Cash Entitlement	$ 40,031	$ 35,515
Accounts Receivable (note 8)	5,745	5,240
Accrued Base Assessments	-	1,040
Capital Assets (note 4)	5,072	5,389
TOTAL ASSETS	**$ 50,848**	**$ 47,184**

	2004	2003
LIABILITIES AND EQUITY OF CANADA		
Liabilities		
Accrued Salaries and Benefits	$ 10,316	$ 8,888
Accounts Payable and Accrued Liabilities (note 8)	4,225	3,211
Deferred Charges	1,978	561
Deferred Private Pension Plan Revenue	267	1,039
Employee Future Benefits other than Pension (note 9)	6,524	5,947
	$ 23,310	**$ 19,646**
Equity of Canada	**27,538**	**27,538**
TOTAL LIABILITIES & EQUITY OF CANADA	**$ 50,848**	**$ 47,184**

Commitments and Contingencies (note 6)



NICHOLAS LE PAN
Superintendent of Financial Institutions

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

STATEMENT OF OPERATIONS AND EQUITY OF CANADA

For the period ended March 31, 2004, with comparative figures for the year ended March 31, 2003
(in thousands of dollars)

	2004	2003
Supervision of Federally Regulated Financial Institutions		
Revenue		
Base Assessments	$ 58,246	$ 56,542
User Fees and Charges	6,495	4,037
Cost-Recovered Services	4,208	3,451
Total Revenues	68,949	64,030
Expenses (note 10)		
Supervision & Regulation	64,919	60,579
Cost-Recovered Services	4,208	3,451
Total Expenses	69,127	64,030
Results before Non-Respendable Filing Penalties Revenue	(178)	-
Non-Respendable Filing Penalties Revenue (note 11)	211	710
Net Results	33	710
Supervision of Private Pension Plans		
Revenue	4,322	3,163
Expenses (note 10)	4,322	3,163
Net Results	-	-
Office of the Chief Actuary of Canada		
Revenue	3,119	2,908
Expenses (note 10)	3,831	3,615
Net Results	(712)	(707)
Net Results of Operations before Government Funding	**(679)**	**3**
Government Funding (note 5)	890	707
NET RESULTS OF OPERATIONS FOR THE YEAR	**211**	**710**
EQUITY OF CANADA, BEGINNING OF YEAR	**27,538**	**27,538**
Non-Respendable Filing Penalties Earned on Behalf of the Government (note 11)	(211)	(710)
EQUITY OF CANADA, END OF YEAR	**$ 27,538**	**$ 27,538**

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

STATEMENT OF CASH FLOWS

For the period ended March 31, 2004, with comparative figures for the year ended March 31, 2003
(in thousands of dollars)

	2004	2003
OPERATING ACTIVITIES		
Net Results of Operations	$ 211	$ 710
Non-Cash Items Included in Operations		
Amortization of Capital Assets (note 4)	2,459	2,234
Employee-Related Liabilities	577	1,187
Change in Assets/Liabilities		
(Increase) in Accounts Receivable	(505)	(3,980)
Decrease in Accrued Base Assessments	1,040	3,738
Increase in Accounts Payable and Accrued Liabilities	2,442	755
Increase/(Decrease) in Deferred Charges/Revenue	645	(867)
Non-Respendable Filing Penalties Revenue (note 11)	(211)	(710)
Cash Provided by Operating Activities	**6,658**	**3,067**
INVESTING ACTIVITIES		
Acquisition of Capital Assets (note 4)	(2,142)	(2,274)
Cash Applied to Investing Activities	**(2,142)**	**(2,274)**
INCREASE IN CASH ENTITLEMENT	**4,516**	**793**
CASH ENTITLEMENT, BEGINNING OF YEAR	**35,515**	**34,722**
CASH ENTITLEMENT, END OF YEAR	**$ 40,031**	**$ 35,515**

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

Notes to the Financial Statements

For the Year Ended March 31, 2004

1 AUTHORITY AND OBJECTIVE

i) 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 to regulate and supervise all federally regulated financial institutions. For OSFI, 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, cooperative credit associations, fraternal benefit societies and pension plans. 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.

ii) The Office of the Chief Actuary (OCA), a division of OSFI, provides actuarial advice to the Government of Canada. The OCA performs actuarial services for a variety of public insurance and pension programs as required under the *Canada Pension Plan Act* and the *Public Pensions Reporting Act*.

iii) In addition, OSFI has responsibilities under the following legislation:

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

iv) Under previous provisions of the *Insurance Companies Act* and 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. However, under the new provisions of the *Winding-Up and Restructuring Act* (Section 23.3), the Superintendent can no longer be appointed as liquidator of a failed institution.

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 the expenses and sets this ceiling at $40 million above the amount of revenue collected.

OSFI revenues comprise assessments, fees, and service charges. 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 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 25 of the *Pension Benefits Standards Regulations, 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

Revenue is recorded in the accounting period in which it is earned whether or not it has been billed or collected.

OSFI charges interim base assessments calculated on its budgeted expenses and forecast industry results. Final base assessments are billed in the subsequent fiscal year, calculated on the actual results from the prior year.

User fees and charges include revenues earned pursuant to *Service Charges Regulations* and surcharges assessed against federally regulated financial institutions assigned a "stage" rating pursuant to the *Guide to Intervention for Federal Financial Institutions*.

Cost-recovered services represent revenue earned on a cost-recovery basis. OSFI recovers the cost of providing these services in accordance with the terms and conditions set out in Memoranda of Understanding.

Pension plan fee rates are set annually based on budgeted expenses, forecast pension plan membership and actual results from the previous year.

On April 1, 2002, OSFI's filing penalty regulations came into force in accordance with the OSFI Act. Penalties are levied quarterly to financial institutions when they submit late and/or erroneous financial and corporate returns due to OSFI during the preceding calendar quarter. Penalties levied by OSFI are non-respendable and are remitted to the Consolidated Revenue Fund.

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 Superannuation Plan administered by the Government of Canada. Both the employees and OSFI contribute to the cost of the Plan. OSFI's contribution amount is currently based on a multiple of the employee's required contributions, and may change over time depending on the experience of the Plan. These contributions represent the total pension obligations of OSFI and are charged to operations on a current basis. OSFI is not required under present legislation to make contributions with respect to any actuarial deficiencies of the Public Service Superannuation Plan.

(ii) Severance benefits

On termination of employment, employees are entitled to certain benefits provided for under their conditions of employment through a severance benefits plan. The cost of these benefits is actuarially determined and is accrued as the employees render their services necessary to earn severance benefits.

The cost of the benefits is actuarially determined 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.

f) Specified purpose account for insurance company liquidations

OSFI has an interest-bearing specified purpose account (note 7) within the Consolidated Revenue Fund for insurance company liquidations. Previous to amendments to the *Winding-up and Restructuring Act*, the courts appointed the Superintendent as the liquidator of several failed insurance companies. In this capacity, 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*. The revenues and expenses related to this account are not included in the Statement of Operations and Equity of Canada.

g) Use of estimates

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

4 CAPITAL ASSETS

($ thousands)	Gross Book Values			Accumulated Amortization			Net Book Values	
Category	Opening Balance	Additions (net)	Closing Balance	Opening Balance	Amortization Expense (net)	Closing Balance	2004	2003
Leasehold Improvements	$ 1,626	$ 344	$ 1,970	$ 923	$ 461	$ 1,384	$ 586	$ 703
Furniture and Fixtures	1,589	(3)	1,586	867	186	1,053	533	722
Office Equipment	351	-	351	206	67	273	78	145
Informatics Hardware	1,703	424	2,127	1,331	285	1,616	511	372
Informatics Infrastructure	2,615	345	2,960	1,455	659	2,114	846	1,160
Informatics Software	5,813	1,032	6,845	3,526	801	4,327	2,518	2,287
Total	**$ 13,697**	**$ 2,142**	**$ 15,839**	**$ 8,308**	**$ 2,459**	**$ 10,767**	**$ 5,072**	**$ 5,389**

5 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 $890 thousand (2003: $707 thousand) composed of parliamentary appropriations to defray the expenses associated with the provision of services by the Office of the Chief Actuary ($712 thousand, 2003: $707 thousand) and a non-recurring appropriation of $178 thousand (2003: Nil) to be applied to activities consistent with the Government Modern Comptrollership initiative.

6 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)

2004-2005	$ 2,759
2005-2006	2,466
2006-2007	2,371
2007-2008	2,348
2008-2009	2,153
	$ 12,097

b) Contingencies

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

7 SPECIFIED PURPOSE ACCOUNT

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

($ thousands)

Specified Purpose Account: **Insurance Company Liquidations**	**2004**	**2003**
Opening Balance	$ 19,578	$ (45)
Recoveries deposited	-	20,459
Interest earned	480	35
Distribution of assets from liquidated estates	(20,595)	-
Other transactions in respect of liquidation expenses	596	(871)
Closing Balance	**$ 59**	**$ 19,578**

Remaining active insurance companies are liable for all expenses related to the liquidation of failed insurance companies.

8 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 $15,547 thousand (2003: $14,434 thousand) and revenues of $6,950 thousand (2003: $3,050 thousand) from transactions in the normal course of business with other Government departments during the year.

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

($ thousands)		Related Parties	External Parties	Total
2004	Accounts Receivable	$ 59	$ 5,686	$ 5,745
	Accounts Payable	$ 1,353	$ 2,872	$ 4,225
2003	Accounts Receivable	$ 47	$ 5,193	$ 5,240
	Accounts Payable	$ 837	$ 2,374	$ 3,211

9 EMPLOYEE FUTURE BENEFITS

i) Pension benefits

The estimated employer contributions to the Public Service Superannuation Plan during the year were $5,696 thousand (2003: $5,366 thousand).

ii) Severance benefits

The net expense for OSFI's severance benefits for the year ended March 31, 2004, was $874 thousand (2003: $999 thousand).

The cost of benefits is actuarially determined using the projected benefit method prorated on services. The accrued benefit liability recognized in the balance sheet at March 31, 2004, in respect of these benefits is $6,524 thousand (2003: $5,947 thousand).

The significant actuarial assumptions adopted in measuring OSFI's accrued benefit liability were as follows:

	2004	2003
Liability discount rate	6.05%	6.13%
General economic increases	3.00%	3.00%

10 EXPENSES BY MAJOR CLASSIFICATION

($ thousands)

	2004	2003
Human Resources	$ 55,801	$ 52,215
Information Management/Technology	8,129	5,519
Facilities	5,109	5,098
Travel	2,860	2,953
Administration	2,444	2,059
Professional Services	1,683	1,237
Professional Development	1,254	1,727
TOTAL EXPENSES	$ 77,280	$ 70,808

11 LATE AND ERRONEOUS FILING PENALTIES

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

During 2003-2004, OSFI levied $211 thousand (2003: $710 thousand) in late and erroneous filing penalties.

Disclosure of Information

The *Office of the Superintendent of Financial Institutions Act* requires the Superintendent to report annually to Parliament on the disclosure of information by financial institutions and the state of progress in enhancing the disclosure of information in the financial services industry.

OSFI's Role in Enhancing Disclosure

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

Over the past few years, 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 under generally accepted accounting principles, as set out in the CICA Handbook, and other OSFI guidelines.

During 2003-2004, OSFI reviewed a sample of financial institution annual reports and regulatory returns to evaluate compliance with the guidelines. This review concluded that:

- Virtually all deposit-taking institutions selected for review comply with quantitative disclosure requirements. In general, the level and quality of disclosures related to risk management and control practices, especially as they relate to the structure of risk governance and the process for risk management practices, have increased. Qualitative risk management and control disclosures among smaller banks and trust companies, however, still require some improvement.

- Overall, life insurance companies are in compliance with OSFI's disclosure guideline and have shown some improvement in risk disclosures since last year. While disclosed information on risks associated with policy liabilities and corporate governance has improved, further improvements could be made to disclosures of risk management and control methods for other types of risk.

- P&C insurance companies met OSFI's minimum disclosure requirements for investments, policy liabilities and, with a few exceptions, interest rate sensitivity analysis. Risk management and control practices disclosures were assessed for a few companies who prepare an annual report and although the major risks were discussed, disclosure of the policies to control those risks could be improved.

OSFI and the Canadian Institute of Actuaries (CIA) developed a model for disclosure of annual gains and losses by source. The CIA is in the process of finalizing an educational note that gives guidance on the methodology of the calculations. OSFI is preparing a new guideline that will require public disclosure of the source of earnings for Canadian life insurance companies for the 2004 fiscal year. Embedded value disclosure is also a reporting feature of several large Canadian life insurers.

Internationally, OSFI has been a leading member country in reaching a consensus on the New Capital Adequacy Framework (Basel II). Pillar III- Market Discipline will require enhanced disclosures of capital and the risk management practices of banks. OSFI monitors the activities of the Transparency Group of the Basel Committee on Banking Supervision that has a member who is actively participating in an International Accounting Standards Board improvements project "Disclosures of risks arising from and other disclosures relating to financial instruments".

OSFI maintains a watching brief on the work of the Enhanced Disclosure Subcommittee of the International Association of Insurance Supervisors (IAIS). In November 2003, the IAIS adopted their paper entitled "Standard on Disclosure Concerning Technical Performance and Risks for Non-life Insurers and Reinsurers". All of these groups focus on promoting market discipline through such means as developing best-practice disclosure guidance.

Financial Institutions and Pension Plans Regulated by OSFI

	Number [1]	Assets [2, 3] (Millions)
Banks		
Domestic	18	$ 1,688,377
Foreign bank subsidiaries	29	$ 88,901
Foreign bank branches	22	$ 31,096
Trust and Loan Companies		
Bank-owned	32	$ 198,337
Other	34	$ 11,050
Cooperative Credit Associations	7	$ 10,967
Life Insurance Companies		
Canadian-incorporated	44	$ 292,838
Foreign branches	54	$ 33,511
Fraternal Benefit Societies		
Canadian-incorporated	12	$ 6,101
Foreign branches	9	$ 1,255
Property and Casualty Insurance Companies		
Canadian-incorporated	88	$ 53,972
Foreign branches	94	$ 23,408
Pension Plans		
	1,256	$ 90,882

1 Number of regulated companies as at 31 March 2004. 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/eng/whoweregulate.asp.
2 As at 31 March 2004 where available, otherwise 31 December 2003.
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.

Summary of Asset Breakdown of Pension Plans Regulated by OSFI

As at March 31, 2004, with comparative figures for the year ended March 31, 2003
(in millions of dollars)

	2004			2003		
ASSETS						
Cash	**$**	**312**	**0.3%**	**$**	**302**	**0.4%**
Debt Securities						
Short Term Notes, Other Term Deposits	$	2,976	3.3%	$	3,361	4.0%
Government Bonds		19,165	21.1%		19,257	22.7%
Corporate Bonds		6,135	6.8%		6,574	7.7%
Mutual Funds – Bonds, Cash Equivalents & Mortgage		5,512	6.1%		4,917	5.8%
Mortgage Loans		1,248	1.4%		1,322	1.6%
General Fund of an Insurer		99	0.1%		122	0.1%
Total Debt Securities	**$**	**35,137**	**38.7%**	**$**	**35,553**	**41.9%**
Equity						
Shares in Investment, Real Estate or Resource Corporation	$	5,162	5.7%	$	4,381	5.2%
Common and Preferred Shares		33,212	36.5%		30,191	35.6%
Stock Mutual Funds		10,533	11.6%		8,729	10.3%
Real Estate Mutual Funds		194	0.2%		256	0.3%
Real Estate		1,456	1.6%		1,418	1.7%
Total Equity	**$**	**50,557**	**55.6%**	**$**	**44,975**	**53.0%**
Diversified and Other Investments						
Balanced Mutual Funds	$	1,849	2.0%	$	1,659	2.0%
Segregated Funds		1,190	1.3%		1,021	1.2%
Miscellaneous Investments		1,560	1.7%		1,363	1.6%
Total Diversified and Other Investments	**$**	**4,599**	**5.1%**	**$**	**4,044**	**4.8%**
Other Accounts Receivable						
(Net of liabilities)	**$**	**277**	**0.3%**	**$**	**48**	**0.1%**
TOTAL NET ASSETS	**$**	**90,882**	**100.0%**	**$**	**84,922**	**100.0%**

How to Reach OSFI

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

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

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

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

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