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

THE IMPORTANCE OF MANAGING RISK

OSFI ANNUAL REPORT 2009–2010

OSFI BSIF

Canada

OSFI AT A GLANCE

- OSFI was established in 1987 to contribute to public confidence in the Canadian financial system. It is an independent agency of the Government of Canada and reports to the Minister of Finance.
- OSFI supervises and regulates 438 banks and insurers, and 1,398 federally registered private pension plans. As at March 31, 2010, these organizations managed a total of $3,951 billion of assets.
- The Office of the Chief Actuary, which is an independent unit within OSFI, provides actuarial services for the Canada Pension Plan, the Old Age Security program, the Canada Student Loans Program and other public sector pension and benefit plans.
- OSFI recovers all of its costs. OSFI is funded mainly through asset-based, premium-based or membership-based assessments on the financial services industry and a user-pay program for selected services. A small portion of OSFI's revenue is derived from the Government of Canada for actuarial services relating to various public sector pension and benefit plans.
- As of March 31, 2010 OSFI employed 551 people in offices located in Ottawa, Montréal, Toronto and Vancouver.

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THE IMPORTANCE OF MANAGING RISK

Canada's financial sector outperformed many of its G-20 counterparts during the financial crisis and the sector remains strong as Canada's economy recovers. This resilience was due to many factors, including better risk management by the institutions themselves, and strong regulation and supervision by OSFI. Throughout 2009–2010, OSFI continued to promote robust risk management practices and effective corporate governance, and focussed on the development of new domestic and international capital and liquidity rules for financial institutions.

SUPERINTENDENT'S MESSAGE

Canada's economy, and its financial sector in particular, withstood the shocks of global financial turmoil better than many of its G-20 partners did. This country's more positive experience has been attributed to a range of factors, including better risk management by the institutions themselves, and strong regulation and supervision by OSFI.

But continued prudence is required because we are not back to a normal state. While economic indicators were encouraging heading into 2010, by April, concerns were emerging about sovereign debt and global economic growth. It is difficult to gauge at time of writing what the impact might be on the nascent economic recovery.

All of the above is encompassed in the theme of this annual report — *The Importance of Managing Risk*. Canadian financial institutions have done a good job of managing risk but the bar is constantly rising. Because Canada fared better than other countries during 2008 and 2009, there is a risk that players (including OSFI itself) could become complacent and think the current rules, and the way that risk is managed, are sufficient. One of the ways OSFI manages this risk is by watching and learning from what other regulators have been doing in response to the financial turmoil. For example, in tandem with other regulators, in 2009–2010, OSFI significantly increased its focus on stress testing and began to place more emphasis on corporate governance of financial institutions, as boards are a key control on risk appetite.

We also continue to place emphasis on system-wide reviews of risk areas in banks. In 2009–2010, OSFI did a number of reviews, including liquidity management, compensation, credit cards, US home equity lines of credit (HELCO), Alt-A mortgages, securitization, derivatives collateral management, and stress testing. These reviews help OSFI, and financial institutions, identify where the strengths and weaknesses are across the sector.

The Canadian experience demonstrates that this type of day-to-day supervisory oversight of financial institutions is extremely important, and as important as having robust rules. A financial sector with strong regulatory rules but weak supervisory oversight can be neither safe nor sound. There is growing acceptance of this fact internationally.

As part of ensuring strong regulatory rules are in place, OSFI took an active role in international forums developing such rules throughout 2009–2010. Canadian financial institutions have clearly communicated to us the importance they place on OSFI's participation in such forums. In the wake of government interventions, which included bank bailouts in many countries, vigorous international debates are underway regarding what kind of rule changes are required. This work is being conducted under the leadership of the G-20 group of countries, with particular work streams led by the Basel Committee on Banking Supervision (BCBS), and the Financial Stability Board (FSB). The pace and extent of the review underway required OSFI to significantly escalate its work in this area.

The BCBS, which is the focal point for developing new global capital and liquidity rules for banks, released proposals in December 2009 for comment. It is anticipated that new rules will be announced by year-end 2010 for implementation by the end of 2012. The BCBS will also consider appropriate transition and grandfathering arrangements. We have been urging that as much attention be paid to supervision as to the new capital and liquidity rules. Indeed, stricter rules, such as substantially higher capital requirements, can create a false sense of security — an institution will never have enough capital if there are material flaws in its risk management practices.

In 2009–2010, OSFI developed additional ways to promote robust risk management practices at financial institutions and pension plans. We held risk management seminars for deposit-taking institutions, life insurance companies, and property and casualty insurance companies. We also held the first of what will be an annual forum for private pension plan administrators. Feedback from participants at all these events was positive and indicated a desire that they continue. We continued to deepen supervisory colleges, including having a focus on "living wills" (contingency plans and resolution plans by financial institutions), and participated in international supervisory colleges organized by other regulators.

Partnerships are also central to our effective functioning and management of risk. This past year, we continued to work closely with the Financial Institutions Supervisory Committee (FISC) on matters relating to the supervision of federally regulated financial institutions (FISC partners include OSFI, the Department of Finance, the Bank of Canada, the Canada Deposit Insurance Corporation, and the Financial Consumer Agency of Canada).

During the year under review, we welcomed Mark White to OSFI's Executive Committee in his new role of Assistant Superintendent, Regulation Sector. Mark joined OSFI in 2008 as Senior Director, Capital Division, bringing with him a wide range of experience in national and international banking, law and finance. Mark replaced Bob Hanna, a long-serving public servant and a key contributor to OSFI's success over the years.

As always, our people are the most important element of OSFI's success. It is their experience and critical judgement that allow us to fulfill our mandate and respond to increased pressure and workloads due to the current challenging economic environment. I extend a sincere thank you to all employees for their continuing hard work and demonstration of commitment to OSFI's values: professionalism, integrity and respect for people. Together, we will continue to learn and improve as an organization, and to contribute to the safety and soundness of Canada's financial system.

Julie Dickson

Julie Dickson
Superintendent of Financial Institutions

PERFORMANCE AGAINST PRIORITIES 2009–2010

OSFI's role is to contribute to the safety and soundness of the Canadian financial system, while allowing federally regulated financial institutions and private pension plans to compete effectively and take reasonable risks. We balance competitiveness with prudence, international rules with Canadian market realities, and efficiency with thoroughness. This approach guided our performance during the continuing global economic challenges of 2009–2010 amid signs of recovery in the Canadian economy.

Last year's Annual Report listed six priorities to achieve OSFI's strategic outcomes for 2009–2010. This section reports major accomplishments under each of the priorities. OSFI achieved its goals for the reporting year and continues to work on these multi-year priorities. More details are available in various chapters of the report.

PRIORITY A – EMERGING RISKS

Continue to improve OSFI's ability to identify, monitor and report on emerging risks to federally regulated financial institutions through enhanced research, more focus on market information, comparative reviews in key areas and updates to internal processes as needed.

STEPS TAKEN

- Continued to strengthen the design and application of OSFI's Supervisory Framework, building on years of experience in its use.
- Reorganized OSFI's Supervision sector along industry lines to better focus risk assessment across large and small financial institutions.
- Planned and conducted comparative reviews for: credit cards, US home equity lines of credit (HELCO), Alt-A mortgages, securitization, derivatives collateral management, liquidity management, stress testing and compensation.
- Continued close monitoring of property and casualty insurance companies with significant auto insurance exposure.

PRIORITY B – INSTITUTIONAL AND MARKET RESILIENCE

Continue to participate in international discussions of key issues arising from global market turmoil, and work with Financial Institutions Supervisory Committee (FISC) partners and the federally regulated financial services industry to maintain strong communications and preparedness.

STEPS TAKEN

- Continued active participation in international forums such as the Financial Stability Board (FSB), the Senior Supervisors Group, Basel Committee on Banking Supervision (BCBS), the International Association of Insurance Supervisors (IAIS), and other organizations to assess and agree on proposals to strengthen the financial sector regulation as a result of the crisis.
- Organized and hosted a College of Supervisors for each of two of the big five Canadian banks, in line with FSB recommendations, which brought executives from each bank together with supervisors from several jurisdictions where they do business.
- Participated in several international supervisory colleges, and developed information-sharing agreements with a number of host-country supervisory authorities that regulate significant foreign operations of Canadian banks and insurers.
- Continued to work closely with our FISC partners to monitor the resilience of the financial sector and discuss critical issues.
- Developed industry guidance for stress testing building on BCBS, IAIS, and existing OSFI principles.
- Held three Risk Management Seminars: second annual for deposit-taking institutions; first annual for life insurance companies, and for property and casual insurance companies.

PRIORITY C – IFRS IMPLEMENTATION

Prepare for the move to International Financial Reporting Standards (IFRS) in 2011, by determining the policy, data collection and reporting implications for OSFI. Work closely with federally regulated financial institutions to gain a clear understanding of their IFRS plans and readiness[1].

STEPS TAKEN

- Addressed accounting and capital policy and reporting implications of moving to IFRS. Following extensive consultations with industry associations and other key stakeholders, an Advisory on the *Conversion to International Financial Reporting Standards (IFRSs) by Federally Regulated Entities (FREs)*[2] was published providing OSFI positions on accounting, capital and regulation treatments due to IFRS changes.
- Hosted industry risk management forums for deposit-taking institutions, life insurance companies, and property and casualty companies on the impact of IFRS on accounting and regulatory capital policies, expectations of FREs on IFRS implementation, and consequential reporting changes.
- Posted draft financial and regulatory reporting forms for FREs reflecting IFRS changes.
- Completed the selection of IFRS accounting and reporting solutions for OSFI and completed targeted milestones to ensure effective implementation.
- Completed the Information Management/Information technology (IM/IT) impact assessment for OSFI as a result of the move to IFRS.
- Commenced consultations on OSFI guidance requiring updates to reflect IFRS.

[1] This priority includes looking externally at the impact on federally regulated entities (FREs) and internally at the impact on OSFI's own financial reporting.

[2] Federally regulated entities (FREs) is a broader category than federally regulated financial institutions (FRFIs) and includes banks, foreign bank branches, bank holding companies, federally regulated trust and loan companies, cooperative credit associations, life insurance companies, foreign insurance companies, fraternal benefit societies, property and casualty insurance companies, and insurance holding companies, all of which must implement IFRS.

PRIORITY D – CAPITAL ADEQUACY

Continue work on current Minimum Continuing Capital and Surplus Requirements (MCCSR) and the Minimum Capital Test (MCT) to develop improved risk-sensitive capital frameworks for life, and property and casualty insurers, and in light of IFRS implementation. Continue monitoring post-implementation phase of Basel II Capital Accord.

STEPS TAKEN

- Continued to work through the MCCSR Advisory Committee (MAC) to develop and incorporate more advanced risk measurement techniques (such as internal company models) into the MCCSR.
- Held discussions with the life insurance MAC about possible improvements to the current internal model capital valuation methodology for segregated funds and about a fundamental review of the current valuation methodology for segregated funds requirements.
- Revised MCCSR Guideline in late 2009 for life insurance companies, particularly in relation to the capital treatment of unregistered reinsurance. Also issued a draft version in early 2010 to incorporate amendments related to implementation of IFRS.
- Continued review of MCCSR with respect to measurement of capital requirements for life insurance companies, including for mortality risk improvement.
- Developed conceptual frameworks for assessing solo / stand-alone capital adequacy for better evaluation of insurance holding company capital adequacy, and commenced consultations with key affected institutions.
- Published *Key Principles for the Future Direction of the Canadian Regulatory Capital Framework for Property & Casualty (P&C) Insurance* in conjunction with the Property and Casualty Minimum Capital Test (MCT) Advisory Committee.
- Operationalized a robust Internal Capital Adequacy Assessment Program (ICAAP) review process and related risk measurement techniques to strengthen our ability to assess capital adequacy.
- Took an active role in the Basel Committee on Banking Supervision development of new rules on risk management and capital regulation, including the July 2009 changes to trading book rules and the December 2009 proposals to strengthen the resilience of the banking sector through enhanced capital, leverage and liquidity rules, and also on the development of *Guiding principles for the revision of accounting standards for financial instruments issued by the Basel Committee*.

PRIORITY E – HUMAN RESOURCES

Ensure OSFI has the human resources available to fulfill its mandate, through improved long-range and integrated planning.

STEPS TAKEN

- Applied OSFI's HR planning process to ensure key resource and skill gaps were prioritized, and action plans developed and monitored.
- Continued to implement and monitor training and development programs consistent with needs analyses to ensure workforce capacity and skills were in place to meet work plans.
- Increased the staff complement to continue to respond to external pressures and to recruit specialized skills in areas such as research, credit and capital, which included strengthening Capital Division's ability to deal with developments such as enhanced Basel rules on bank capital adequacy and increased use of models by insurance companies.
- Reviewed staffing needs to address gaps moving forward with IM/IT strategy.
- Conducted a review and risk assessment of our executive compensation structure in light of the *Expenditure Restraint Act*.
- Enhanced our business continuity and pandemic plan capacity.

PRIORITY F – INFRASTRUCTURE ENHANCEMENTS

Develop long-term Information Management and Information Technology strategies to support OSFI's evolving supervisory and regulatory activities.

STEPS TAKEN

- Completed IM/IT Strategy outlining a multi-year roadmap to address 'end of life' technologies and the modernization of OSFI's application suite to increase business value and system flexibility and agility.
- Implemented portfolio management and optimized governance to provide oversight and accountability over IM/IT investments and ensure alignment with OSFI plans and priorities.
- Commissioned a review to be undertaken in 2010–2011 of OSFI's returns processing system, the Tri-Agency Database System, to confirm 'end of life' and to recommend a replacement strategy.
- Completed the Pension Systems Renewal project for Private Pension Plan Approvals activity. In 2010–2011, OSFI will begin development of enabling technology to support Pension Plan Supervisory processes.

PRIORITIES FOR 2010–2011

OSFI has identified the following six priorities to achieve our strategic outcomes for 2010–2011. More details can be found on OSFI's Web site in the *Plan and Priorities 2010–2011 to 2012–2013*.

A. **Enhanced Identification of Emerging Risks:** Continue to improve OSFI's ability to identify, monitor and report on emerging risks to federally regulated financial institutions and private pension plans, including system-wide risks, through enhanced research and intelligence gathering, international and domestic monitoring, and comparative reviews in key risk areas.

B. **Institutional and Market Resilience:** Continue to participate in international discussions of key issues arising from global financial events, and work with Financial Institutions Supervisory Committee (FISC) partners and OSFI-regulated industries to maintain strong communications, preparedness and overall market resilience.

C. **IFRS Implementation:** Implement the move to International Financial Reporting Standards (IFRS) in 2011, by assessing the impact on federally regulated financial institutions and pension plans, and addressing implications for OSFI's prudential regime and regulatory policies.

D. **Capital Adequacy:** Continue to participate actively in international forums (Basel Committee on Banking Supervision, Financial Stability Board, Joint Forum and International Association of Insurance Supervisors) to contribute to the development of internationally agreed bank and insurance capital standards; review and improve domestic regulatory capital requirements and assessment practices; and enhance risk sensitivity of capital requirements in the insurance and banking sector.

E. **Human Resources:** Identify changing human resources requirements to ensure timely availability of qualified staff and the assignment of these resources based on identified risks and priority areas; implement strategic learning and development (training) plans.

F. **Infrastructure Enhancements:** Implement the long-term strategies and related governance for Information Management and Information Technology necessary to support our evolving supervisory and regulatory activities.

The six priorities identified for 2010–2011 flow from the following five ongoing responsibilities related to OSFI program activities:

Federally Regulated Financial Institutions

1. Accurate risk assessments of financial institutions and timely, effective intervention and feedback.
2. A balanced, relevant regulatory framework of guidance and rules that meets or exceeds international minimums.
3. A prudentially effective, balanced and responsive approvals process.

Federally Regulated Private Pension Plans

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

Office of the Chief Actuary

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

CORPORATE OVERVIEW

ROLE AND MANDATE

OSFI was established in 1987 by an Act of Parliament: the *Office of the Superintendent of Financial Institutions Act* (OSFI Act). OSFI supervises and regulates all banks in Canada and all federally incorporated or registered trust and loan companies, insurance companies, cooperative credit associations, fraternal benefit societies and private pension plans. *(See figure 1)*

OSFI's mandate is to:

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

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

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

Federally Regulated Financial Institutions and Private Pension Plans*

FIGURE 1

	Deposit-Taking Institutions	Life Insurance Companies	Property & Casualty Companies	Federally Regulated Private Pension Plans	TOTAL
Number of organizations	150	101	187	1,398	**1,836**
Assets (billions)	$3,196	$508	$124	$123	**$3,951**

*For a more detailed breakdown of each category, see figures 8 and 13.

Under the OSFI Act, the Minister of Finance is responsible for OSFI. The Superintendent is solely responsible for exercising OSFI's authorities under the financial legislation and is required to report to the Minister of Finance from time to time on the administration of the financial institutions legislation.

The Office of the Chief Actuary (OCA), which is an independent unit within OSFI, provides actuarial services to the Government of Canada in the form of reports tabled in Parliament. While the Chief Actuary reports to the Superintendent, he is solely responsible for the content and actuarial opinions in reports prepared by the OCA. He is also solely responsible for the actuarial advice provided by the Office of the Chief Actuary to the relevant government departments, including the executive arm of provincial and territorial governments, which are co-stewards of the Canada Pension Plan (CPP).

STRATEGIC OUTCOMES

From our mandate, OSFI identified two strategic outcomes for 2009–2010:

1. **To regulate and supervise to contribute to public confidence in Canada's financial system and safeguard from undue loss.**

   OSFI safeguards depositors, policyholders and private pension plan members by enhancing the safety and soundness of federally regulated financial institutions and private pension plans.

2. **To contribute to public confidence in Canada's public retirement income system.**

   The Office of the Chief Actuary provides statutory actuarial reports, and advises on the state of various public pension plans and on the financial implications of options being considered by policy makers.

OSFI achieves these two strategic outcomes as set out in figure 2 on page 13.

RESOURCES

FINANCIAL RESOURCES

OSFI recovers all of its costs, as stipulated under the OSFI Act. The organization is funded mainly through asset-based, premium-based or membership-based assessments on the financial services industry and a user-pay program for selected services. A very small portion of OSFI's revenue (1.1%) 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. Funding in 2009–2010 for OSFI's international assistance program was provided by the Canadian International Development Agency.

HUMAN RESOURCES

As at March 31, 2010, OSFI employed 551 people in offices located in Ottawa, Montréal, Toronto and Vancouver.

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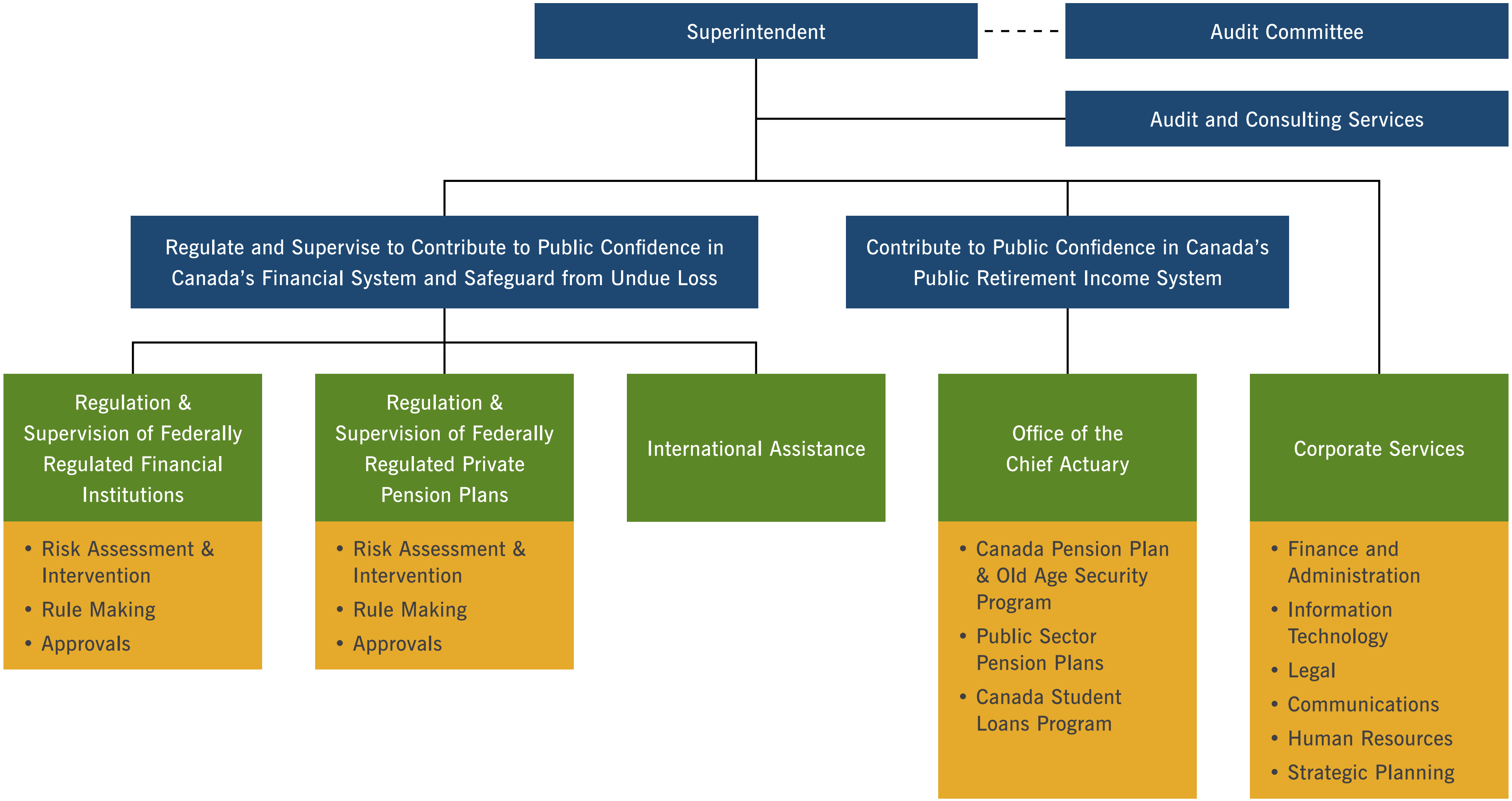
Business Analyst,
Client Portfolio Management, IM/IT,
Corporate Services Sector

Narinder Virk [R]
Information Technician,
Information Management, IM/IT,
Corporate Services Sector

Framework of Strategic Outcomes, Programs and Activities*

FIGURE 2



* As of April 1, 2010, the two strategic outcomes were revised to read "A safe and sound Canadian financial system" and "A financially sound and sustainable Canadian public retirement income system".

As at April 1, 2009

EXECUTIVE TEAM

Julie Dickson was appointed **Superintendent of Financial Institutions** in July 2007, for a seven-year term. Ms. Dickson joined OSFI in April 1999, and was Assistant Superintendent, Regulation Sector, from January 2000 to June 2006, when she was named Deputy Superintendent. In October 2006, she was appointed Acting Superintendent. Prior to joining OSFI, Ms. Dickson served as Group Leader of the Financial Institutions Practice for a national consulting firm from 1995 to 1998. Before that, she served for 15 years with the Department of Finance, primarily in areas related to financial institution policy. She is a member of the Accounting Standards Oversight Council of Canada. She represents OSFI on the Financial Stability Board and the Integrated Supervisors group. As Superintendent, Ms. Dickson serves on the Council of Governors of the Canadian Public Accountability Board and on the boards of directors of the Canada Deposit Insurance Corporation and the Toronto Leadership Centre. As per the OSFI Act, the Superintendent also chairs the Financial Institutions Supervisory Committee (FISC), whose membership includes OSFI, the Bank of Canada, the Canada Deposit Insurance Corporation, the Financial Consumer Agency of Canada and the Department of Finance.

Ted Price was appointed **Assistant Superintendent, Supervision Sector,** in June 2006. Since joining OSFI in 2001, Mr. Price has served in several senior management roles, most recently as Senior Director, Financial Conglomerates Group. He led the implementation of the Basel II Capital Accord Framework in Canada. Prior to joining OSFI, Mr. Price was a senior executive with Prescient Markets, Inc., an Internet-based investment bank, from 2000 to 2001. Between 1983 and 1999, Mr. Price held various positions in government finance, fixed income and capital markets product development at ScotiaCapital, Inc. In 1995, he was appointed to the Executive Committee and relocated to New York to direct the firm's U.S. business.

Gary Walker was appointed **Assistant Superintendent, Corporate Services Sector**, in November 2008. Mr. Walker joined OSFI in 2002 as Senior Director, Human Resources, before taking on the additional responsibilities for Security, Administration and Regulatory Information in 2006. Prior to joining OSFI, Mr. Walker held a number of senior-level corporate services positions in both the private and public sectors with such companies as Atomic Energy of Canada Ltd., Laidlaw Inc., AM International and MacDonald Dettwiler Ltd.

Mark White was appointed **Assistant Superintendent, Regulation Sector,** in July 2009. Mr. White joined OSFI in April 2008 as Senior Director, Capital, Accounting and Research Division. Previously, he was at RBC Capital Markets for nearly seven years in several positions, including Managing Director and Global Head of the Strategic Transactions Group. In

Left to Right

Ted Price
Assistant Superintendent,
Supervision Sector

Gary Walker
Assistant Superintendent,
Corporate Services Sector

Julie Dickson
Superintendent of Financial Institutions

Mark White
Assistant Superintendent,
Regulation Sector

that role, he led an international structured finance team. Prior to RBC, Mr. White was a partner at Ernst & Young Management Consultants and Donahue Ernst & Young, Barristers & Solicitors. He is a former Senior Vice-President and Director of a U.S. multi-national structured finance and leasing business in Canada and in Europe. In addition to practising law, Mr. White gained experience in a regulatory environment with the Ontario Energy Board and in accountancy. Mr. White is currently chair of the Basel Committee's Risk Management and Modelling Group and a member of the Basel Committee on Banking Supervision and the Basel Committee's Policy Development Group.

ACCOUNTABILITY

AUDITING

Established in 2006, OSFI's Audit Committee met six times in 2009–2010. The Audit Committee is comprised of two independent members, an independent Chair and the Superintendent as an ex-officio member. The Committee provides objective advice, guidance and assurance to help OSFI efficiently and effectively achieve its business objectives and fulfill its mandate. The Committee exercises active oversight of core areas of OSFI's accountability, risk and control processes. It also recommends for approval OSFI's financial statements, which are audited annually by the Office of the Auditor General.

OSFI's internal audit group conducts assurance audits based on comprehensive risk-based internal audit priorities involving consultation with senior management and the Superintendent, and review by the Audit Committee. Both annual internal audit plans and audit reports are posted on OSFI's Web site. In 2009–2010, seven reports were published, including reviews on the Regulation Sector-Legislation and Policy Initiatives — Rule Making, Superintendent Management Oversight Framework, and Human Resources Planning Framework.

SURVEYS AND CONSULTATIONS

OSFI regularly conducts anonymous surveys of knowledgeable industry observers to help assess its performance and effectiveness as a regulator. Survey results are disclosed on OSFI's Web site.

DEPOSIT-TAKING INSTITUTIONS

In early 2010, The Strategic Counsel, on OSFI's behalf, conducted a confidential consultation with deposit-taking institutions regulated by OSFI. One-on-one interviews were completed with a sample of executives representing a cross-section of deposit-taking institutions to explore their perceptions of OSFI's performance.

This research forms part of OSFI's rotating consultations with key stakeholders in various industry sectors, which allow OSFI to assess its effectiveness and fulfill its commitment to continuous improvement. More details can be found in this annual report in the chapter on Federally Regulated Financial Institutions. The final report, *Deposit-Taking Institutions Sector Consultation (DTISC) Findings*, is available on OSFI's Web site under Accountability / Consultations and Surveys.

BENEFITS TO CANADIANS

OSFI's strategic outcomes, supported by our plans and priorities, are intrinsically aligned with broader government priorities, specifically strong economic growth, income security and employment for Canadians, and a safe and secure world through international cooperation, as identified in the Treasury Board Secretariat report *Canada's Performance*. A properly functioning financial system that inspires a high degree of confidence among consumers and others who deal with financial institutions makes a material contribution to Canada's economic performance.

CONNECTING WITH STAKEHOLDERS

OSFI regularly communicates its plans and activities to a wide range of stakeholders. In 2009–2010, OSFI made public numerous reports, including its *2010–2012 Report on Plans and Priorities*; and several Actuarial Reports from the Office of the Chief Actuary, including the *Actuarial Report on the Pension Plan for the Public Service of Canada*. The full text of these reports can be found on OSFI's Web site.

As in previous years, OSFI also received many requests to address other conferences and events. The Superintendent and senior OSFI officials delivered presentations to industry and regulatory forums across Canada and internationally including: the National Insurance Conference of Canada, the Canada-UK Colloquium on Global Finance, the Osgoode Hall Financial Regulatory Reform Conference, the Asian Banker Summit, the RBC Capital Markets Central Bank Conference, and the Women in Capital Markets Distinguished Speakers Luncheon.

Senior OSFI officials also made several presentations to the House of Commons Standing Committee on Finance and the House of Commons Standing Committee on the Status of Women. Most speeches and presentations are available on OSFI's Web site.

OSFI's external newsletter, *The Pillar*, was published four times in 2009–2010. It serves to remind key stakeholders of the latest guidelines, notices, public statements, and other pertinent information released by the Office.

SHARING OSFI'S EXPERTISE

Throughout 2009–2010, OSFI shared its expertise with interested Canadians, including members of the general public, industry, regulators, legislators and the news media:

- Served 968,396 visitors to OSFI's Web site
- Responded to 13,896 public enquiries
- Responded to 174 enquiries from Members of Parliament
- Responded to 220 enquiries from representatives of the news media
- Delivered over 50 speeches and presentations to industry and regulatory forums
- Processed 65 access to information requests or consultations within permitted statutory timelines as per the *Access to Information Act*.

Peter Pearson [L]
Senior Security Officer, Security Services,
Corporate Services Sector

Mari Kraik [R]
Manager, Financial Planning and Analysis,
Finance and Corporate Planning,
Corporate Services Sector

FEDERALLY REGULATED FINANCIAL INSTITUTIONS

RISK ASSESSMENT AND INTERVENTION

OSFI supervises federally regulated financial institutions (FRFIs), monitors the financial and economic environment to identify issues that may impact these institutions negatively, and intervenes in a timely manner to protect depositors and policyholders from undue loss, while recognizing that management, boards of directors and plan administrators are ultimately responsible, and that financial institutions and plans can fail.

Throughout 2009–2010, OSFI continued the heightened level of monitoring and scrutiny of financial institutions and markets exercised in the prior year, while taking into account clear evidence of economic recovery and a decline in volatility and uncertainty in financial markets. We enhanced risk identification activities, strengthened the design and application of supervisory processes, targeted cross-sector reviews in areas identified as high risk, and introduced organizational changes to focus our resources better.

FINANCIAL ENVIRONMENT

The functioning of liquidity and credit markets has improved since the global financial crisis intensified at the end of 2008. Policy makers around the world have acted vigorously to restore confidence in the global financial system and promote the flow of credit but significant risks remain. The strength of the Canadian financial regulatory and supervisory framework helped our banking system weather the storm better than many global counterparts, as noted by the International Monetary Fund in its 2009 assessment of member countries. As 2009–2010 came to a close, key economic indicators in Canada pointed to recovery. Generally, the Canadian economy was less exposed to the crisis because private and public sector balance sheets were in better shape than in most countries. In addition, Canadian financial institutions benefited from relatively conservative lending and maintaining higher levels of capital.

A number of factors contributed to the global financial crisis, including weaknesses in macroeconomic policy and financial regulation, and a general mispricing of risk. The consequences were far-reaching and, while they have been mitigated, continue to affect countries and financial institutions world-wide. Policy makers around the globe are considering proposals to reduce the risk of future financial crises. There has been substantial work examining such issues as balance sheet leverage, liquidity and capital requirements, the treatment of systemically important institutions, and accounting rules, but the finalization and implementation of these developments will continue for some time.

During 2009–2010, OSFI worked with various domestic partners on the Financial Institutions Supervisory Committee (the Department of Finance, the Canada Deposit Insurance Corporation, the Bank of Canada, and the Financial Consumer Agency of Canada) to review lessons learned, and to discuss and coordinate issues related to the oversight of the financial sector. OSFI has considered where it can improve its regulatory regime and is actively taking steps to do so.

We continued our active participation in international forums to develop and implement better practices. These include the Basel Committee on Banking Supervision (BCBS), the Financial Stability Board, the International Association of Insurance Supervisors, the Joint Forum and the Senior Supervisors Group. Notably, the BCBS published consultative proposals to strengthen global capital and liquidity regulations in December 2009 with the goal of promoting a more resilient banking sector. (See details under BCBS section of Rule Making.)

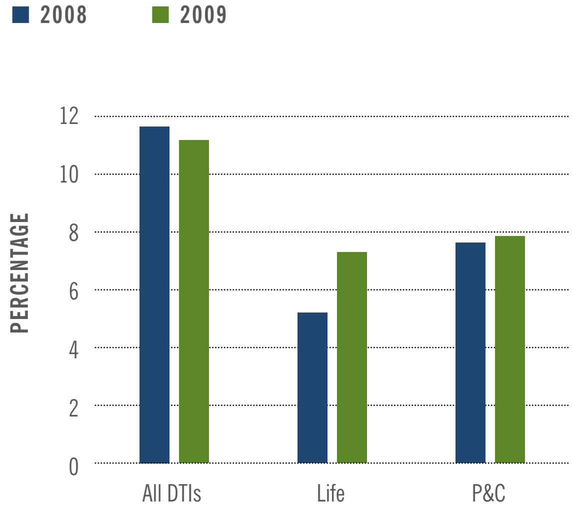
REVIEW BY SECTOR

DEPOSIT-TAKING INSTITUTIONS

In 2009, capital and credit markets began to show signs of stabilization and improvement. The traditionally high rates of return enjoyed by banks continued to be negatively impacted by challenging global macroeconomic and credit conditions; however, Canadian banks remain profitable and adequately capitalized. The majority of banks reported increased profits with many benefiting from increased capital markets revenues. Despite this positive trend in earnings, the average return on equity for the banking sector declined modestly from 11.6% in 2008 to 11.2% in 2009. *(See figure 3)*

Return on Equity

FIGURE 3



Average return on equity in 2009 declined slightly for DTIs but improved modestly for P&C and life insurance.

Christopher Cardoza [L]
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Among Canada's federally regulated deposit-taking institutions (DTIs), the six largest domestic banks account for approximately 90% of total banking assets. These banks reported financial performance improvement throughout 2009 and continued to outperform many of their international peers. For the most part, they have broad, geographically diversified portfolios, with extensive operations both in Canada and in many parts of the world, most notably in the United States. Their businesses extend beyond traditional lending and deposit-taking activities to include operations in insurance, trading, investment banking and wealth management.

The remaining 10% of banking assets in Canada are held by smaller banks that manage niche banking business models with a focus on one or two business lines such as mortgage lending, commercial real estate or credit cards. While they do not have diversification benefits in their operations as do the large banking institutions, this group avoided much of the international turmoil and their financial performance was similarly positive to the larger banks in 2009.

The Canadian banking industry continued to be adequately capitalized throughout 2009. The average total capital ratio rose from 12.3% in 2008 to 14.7% in 2009, chiefly due to an increase in Tier 1 capital from 9.8% to 12.2%. *(See figure 4)* These capital levels were well above the Bank of International Settlements' 8% minimum threshold as well as OSFI's 10% target.

In 2009–2010, OSFI operationalized a robust Internal Capital Adequacy Assessment Program (ICAAP) review process and related risk measurement techniques to strengthen our ability to assess capital adequacy.

For 2010, if economic conditions continue to improve, economists are forecasting lower unemployment levels, reduced credit market spreads and decreasing equity market volatility. However, we think challenges are likely to remain in commercial real estate lending and securitization markets, and from the impact of possible interest rate increases. In addition, ongoing concerns related to sovereign indebtedness will overshadow the international outlook.

Two additional factors will pose challenges going forward: the adoption of International Financial Reporting Standards (IFRS) for accounting in 2011, and increased capital and liquidity requirements.

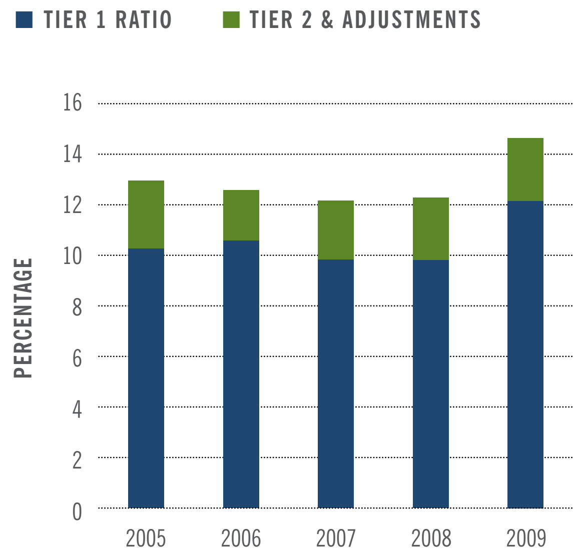
For example, under the new IFRS guidelines, most securitized assets will have to be included in the bank's leverage ratio calculation. (For more on how OSFI is working with FRFIs to prepare for IFRS, see Rule Making.)

As international standards are redefined in response to the financial crisis, the quality and quantity of capital and liquidity will be strengthened. Accordingly, in 2009–2010, in addition to active participation in the formulations of proposed new standards, OSFI worked closely with banks to monitor the implications of revised standards for banks and for their respective capital and liquidity management programs.

OSFI will continue to monitor closely and evaluate the impact to the DTI sector of these and other changes.

All DTIs: Risk-Weighted Capital Ratios

FIGURE 4



In 2009, DTIs' average risk-weighted capital ratios remained above OSFI's capital targets of 10% total capital and 7% Tier 1 capital.

OVERVIEW OF THE 2009–2010 DEPOSIT-TAKING INSTITUTIONS SECTOR CONSULTATION

In early 2010, on OSFI's behalf, The Strategic Counsel[3] conducted a confidential consultation with deposit-taking institutions, to explore their perceptions of OSFI's performance. This research forms part of OSFI's rotating consultations with key stakeholders in various industry sectors, which allow OSFI to assess its effectiveness and fulfill its commitment to continuous improvement.

The Deposit-Taking Institutions Sector Consultation comprised a series of confidential, one-on-one interviews with a sample of executives representing a cross-section of deposit-taking institutions regulated by OSFI. The participants were selected by The Strategic Counsel; OSFI does not know who was interviewed. The final report, *Deposit-Taking Institutions Sector Consultation (DTISC) Findings*, is available on OSFI's Web site.[4]

Key findings from the DTISC are:

- Overall, most participants are satisfied with OSFI's performance as a regulator. In particular, many hold positive impressions of OSFI's performance during the recent financial turmoil.
- Most believe that OSFI has played a significant role in contributing to public confidence in Canada's financial services industry, particularly through the recent period of economic volatility.
- OSFI's Relationship Managers are considered to be responsive, organized and good at coordinating supervisory teams.
- OSFI is seen to identify and focus on the appropriate areas of risk.
- The vast majority believe that OSFI makes its expectations clear through its guidance, as well as concerning applications for approvals.
- OSFI is perceived as effective in representing the interests of the Canadian financial services industry internationally, and its communications about international activities are perceived as more effective than in the past.

Some areas identified for further improvement include improving the consistency of written communications with institutions, and continuing to improve staff knowledge of complex products and services offered by financial institutions.

[3] The Strategic Counsel, an independent research firm, conducted the consultations on OSFI's behalf. In early 2010, 49 CEOs, CFOs, CCOs, CROs, lawyers and auditors of the deposit-taking institutions regulated by OSFI participated in the qualitative research. The Strategic Counsel chose the participants at random, and OSFI does not know who participated.

[4] The report, entitled *Deposit-Taking Institutions Sector Consultation (DTISC) Findings*, presents the results in summary form. It is posted on OSFI's Web site under Accountability / Consultations and Surveys.

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LIFE INSURANCE COMPANIES

Equity market performance continued to be the key driver of life insurance industry results in Canada in 2009. Positive equity market returns provided the industry with improvements in both earnings and return on equity. At the same time, life companies strengthened their reserve bases in recognition of the increased volatility that equity markets have displayed, in order to ensure that policyholder benefits and shareholder returns will be well supported during both strong and weak market conditions going forward. Total net income for the year was $5.3 billion (76% from the three large conglomerates) for a return on equity of 7.3 %. This compares with 2008 performance of $3.6 billion in net income (92% from the three large conglomerates) and a return on equity of 5.2 %.

The Canadian life insurance industry improved its capital position in 2009, as the excess of capital levels over regulatory requirements showed a noticeable increase. OSFI's supervisory target ratio is set at 150% for both the Minimum Continuing Capital and Surplus Requirement (MCCSR) for Canadian life insurance companies and the Test of Adequacy of Assets and Margin (TAAM) for branches of foreign companies operating in Canada. The average combined ratio for Canadian life insurers in 2009 was 221%, up from 216% in 2008 and significantly above OSFI's target capital level. *(See figure 5)*

With an adequate capital base and improving income levels, the life insurance industry was in a relatively healthy position going into 2010. Looking forward, however, the industry will be dealing with several challenges.

After dominating life insurance industry results in 2008, investment risks declined in 2009. The industry responded to the lessons learned during the financial crisis, and has been asked to prepare for another possible cycle of equity market declines, credit weakness in bonds, mortgages and other fixed income investments, or a sustained period of low interest rates.

The low interest rate environment in recent years had a negative impact on the financial results of many life insurers, prompting more conservative product features, including price, on newer issues of products that depend on fixed income investment returns to deliver desired profit levels.

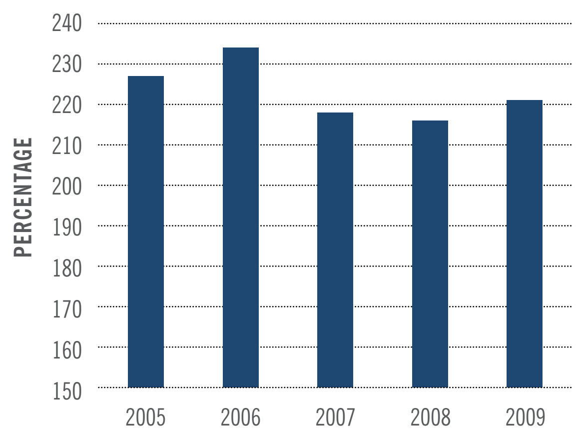
Exposure to credit risk also created some erosion in the financial results of some of the larger life insurers due to increased provisions to deal with higher default probabilities, especially in their corporate bond and commercial mortgage portfolios. As an industry, however, the conservative nature of life insurance company investment portfolios has helped to keep the industry's exposure to credit risk and its contribution to weaker financial performance at manageable levels, particularly at smaller companies.

After declining considerably in 2008, individual life insurance sales showed a modest improvement in 2009 but have not returned to the level experienced before the economic downturn. While industry financial results can withstand a short term decline in sales, if they are sustained, lower sales volumes would cause lower earnings over the longer term as a result of smaller portfolios of insurance policies generating profits.

The potential adverse impact of a global pandemic on claims and operations has been highlighted in recent years. Life insurers regularly include scenarios

Life Insurance Companies: MCCSR Ratios

FIGURE 5



> In 2009, the average MCCSR ratio for Canadian life insurers was 221%, up 5% over 2008 and significantly above OSFI's capital target of 150%.

related to the impact of a pandemic in their annual dynamic capital adequacy testing (DCAT). This testing looks not only at the impact of higher mortality but at other aspects as well, such as the impact of a depressed equity market. OSFI's review of DCAT results for 2009 indicated that in the event of a relatively severe pandemic event, Canadian life insurers would suffer an earnings decline but would remain solvent.

A number of Canadian life insurers are part of the global operations of foreign financial institutions. There were instances in 2009 where the impact of global economic events caused distress to the foreign parent operations of Canadian life insurance entities. These situations have the potential to create a demand for the capital value of the Canadian life insurance operations as support for the parent company's financial position. During 2009–2010, OSFI monitored such institutions closely.

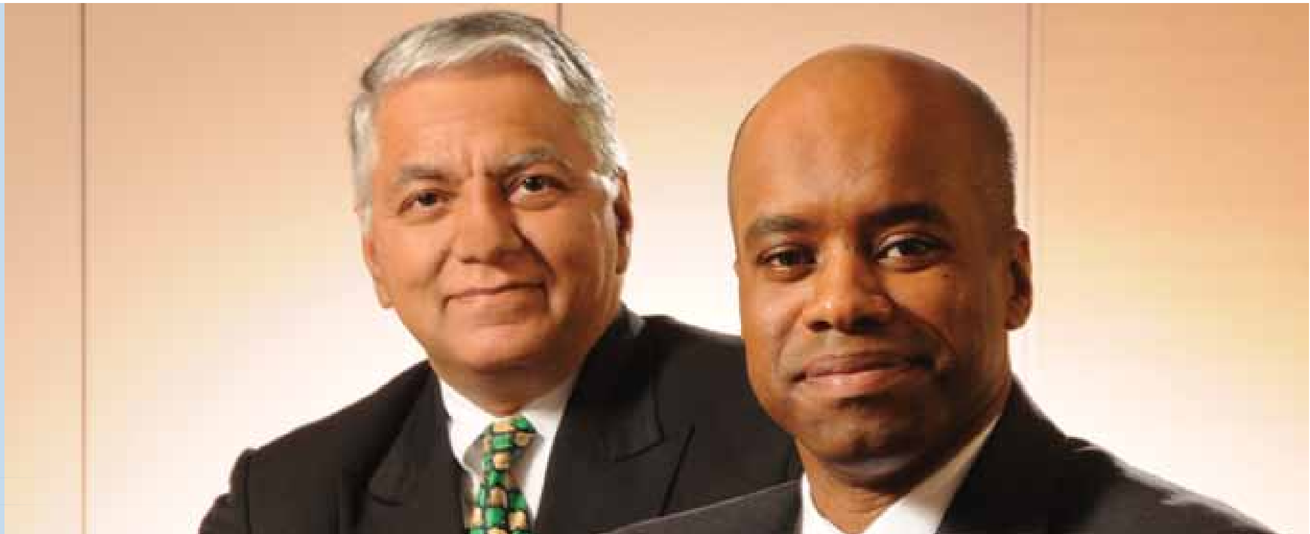
OSFI also continued to monitor risk mitigation strategies in the life insurance sector. For example, reinsurance of a portion of claims risk with reinsurers provides an effective mitigant to the risk of increased levels of claims at an affordable price and spreads risk in the system, albeit with some counter-party credit risk. OSFI encouraged institutions to review regularly their risk management practices with an eye to emerging risks and the impact these may have on their solvency. In 2009–2010, OSFI asked a selected number of life insurers and life reinsurers that represent a significant portion of the life insurance business in-force in Canada to complete a stress test based on a standardized scenario. OSFI reviewed the results of the exercise, shared the aggregate results with industry, and is using them to determine if there are any significant changes in the risk profile of each life insurer.

PROPERTY AND CASUALTY INSURANCE COMPANIES

The operating results of the property and casualty (P&C) insurance sector have been significantly lower in the past two years compared to immediately preceding years. Net income for the sector in 2009 was $2.5 billion, a negligible increase over the prior year, and still not recovered to pre-2008 levels. The major underwriting challenges have been in the personal lines — personal auto, in particular Ontario-Auto and personal property.

Industry return on equity was 7.6%, a reduction from 8% in 2008 and well down from the 16% recorded in 2007.

On the positive side in 2009, investment income — a major contributor to net income — generated approximately $3.3 billion in earnings. The partial recovery of equity markets and the continued low interest rate environment contributed a further $1.7 billion in unrealized investment gains and served to strengthen capital.



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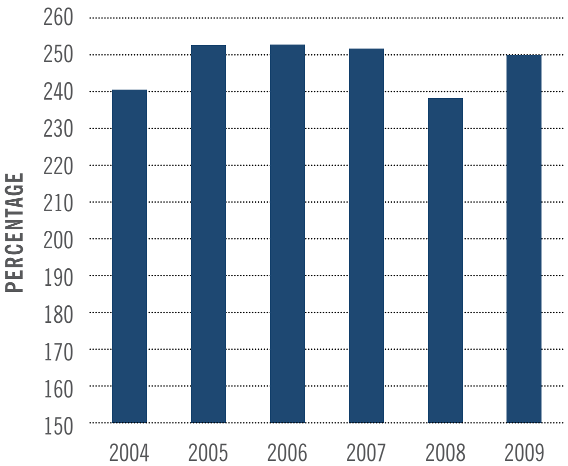
The P&C industry continues to be adequately capitalized in Canada. The results of 2009 operations continued to support strong Minimum Capital Test (MCT) results for Canadian companies and Branch Adequacy of Assets Test (BAAT) results for foreign companies. The 2009 combined MCT/BAAT ratio for the industry was 250% — an increase of 12 % from 2008 and well in excess of OSFI's minimum supervisory target of 150%. *(See figure 6)*

A principle measure of profitability for the industry is the 'combined ratio' which measures total claims

P&C Insurance Companies: MCT/BAAT Ratios

FIGURE 6



The 2009 combined MCT/BAAT ratio for the industry was 250% — an increase of 12% from 2008 and well in excess of OSFI's capital target of 150%.

(and associated insurance expenses) divided by premium income. A result under 100% indicates that premium income exceeds claims expenses (before investment returns). In 2009, the combined ratio remained steady at 100%, after rising 9% the previous year. This is essentially a breakeven point for underwriting results that compares unfavourably to combined ratios in the low 90% range for the three years preceding 2008.

Looking ahead, prospects for regaining and sustaining profitability vary according to the characteristics of individual product lines of the P&C industry. The largest market segment is automobile insurance. Provinces legislate coverage provisions for automobile insurance lines, and approve premium rates according to varying classification systems.

Generally, automobile insurance claims had been increasing in most provinces for the past few years. The largest market, Ontario, has experienced worsening profitability results for several years. At the end of 2009, the Government of Ontario introduced automobile reform measures scheduled to take force in September 2010, in an effort to address the worsening claims experience and the issue of rising automobile insurance premiums. The declining earnings trend that began in 2006 is anticipated to continue in 2010 as Ontario auto claims inflation is expected to continue to outpace premium growth, and the impact of the mandatory auto reforms will not be felt until late in the year.

Legal challenges have been heard in two provinces (Alberta and Nova Scotia) to overturn those provinces' caps on minor injury awards resulting from automobile accidents. Neither challenge was successful in Appeal Courts.

Personal property (generally homeowners') insurance has experienced significant declines in profitability for several years. Closely correlated to the worsening combined ratios has been the increased frequency of severe, regional storm activity. While the weather during 2009–2010 in much of Canada was benign, this could quickly change.

SUPERVISORY TOOLS

MANAGING RISK EFFECTIVELY

OSFI's risk-based supervisory framework, in use for over 10 years, supports our ability to identify and assess risk consistently across multiple institutions. It also supports and promotes timeliness in risk identification and intervention when a financial institution's practices are imprudent or unsafe.

The framework assesses an institution's inherent business risks, risk management processes and financial condition. Where appropriate, OSFI uses the work of an institution's oversight functions, and relies on the work of the institution's external auditor and appointed actuary, to ensure that suitable risk management practices and processes are operational. This allows OSFI to focus our own resources on reviewing areas of an institution that are likely to have a material impact on its safety and soundness. Over time, OSFI has adjusted how the supervisory framework is applied based on experience in using it.

In 2009–2010, we began a process to assess it more broadly and refine it further as appropriate.

In 2008–2009, OSFI introduced annual risk management sessions with various industry segments to reinforce the need for strong risk management and to share lessons learned. The goal is to communicate OSFI's expectations related to key risk management areas based on detailed work OSFI has undertaken during the year, and to share information on issues being discussed internationally by regulators. The seminars also provide participants with the opportunity to ask questions of OSFI's senior supervisory and regulatory teams. In 2009–2010, these seminars were expanded to the life and P&C insurance sectors.

[Risk management] seminars were expanded to the life and P&C insurance sectors.

Continuing the practice of organizing Colleges of Supervisors, in 2009–2010 OSFI hosted a college for each of two of the big five Canadian banks, in line with FSB recommendations, which brought executives from each bank together with supervisors from several jurisdictions where they do business.

OSFI established an Emerging Risk Committee (ERC) in 2007–2008 that has proven to be an effective mechanism across all industry sectors. The committee has strengthened our early identification and tracking of developments or events that might have a serious impact on, or indicate a future hazard for, FRFIs. In 2009–2010, OSFI enhanced the operations of the committee by developing a market risk indicator dash board, as a further step in the evolution of this process. The ERC met regularly to review key market indicators and identify any additional supervisory work needed to assess the risks and impacts to financial institutions.

COMPOSITE RISK RATINGS

The Composite Risk Rating (CRR) represents OSFI's overall assessment of an institution's safety and soundness. The CRR is guided by a set of assessment criteria that were developed in consultation with the industry. There are four ratings for Composite Risk: 'low', 'moderate', 'above average' and 'high' risk. The CRR is reported to most institutions at least once a year (certain inactive or voluntary wind-up institutions may not be rated). The confidentiality of these ratings is protected by regulation.

As at the end of March 2010, OSFI assigned a low or moderate CRR to 88% of all rated institutions and rated 12% (48 financial institutions) as either above average or high risk (compared to 89% and 11% as at March 31, 2009).

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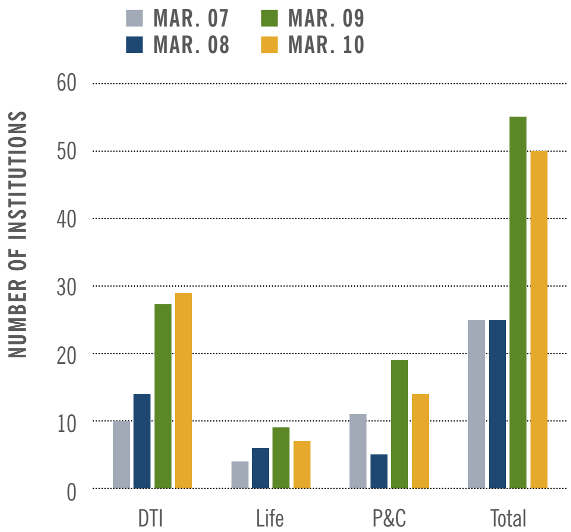
INTERVENTION RATINGS

Financial institutions are also assigned an intervention rating, as described in OSFI's guides to intervention for federally regulated financial institutions, which determines the degree of supervisory attention they receive. Broadly, these ratings are categorized as: normal (stage 0); 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).

As at March 31, 2010, there were 50 staged institutions. *(See figure 7)* With a few exceptions, the majority of the staged institutions were in the early warning (stage 1) category. While the number of staged institutions has decreased by six from a year ago, the number remains higher than two years ago, notably in the DTI and P&C industries.

Number of Staged Institutions

FIGURE 7



In 2009–2010, the number of staged institutions declined slightly overall with the majority being in the early warning category.

Financial Institutions Regulated by OSFI

FIGURE 8

	Number[1]	Assets[2, 3] ($ Millions)
Banks		
Domestic	22	2,662,874
Foreign Bank Subsidiaries	25	145,302
Foreign Bank Branches	30	65,434
Trust and Loan Companies		
Bank-owned	30	243,074
Other	36	52,510
Cooperative Credit Associations	6	23,360
Cooperative Retail Association	1	3,735
Life Insurance Companies		
Canadian-incorporated	45	484,425
Foreign Branches	39	14,483
Fraternal Benefit Societies		
Canadian-incorporated	10	6,642
Foreign Branches	7	2,064
Property and Casualty Insurance Companies		
Canadian-incorporated	95	89,950
Foreign Branches	92	33,686

[1] Number of regulated companies as at March 31, 2010. 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 under "Who We Regulate".

[2] As at January 31 or March 31, 2010 (depending on fiscal year-end) where available, otherwise December 31, 2009.

[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.

RULE MAKING

OSFI provides a regulatory framework of guidance and rules that meets or exceeds international minimums for financial institutions. In addition to issuing guidance, OSFI provides input into federal legislation and regulations affecting financial institutions; comments on accounting, auditing and actuarial standard developments and determines how to incorporate them into or regulatory framework; and is involved in a number of international and domestic rule-making activities.

During 2009–2010, OSFI continued to promote sound risk management practices through its rule-making activities. As the International Monetary Fund noted in its March 2009 assessment of member countries, Canada's strong regulatory and supervisory framework was one of the factors responsible for the resilience of our banking system compared to global competitors during the financial turmoil of the past few years.

DOMESTIC RULE MAKING

REVISIONS TO FINANCIAL INSTITUTIONS LEGISLATION

The governing statutes applicable to federally regulated financial institutions (FRFIs) are reviewed regularly to ensure they remain current and promote an efficient, competitive and prudent financial services sector. *An Act to amend the law governing financial institutions and to provide for related and consequential matters* received Royal Assent in March 2007. OSFI continued to work with the Department of Finance in 2009–2010 to develop regulations required for the implementation of various measures in the Act, particularly those in respect of Part XIII of the *Insurance Companies Act*, which deals with foreign insurance companies.

COLLABORATION WITH CANADIAN STANDARD SETTERS

Through direct and indirect (e.g., Basel Committee Accounting Task Force) collaboration with Canadian standard setters and the International Accounting Standards Board, we work to understand and influence international accounting rules that may apply to Canadian financial institutions.

OSFI works closely with the Canadian Institute of Actuaries (CIA) and the Actuarial Standards Board to ensure that actuarial standards are appropriate and lead to acceptable practice in areas such as valuation, risk and capital assessment, as these topics relate to entities regulated by OSFI. In 2009–2010, OSFI continued to participate on several CIA practice committees.

OSFI maintains a strong cooperative relationship with the Canadian Accounting Standards Board (AcSB). During 2009–2010, OSFI worked closely with staff at AcSB, including on issues related to the adoption of International Financial Reporting Standards (IFRS) by 2011. OSFI will continue to work with AcSB staff on this initiative, which will result in fundamental changes to financial reporting by FRFIs. OSFI also participated in a Canadian

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Institute of Chartered Accountants Task Force to review auditing guidelines AuG-43 — Audit of policy liabilities of insurance companies, and AuG-29 — Audit of employee future benefits — defined benefit plans.

OSFI is a member of the AcSB's User Advisory Council, Insurance Accounting Task Force and the IFRS Advisory Committee. OSFI collaborated with the Auditing and Assurance Standards Board, and was represented on the Auditing and Assurance Standards Oversight Council and the Accounting Standards Oversight Council.

CAPITAL GUIDANCE

BANKS AND TRUST AND LOAN COMPANIES — CAPITAL ADEQUACY REQUIREMENTS

During 2009–2010, OSFI released two Advisories related to the measurement of capital and capital adequacy of banks and trust and loan companies:

- *Capital Treatment of Reverse Mortgages* (May 2009)
- *Capital Treatment of Computer Software Intangibles* (October 2009)

In December 2009, OSFI issued a *Stress Testing Guideline* applicable to all federally regulated entities.[5] The guideline reflects developing international standards that emphasize the importance of stress testing for senior management in making business strategy, risk management and capital management decisions.

LIFE INSURANCE COMPANIES

OSFI undertook its annual update of the Minimum Continuing Capital and Surplus Requirements (MCCSR) guideline in the fall of 2009, with the revised version coming into effect for the 2010 fiscal year. Many of the updates — the most important of which relate to the capital treatment of unregistered reinsurance — were necessary due to the coming into force of the revised interpretation of Part XIII of the *Insurance Companies Act*.

OSFI is developing a new framework for the standardized MCCSR approach with the help of the Autorité des marchés financiers (AMF) and Assuris. This responds to the anticipated move to international accounting standards (IFRS – Phase II) that is expected to modify the principles for determining insurance liabilities.

Accordingly, during 2009–2010, OSFI and the life insurance industry discussed how to update the existing approach to measuring life insurance regulatory capital requirements. OSFI conducted a Quantitative Impact Study (QIS) to evaluate the impact of proposed modifications to the MCCSR's standard approach and, by the end of March 2010, was completing analysis of the results in order to recalibrate our proposed modifications, if necessary. Another QIS is scheduled for 2010–2011 to obtain further data on the impact of proposed MCCSR modifications.

OSFI worked through the MCCSR Advisory Committee (MAC) to develop and — with respect to segregated fund guarantees — incorporate more advanced risk measurement techniques (such as internal company models) into the MCCSR. The MAC is composed of representatives from the Canadian Life and Health Insurance Association, the Canadian Institute of Actuaries, Assuris, the AMF and OSFI. In 2009, the MAC focused on improving the existing framework for the use of internal models to determine capital requirements for segregated fund guarantees; this included undertaking a benchmark study and a comparative study of different practices used by Canadian companies in such internal models.

OSFI issued a Stress Testing Guideline applicable to all federally regulated entities… [that] reflects developing international standards.

PROPERTY AND CASUALTY INSURANCE COMPANIES

OSFI started discussions with property and casualty (P&C) insurers in 2008–2009 in response to an expression of interest from the industry regarding the use of models-based approaches to risk measurement. A P&C Minimum Capital Test (MCT) Advisory Committee was formed to facilitate these discussions. The committee consists of representatives from OSFI, the Québec and British Columbia regulators, the Insurance Bureau of Canada (IBC), the Property and Casualty Insurance Compensation Corporation, the Canadian Council of Insurance Regulators and several insurance companies.

[5] Federally regulated entities is a broader category than FRFIs and includes banks, foreign bank branches, bank holding companies, federally regulated trust and loan companies, cooperative credit associations, life insurance companies, foreign insurance companies, fraternal benefit societies, property and casualty insurance companies, and insurance holding companies.

In July 2009, the MCT Advisory Committee developed and proposed a set of high level key principles to guide the development of a new capital framework for property and casualty insurers. OSFI published the *Key Principles for the Future Direction of the Canadian Regulatory Capital Framework for Property & Casualty (P&C) Insurance* for comment. The MCT Advisory Committee revised the principles after reviewing the comments received and submitted them to OSFI and the AMF. OSFI endorsed the key principles and posted them on its Web site in January 2010.

As the MCT Advisory Committee completes its work, OSFI will follow its normal public consultation and approval process before any changes are made to the framework. An important collateral benefit of this work will be stronger conceptual and analytical bases.

Following a January 2009 submission from the IBC, OSFI started developing a new capital framework for its standardized MCT approach with the objective of improving the fairness, effectiveness and efficiency of the MCT/BAAT. This was an opportune moment to also implement some changes to the MCT/BAAT to bring greater consistency with the life insurance and banking industries. These initiatives are in keeping with OSFI's long-term plans and priorities to ensure the MCT/BAAT better reflect risks in the P&C insurance industry, through more sensitive and forward looking risk management techniques.

OTHER GUIDANCE

IFRS

During 2009–2010, OSFI addressed policy and reporting implications for federally regulated entities of moving to IFRS, holding numerous discussions early in the year with industry, auditors, standard setters and other stakeholders. The result was a Draft Advisory on the *Conversion to International Financial Reporting Standards (IFRSs) by Federally Regulated Entities (FREs)* issued in October 2009 for industry comments, which OSFI reviewed and took into consideration in the Final Advisory issued in March 2010.

The Advisory outlines OSFI's expectation and requirements for the implementation of IFRS, as well as additional requirements for filing IFRS progress reports and the first quarter regulatory financial returns filed with OSFI under IFRS. These positions in accounting and capital are instrumental to managing the transition to IFRS as the industry approaches conversion in 2011. (For more on IFRS see later section of Rule Making on Changes to International Accounting and Auditing Standards.)

OSFI addressed policy and reporting implications for federally regulated entities of moving to IFRS, holding numerous discussions… with industry, auditors, standard setters and other stakeholders.

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[R] **Julie Thomson**
Practices Specialist, Regulatory and Supervisory Practices Division, Supervision Sector

REINSURANCE INITIATIVES

Following a comprehensive assessment of comments received about OSFI's December 2008 discussion paper on reinsurance, OSFI issued a follow-up response paper in March 2010, *Reforming OSFI's Regulatory and Supervisory Regime for Reinsurance*, which finalizes our approach to this issue. The response paper outlines policy decisions and impending reforms to OSFI's reinsurance regulatory and supervisory framework, articulates the rationale for these decisions, and sets out a timetable for implementation. These reforms will provide the insurance industry with added flexibility, particularly in the area of limits on unregistered reinsurance, once compensating safeguards (such as additional guidance) are in place.

ANTI-MONEY LAUNDERING AND ANTI-TERRORISM FINANCING ACTIVITIES (AML/ATF)

The ability of criminals and criminal organizations to use financial institutions to launder the proceeds of crime — along with the potential risk to such institutions' reputations and their ultimate safety and soundness — continues to be a concern to governments and financial regulators around the world. Robust AML/ATF programs are critical to Canada's financial sector.

During 2009–2010, OSFI focused its AML/ATF assessment program on the conglomerate banking sector and found noticeable differences among institutions' development of AML/ATF programs. Although some conglomerate banks have made satisfactory progress in developing their programs, others require more work. OSFI intervened to ensure that conglomerate banks identified and addressed any weaknesses and deficiencies. OSFI continued to share assessment findings with the Financial Transactions and Reports Analysis Centre of Canada (FINTRAC) under its joint Memorandum of Understanding.

OSFI played an active role in the work of the Financial Action Task Force (FATF), which is the inter-governmental policy-making body that develops and promotes national and international standards to combat money laundering and terrorism financing. In 2009–2010, in response to the G-20 Leaders summit, the FATF introduced a process to identify jurisdictions around the world with strategic deficiencies in their AML/ATF regimes. In addition, the FATF is studying possible improvements to its AML/ATF standards for implementation in the next round of mutual evaluations of FATF members. OSFI is also a member of the Public/Private Sector Advisory Committee established by the Department of Finance to discuss Canada's AML/ATF regime on an ongoing basis.

INTERNATIONAL ACTIVITIES

International organizations play a key role in the development of regulatory frameworks for banks and, increasingly, insurers. In 2009–2010, OSFI participated in the development of appropriate rules that can be applied internationally. While the Canadian financial system continues to benefit from approaches taken in Canada, the global marketplace has gone through a period of severe stress from which it has not fully recovered. As a result, international regulatory reform is at the top of the agenda for the G-20. OSFI played a key role in encouraging the development of international rules that balance safety and soundness with the need for financial institutions to be able to compete effectively and on a level playing field.

A number of Canadian financial institutions continued to be active internationally and, in some cases, this represents a material and increasing portion of their business.

Although some curtailment of activity has been noted due to adverse market conditions, international financial institutions continue to be active in Canada through branches and subsidiaries, with more than 200 foreign banks and insurance companies operating in Canada.

OSFI strengthened relationships with foreign supervisors by participating in international rule-making discussions, participating in and hosting several international supervisory colleges, and developing information-sharing agreements with a number of host-country supervisory authorities that regulate significant foreign operations of Canadian banks and insurers. In 2009–2010, OSFI finalized agreements with Michigan, Barbados and Thailand, bringing the total of completed agreements to more than 30. OSFI will work to negotiate additional agreements, as they lead to improved coordination of supervisory work between home and host supervisors.

BASEL COMMITTEE ON BANKING SUPERVISION

The Basel Committee on Banking Supervision (BCBS) provides a forum for rule making and cooperation on banking supervisory matters. OSFI is an active member and participates in the following three main activity streams:

The Standards Implementation Group (SIG) allows supervisors to share information and monitor the implementation of standards previously agreed to by members of the BCBS.

The Accounting Task Force (ATF) works to ensure that international accounting and auditing standards and practices promote sound risk management at financial institutions, support market discipline through transparency, and reinforce the safety and soundness of the banking system.

The Policy Development Group (PDG) supports the BCBS by identifying and reviewing emerging supervisory issues and, where appropriate, proposing and developing policies that promote a sound banking system and high supervisory standards. The PDG directs substantive analysis of issues through its various subcommittees and working groups such as the Trading Book Group, Working Group on Liquidity, Definition of Capital Group, Research Task Force, Capital Monitoring Group, Risk Management and Modelling Group (currently chaired by OSFI), and others.

In July 2009, the BCBS published major reforms to the capital rules for market risk, *Revisions to the Basel II Market Risk Framework*, and for securitization, *Enhancements to the Basel II Framework*. In December 2009, the Committee issued a broad ranging set of proposals for strengthening the resiliency of the banking sector that have the potential to significantly influence the way capital adequacy and liquidity are measured, namely *Strengthening the resilience of the banking sector — consultative document*, and *International framework for liquidity risk measurement, standards and monitoring — consultative document*. OSFI played an active role in the development of the proposals and, in 2010–2011, will participate in a quantitative impact study and multiple work streams of additional research and consultation to fairly represent the Canadian experience in the design of the final proposals, which are planned for release by the end of 2010 and implementation by the end of 2012.

OSFI also worked actively with other BCBS members throughout 2009–2010 to develop and issue new rules for sound risk management and capital regulation, including proposing a loan provisioning model (discussions on the model continue). In addition to those mentioned above, significant BCBS pronouncements developed with OSFI involvement included:

- *Compensation Principles and Standards Assessment Methodology*
- *Supervisory guidance for assessing banks' financial instrument fair value practices — final paper*
- *Guiding principles for the revision of accounting standards for financial instruments issued by the Basel Committee*
- *Report and recommendations of the Cross-border Bank Resolution Group — final paper*

More information on these important initiatives and plans for their implementation can be found on the BIS Web site under BCBS.

CHANGES TO INTERNATIONAL ACCOUNTING AND AUDITING STANDARDS

The Canadian Accounting Standards Board (AcSB) has decided to adopt International Financial Reporting Standards (IFRS) by 2011 as the basis for financial reporting by publicly accountable entities in Canada. Also, the Canadian Auditing and Assurance Standards Board (AASB) decided to adopt International Standards on Auditing (ISAs) as Canadian Auditing Standards (CASs) for the audits of financial statements for periods ending on or after December 14, 2010. OSFI responded to International Accounting Standards Board (IASB) and International Auditing and Assurance Standards Board (IAASB) projects through active participation in the Accounting Task Force (ATF) of the BCBS and the Accounting and Insurance Contracts Subcommittees of the International Association of Insurance Supervisors (IAIS).

In 2009–2010, as part of its work on the ATF, OSFI participated in the Basel Committee comment letters to, and discussions with, the IASB and IAASB on key accounting and auditing standard setting initiatives, including:

- Financial Instruments (IAS 39 replacement) – classification and measurement and impairment
- Fair value measurement
- Consolidated Financial Statements
- De-recognition
- Financial Statement Presentation
- Instruments with Characteristics of Equity
- Revenue Recognition
- Auditing Complex Financial Instruments

Active participation in the discussion and development of these standards promotes and supports a set of high quality global standards and enhances our understanding of key IFRS and IASs that impact federally regulated entities (FREs).

Throughout 2009–2010, OSFI conducted extensive consultations with FREs regarding the effects of adopting IFRS, so as to work towards a smooth implementation. OSFI hosted IFRS industry forums for deposit-taking institutions, life insurance companies, and property and casualty companies. The forums featured an open session for dialogue and discussion on the impact of IFRS on accounting and regulatory capital policies, as well as expectations of FREs on IFRS implementation and consequential reporting changes. These forums also offered participants an opportunity to ask specific questions on OSFI's Draft Advisory on *Conversion to IFRSs by FREs* issued for comment in October 2009 (details provided earlier under Other Guidance). Ongoing communication between OSFI and the industry provided additional clarity on OSFI positions and enhanced awareness of issues relating to IFRS.

The conversion to IFRS presents various unique external and internal risks that require active management by institutions. During 2009–2010, OSFI's annual Risk Management seminars for various industry sectors highlighted these key risks.

Through discussions with industry organizations (such as the Canadian Bankers Association, CLHIA and IBC) and through IFRS progress reports submitted by FREs, OSFI continues to monitor the status of implementation plans, assess impacts and assess industry readiness for the changeover dates at the end of 2010 or in 2011. There were also education sessions for OSFI's IFRS project team members and internal stakeholders.

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INTERNATIONAL ASSOCIATION OF INSURANCE SUPERVISORS

OSFI actively participates in the work of the International Association of Insurance Supervisors (IAIS), which represents insurance regulators and supervisors of some 140 countries. Its objectives are to contribute to the improved supervision of the insurance industry for the protection of policyholders worldwide, to promote the development of well-regulated insurance markets and to contribute to global financial stability. OSFI is a member of the Executive, Technical and Budget Committees, and several subcommittees.

In 2009–2010, OSFI contributed to the development of IAIS standards and/or guidance papers on:

- Standard on valuation of assets and liabilities for solvency purposes
- Guidance paper on treatment of non-regulated entities in group-wide supervision
- Standard on cross-border cooperation on crisis management
- Standard and Guidance on the structure of capital resources for solvency purposes
- Guidance on the use of Supervisory Colleges

OSFI also participated in the preparation of a paper on systemic risk in the insurance sector (IAIS position paper on key financial stability issues), which responded to requests from the G-20 and the Financial Stability Board.

In 2010, the IAIS will start work on the development of a solvency and supervisory framework for internationally active insurance groups. OSFI will play a significant role in the development of this framework.

In addition, through the Accounting and Insurance Contracts Subcommittees, OSFI contributed to development of comment letters from the IAIS to the IASB on various IFRS exposure drafts and also with respect to the IASB project to develop a comprehensive insurance contracts accounting standard (Phase II project).

JOINT FORUM

The Joint Forum, established in 1996 by the BCBS, the IAIS and the International Organization of Securities Commissions, works to achieve consistency of supervisory approaches on issues of common interest across financial sectors and national borders.

During 2009–2010, OSFI continued its active membership in the Joint Forum, including participation in two work streams: 1) the differentiated nature and scope of regulation and 2) risk aggregation.

The first work stream resulted in a report entitled *Review of the Differentiated Nature and Scope of Financial Regulation – Key Issues and Recommendations,* released in January 2010. Key recommendations of importance to OSFI addressed the need to strengthen the supervision and regulation of financial groups as well as the need to reduce key regulatory differences across the banking, securities and insurance sectors (e.g., similar risks should receive similar treatment, regardless of the sector).

The second work stream resulted in a draft report entitled "Developments in Modeling Risk Aggregation," to be published in 2010–2011. This report addresses current methods being used by firms and regulators to aggregate risk, and the ways in which firms and regulators achieve confidence that aggregation methods perform as anticipated under a wide range of conditions; it also suggests potential improvements for risk aggregation by firms and supervisors.

OSFI continued its involvement with a number of other international groups during 2009–2010, including the Integrated Financial Supervisors, the Association of Supervisors of Banks of the Americas, the International Actuarial Association, and le Groupe des superviseurs bancaires francophones. Going forward, OSFI is reviewing its full participation in these organizations, due to budget restraints.

DISCLOSURE OF INFORMATION

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

OSFI promotes effective disclosure by: publishing selected financial information on OSFI's Web site and through Beyond 20/20 Inc. (see their Web site for more information); providing guidance to institutions on their disclosures; and participating in international supervisory groups with similar objectives.

DISCLOSURE ASSOCIATED WITH THE FINANCIAL CRISIS

Emerging from the global financial crisis is a heightened sense of awareness of areas of risk. Sound disclosure is essential to achieving transparency, maintaining market confidence and promoting effective market discipline. The Financial Stability Board (FSB), which comprises senior representatives of national financial authorities (central banks, regulatory and supervisory authorities, and ministries of finance), international financial institutions, standard setting bodies, and committees of central bank experts, has promoted the importance of transparency in the financial sector.

Since the global financial crisis began, OSFI has monitored the FSB disclosure requirements of Canadian banks that had significant exposures to off-balance sheet vehicles, securitizations and other financial products associated with the crisis. Canadian banks continue to comply in all material respects with disclosure requirements.

In July 2009, the Basel Committee on Banking Supervision (BCBS) issued *Enhancements to the Basel II Framework* and *Revisions to the Basel II Market Risk Framework*, which includes Pillar 1 enhancements and enhancements to existing Pillar 3 guidance to strengthen disclosure requirements related to: securitization exposures in the trading book, sponsorship of off-balance sheet vehicles and trading activities. The implementation date is December 31, 2010. OSFI is committed to improving disclosures in these areas and continues to support these initiatives through its membership in the BCBS.

The International Accounting Standards Board (IASB) continues to improve the accounting and disclosure standards. As an active member in the Accounting Task Force (ATF) of the BCBS, OSFI participates in the work to improve disclosures in financial reporting under international standards.

APPROVALS

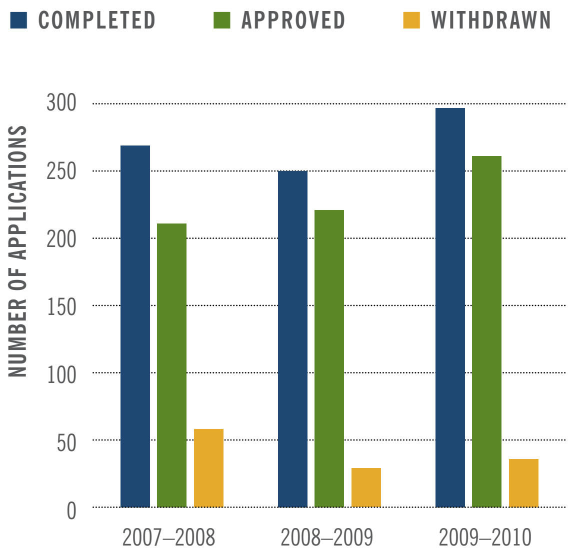
Federally regulated financial institutions (FRFIs) that wish to carry out certain transactions or business undertakings, persons wishing to incorporate a FRFI, and foreign banks or foreign insurance companies wishing to establish a presence or to make certain investments in Canada are all required to seek regulatory approval (depending on the legislative provision) from the Minister of Finance, acting on the advice of OSFI, or from the Superintendent of Financial Institutions. OSFI administers a regulatory approval process that is prudentially effective, balanced, responsive, clear and transparent, and when appropriate, innovative. OSFI's Approvals team strives to ensure that its recommendations to the Minister and the Superintendent are in the best interest of Canadians and the Canadian financial sector.

During 2009–2010, the financial crisis continued to have an affect on OSFI's approval process. The state of the global economy, the 2011 implementation of International Financial Reporting Standards, impending changes to international capital requirements and the requirement for internal capital adequacy assessments have increased the processing time and complexity of many approvals. Despite these challenges, in 2009–2010, OSFI made every effort so that applicants were not impeded from following viable business strategies, and that requests for regulatory approvals were processed on a consistent and timely basis.

In 2009–2010, OSFI processed 297 applications involving 523 approvals (individual applications often contain multiple approval requests), of which 28% were Ministerial approvals. Of these, 261 applications were approved and 36 were withdrawn at the request of the applicant. This represents a 19% increase in applications over the previous year when 250 applications involving 551 approvals were processed. As with previous years, OSFI spent a considerable amount of time on applications relating to corporate restructurings and reorganizations, changes of ownership, and the establishment of new federal financial institutions. *(See figures 9 and 10)*

3-Year Comparison of Completed, Approved and Withdrawn Applications*

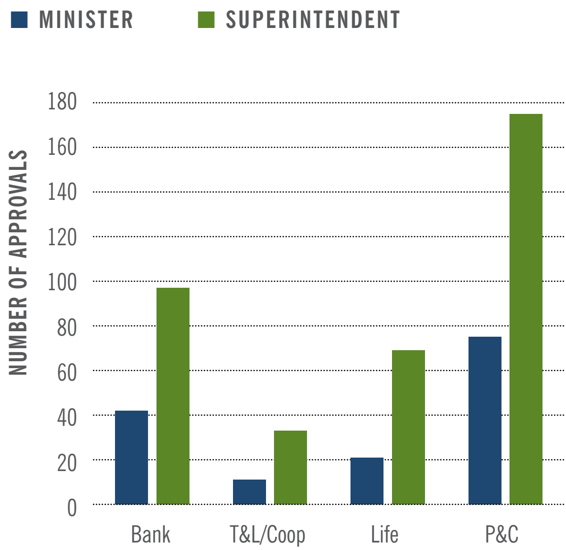
FIGURE 9



* An application may involve multiple approvals

Approvals by Industry Sector 2009–2010

FIGURE 10



In 2009–2010, applications increased by 19% over the previous year. OSFI processed 297 applications involving 523 approvals, of which 28% were Ministerial approvals. Of these, 261 applications were approved and 36 withdrawn.

During 2009–2010, there were 10 new entrants: one domestic bank, one foreign bank subsidiary, two full-service foreign bank branches, one life insurance company, and five foreign property and casualty (P&C) insurance branches. At March 31, 2010, there were 20 ongoing applications for new entrants: seven domestic banks, three foreign bank subsidiaries, four trust companies, one life insurance company, one P&C company and four foreign P&C branches.

This past year saw an exceptionally high level of life and P&C insurance exits compared to 2008–2009. This change is largely attributable to foreign insurers which had placed their Canadian insurance operations in run-off a number of years ago and were finally in a position to meet the requirements for the release of their assets in Canada. *(See figure 11)*

Upon request, OSFI provides advance capital confirmations on the eligibility of proposed capital instruments. A total of 35 such opinions and validations were provided in 2009–2010, compared to 95 the previous year. The number of capital confirmations had more than doubled in 2008–2009, primarily due to an increase in capital raising activity by FRFIs. The number of confirmations in 2009–2010 moved closer to long-term averages.

FRFI Entry, Exit and Ongoing* New Entry and Exit Applications 2009–2010

FIGURE 11

		Entry	Ongoing Entry	Exit	Ongoing Exit
Bank	– Schedule I	1	7		
	– Schedule II	1	3		
	– Schedule III	2		2	1
Trust & Loan			4		
Life	– Canadian	1	1	2	1
	– Foreign			7	1
P&C	– Canadian		1		
	– Foreign	5	4	9	1
TOTAL		10	20	20	4

*Applications in progress at the end of 2009–2010

In 2009–2010, there were 10 new entrants and an exceptionally high level of life and P&C insurance exits.

GUIDANCE AND EDUCATION

In keeping with objectives of enhancing the transparency of OSFI's legislative approvals process and of promoting better understanding of our interpretation of the federal financial institution statutes, OSFI develops and publishes Advisories and Rulings. In 2009–2010, OSFI published the Ruling *Business and Powers – Insurance Promotion on a Bank's Website*.

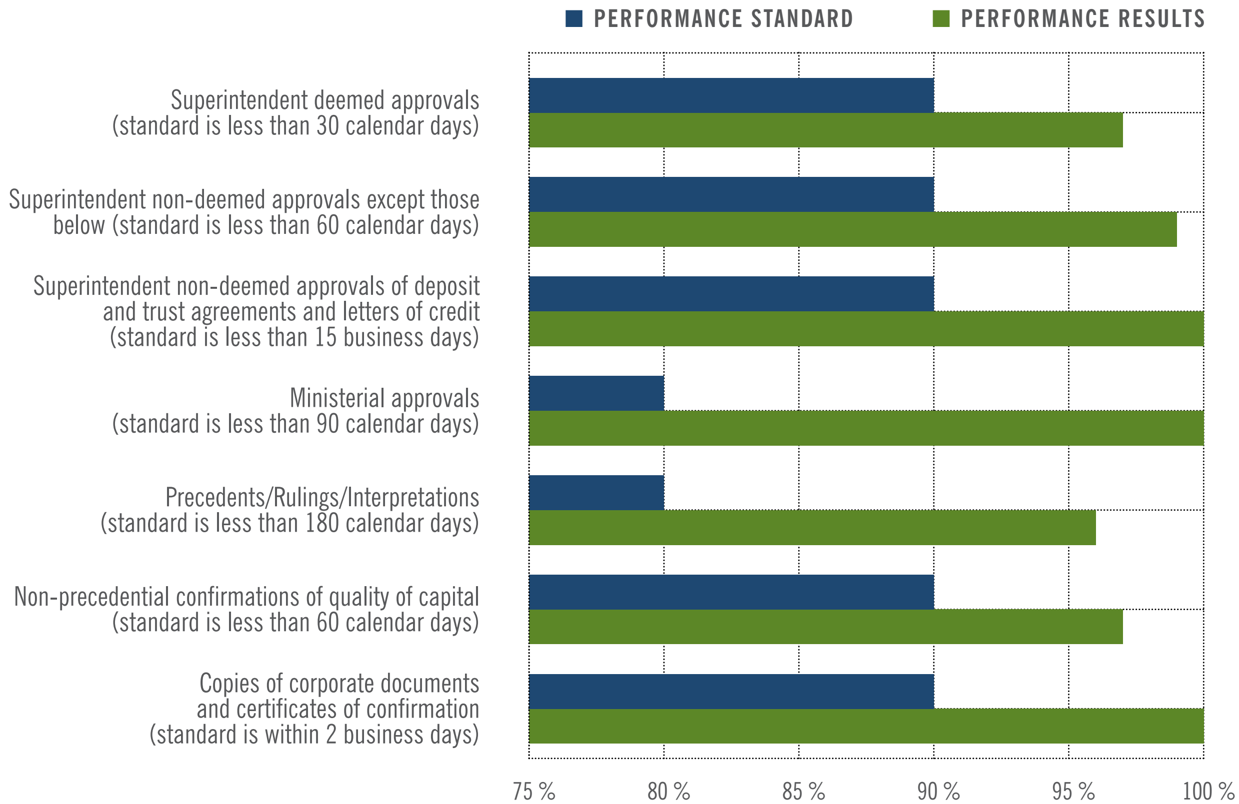
In 2009–2010, OSFI spent a considerable amount of time dealing with technical issues related to the insuring in Canada of risks by foreign insurance companies under the "Foreign Companies" part of the *Insurance Companies Act*. In May 2009, OSFI released the Advisory *Insurance in Canada of Risks*, in an effort to provide greater certainty on circumstances where OSFI will consider that a foreign entity has insured in Canada risks. Legislative matters relating to the classes of insurance, permitted activities in Canada by domestic and foreign entities, and self-dealing transactions were also addressed frequently during the past year.

As part of ongoing communication with stakeholders, OSFI hosted its eighth annual Legislation and Approvals Seminar in October 2009, attended by approximately 130 representatives of financial institutions and professional advisors.

In keeping with OSFI's and the Government of Canada's commitment to enhance accountability and transparency relating to services provided, OSFI has performance standards establishing time frames for processing applications for regulatory approval and for other services. In 2009–2010, OSFI met or exceeded all of these standards. (*See figure 12*) More information on OSFI's performance standards can be found on our Web site under Banks / User Fees / OSFI Service Standards.

OSFI Performance against User Fee Service Standards 2009–2010

FIGURE 12



In 2009–2010, OSFI met or exceeded all its performance standards for approvals and related services.

FEDERALLY REGULATED PRIVATE PENSION PLANS

OSFI conducts risk assessments of pension plans covering employees in federally regulated areas of employment; provides timely and effective intervention and feedback; employs a balanced relevant regulatory framework; and manages a prudentially effective and responsive approvals process.

PRIVATE PENSION ENVIRONMENT

Financial challenges continued throughout 2009 for private pension plans, along with intensive public debate about retirement income issues. Going into 2010, markets recovered some of their 2008 losses, but long-term interest rates remained low. Nevertheless, at year-end 2009, the solvency position of federally regulated defined benefit pension plans had improved modestly from the record lows of year-end 2008.

The global financial market turmoil of 2008 and economic slowdown that followed drew attention to the pressures on pension plans in a volatile environment. The Government of Canada responded with both temporary funding relief for defined benefit plans and a country-wide consultation on enhancing the legislative and regulatory framework for federally regulated private pension plans. This consultation led to the October 2009 announcement of reforms to the framework, and the subsequent tabling in Parliament of a number of amendments to the *Pension Benefits Standards Act*, 1985 (PBSA) in late March 2010.

Continuing uncertainty in the environment highlighted the importance of effective risk management by pension plan administrators. Accordingly, in 2009 OSFI surveyed a number of pension plans about their stress testing practices (see *Ad hoc Reviews* later in this chapter).

In an innovative effort to remain responsive to stakeholders, OSFI held its first pension industry forum in Toronto in February 2010. Over 120 plan administrators and other pension professionals attended. Participant evaluation of this forum was both positive and useful, and will help guide future communications with the industry.

MONITORING

As at March 31, 2010, 1,398 private pension plans were registered under the PBSA, covering over 637,000 employees in federally regulated areas of employment, such as banking, inter-provincial transportation and telecommunications. Between April 1, 2009 and March 31, 2010, plan assets increased by 12%, to a value of approximately $123 billion. (*See figure 13*)

OSFI regulates approximately 7% of pension plans in Canada, according to Statistics Canada data as of January 2009. The majority of pension plans in Canada are under provincial regulation, representing 5.4 million employees with total assets of $911 billion.

The most current pension plan financial statements filed during the 12-month period ending March 31, 2010 report that 52% of pension assets are invested in equities, 40% in debt instruments and 8% in diversified and other assets.

Federally Regulated Private Pension Plans by Type (last 4 years)*

FIGURE 13

	2006–2007	2007–2008	2008–2009	2009–2010
Total Plans	**1,332**	**1,350**	**1,379**	**1,398**
Defined Benefit	359	351	349	359
Combination	89	95	98	100
Defined Contribution	884	904	932	939
Total Membership	**582,000**	**594,000**	**612,000**	**637,000**
Defined Benefit	386,000	391,000	357,000	379,000
Combination	98,000	99,000	139,000	137,000
Defined Contribution	98,000	104,000	116,000	121,000
Total Assets	**$ 130 billion**	**$ 132 billion**	**$ 109 billion**	**$ 123 billion**
Defined Benefit	$ 108 billion	$ 109 billion	$ 81 billion	$ 89 billion
Combination	$ 19 billion	$ 19 billion	$ 25 billion	$ 30 billion
Defined Contribution	$ 3 billion	$ 4 billion	$ 3 billion	$ 4 billion

*as at March 31st

As at March 31, 2010, there were 1,398 private pension plans registered under the *Pension Benefits Standards Act*, 1985, covering over 637,000 employees.

On average, private pension plans under federal regulation recorded a 13% return on their investments, a significant improvement on the -16% average return reported in the previous fiscal year.

The average estimated solvency ratio (ratio of assets over liabilities on plan termination basis) for all plans was 0.90 at December 31, 2009 (up from 0.85 at the previous year end). Estimated solvency ratios calculated by OSFI, using data available at year-end 2009, showed that approximately 76% of all defined benefit plans supervised by OSFI were underfunded (an improvement from 83% in 2008), meaning their estimated liabilities exceeded assets, on a plan termination basis. Of particular note, the percentage of plans with an estimated solvency ratio of less than 0.80 (considered materially underfunded) came down from 43% to 15% at year-end 2009.

RISK ASSESSMENT, SUPERVISION AND INTERVENTION

Through 2009–2010, OSFI continued to monitor carefully the condition of private pension plans and, to the extent possible, that of their sponsors, and intervened when necessary to protect promised benefits.

A number of plans faced challenges during 2009–2010. Plans with financially weak sponsors and defined benefit plans with negotiated contributions are particularly vulnerable to funding pressures and volatility. OSFI addressed potentially risky situations in a timely manner, promoted actions that mitigate risks and intervened where appropriate.

OSFI continued initiatives during 2009–2010 to modernize the tools it uses to monitor and supervise pension plans. In particular, the initiative to upgrade the pension supervisory systems that support OSFI's risk assessment framework is well underway and will be implemented over the next few years.

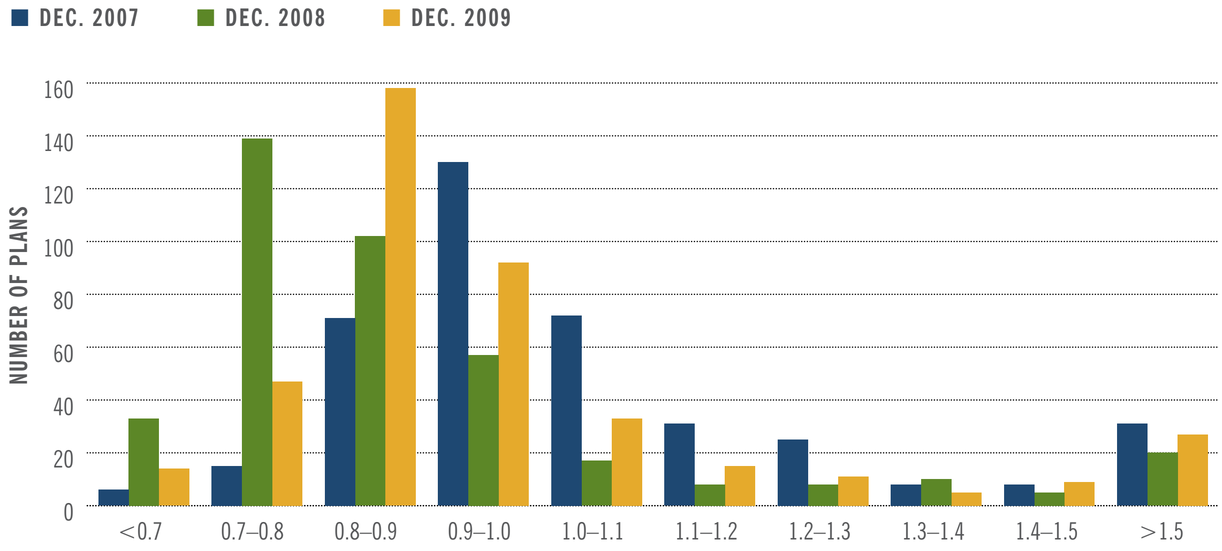
The main pillars of OSFI's risk assessment framework for pension plans are: tiered risk indicators, solvency testing, on-site examinations, the watch list, use of intervention powers and ad hoc reviews.

TIERED RISK INDICATORS

OSFI applies a series of tiered risk indicators that detect risks based primarily on information submitted in regulatory filings; the results are used to identify higher risk plans. In an effort to assess whether further action should be taken, these higher risk plans are subjected to a more detailed analysis by OSFI's

Defined Benefit Plans Estimated Solvency Ratio (ESR) Distribution (past 3 years)*

FIGURE 14



*as at December 31st

> There was a significant decrease in the number of plans with an ESR < 0.8 at the end of December.

pension plan supervisors. In 2009–2010, this analysis affected 19% of plans that submitted regulatory filings.

SOLVENCY TESTING

Early detection of solvency and funding problems is a key element in safeguarding members' benefits. OSFI runs a solvency test on a semi-annual basis to estimate solvency ratios for all defined benefit pension plans. This test provides OSFI with important information, allowing it to intervene earlier in higher-risk pension plans. (*See figure 14*)

Through this testing, OSFI identified underfunded pension plans that were taking contribution holidays. In certain instances, it was OSFI's view that taking a contribution holiday was not prudent. OSFI took action, ranging from requesting plan sponsors to cease contribution holidays, to requiring enhanced notification to members, and/or filing of an early actuarial valuation report to trigger enhanced funding.

ON-SITE EXAMINATIONS

OSFI's risk-based supervisory approach includes on-site examinations of selected pension plans, allowing OSFI to enhance its assessment of both the plan's financial situation and the quality of administration.

OSFI performed a number of on-site examinations during the year, and also completed detailed desk reviews of selected plans. OSFI continued to focus on governance, risk management and disclosure to members — all areas that have generally been identified as requiring more attention from plan administrators.

OSFI remains committed to providing timely information to plan administrators. OSFI set a target of less than 27 working days after an examination wrap-up meeting to issue its findings. OSFI met this target 93% of the time in 2009–2010.

OSFI continued to focus on governance, risk management and disclosure to members.

WATCH LIST

Consistent with a risk-based approach to supervision, OSFI considers the size of the plan's deficit and the sponsor's capacity to fund it. Pension plans that give rise to serious concern, due to their financial condition or for other reasons, are placed on a watch list and actively monitored.

The number of private pension plans on OSFI's watch list increased slightly during 2009–2010 from 74 at the start of the year to 79 at the end of the year. Of these, 66 were defined benefit plans (62 in 2008–2009) and 13 were defined contribution plans (12 in 2008–2009). During the course of 2009–2010, 22 new plans were added to the watch list and 17 were removed, in part due to OSFI's intervention. (*See figure 15*)

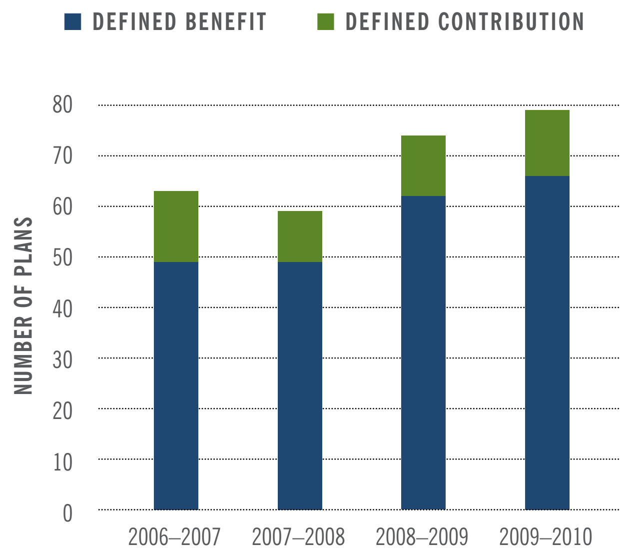
INTERVENTION

OSFI continued to work closely with plan sponsors, administrators, custodians and other stakeholders in order to find reasonable solutions to issues that OSFI believes may jeopardize members' benefits.

In 2009–2010, OSFI intervened with respect to high-risk pension plans, including taking measures to enforce minimum funding requirements and ensure timely remittance of contributions. OSFI also required plans to restrict portability of benefits and used its authority to terminate pension plans, with the objectives of stopping the impairment of the pension fund and providing equitable treatment of all members and beneficiaries in situations where the future of a plan was uncertain.

Watch List Trend by Plan Type (past 4 years)*

FIGURE 15



*as at March 31st

The number of pension plans on OSFI's watch list increased slightly to 79 in the fiscal year 2009–2010 from 74 in 2008–2009.

AD HOC REVIEWS

Periodically, OSFI surveys its pension plans in an effort to better understand how they handle specific issues. Past reviews have included a survey of plans' exposure to asset-backed commercial paper, as well as an assessment of the impact of the market downturn on pension plans.

In 2009–2010, OSFI surveyed selected pension plans regarding their use of stress testing. Over 67% of plans surveyed perform some kind of stress testing. These plans identified a range of reasons for this testing, which included supporting their review of funding policies, asset mix, benefit levels and monitoring risks, and determining whether an actuarial report should be filed. OSFI will continue to encourage the use of stress testing.

RULES AND GUIDANCE

Over the past year, a number of changes to the regulatory and guidance framework were introduced. In June 2009, the Government of Canada enacted temporary solvency funding relief regulations for defined benefit pension plans in respect of 2008 deficiencies. Almost 80 pension plans took advantage of these regulations.

As noted earlier, the Government of Canada tabled legislative changes to the PBSA in late March 2010. OSFI supported their efforts to bring some of the regulatory changes into effect in time for the filing of year-end 2009 regulatory returns.

In 2009–2010, OSFI continued to promote responsible pension plan governance and actuarial practices by working closely with the Canadian Institute of Actuaries (CIA) and the Canadian Association of Pension Supervisory Authorities (CAPSA). OSFI is a member of CAPSA — a forum for discussing common issues faced by federal and provincial pension plan supervisory authorities — and an active contributor to many of its initiatives. Of note in 2009–2010 was the publication of a draft "Consultation paper on the Prudence Standard and the Roles of the Plan Sponsor and Plan Administrator in Pension Plan Funding and Investment". In addition, CAPSA issued its comments on the CIA's proposed changes to the Standards of Practice — specific standards for Pension Plans. CAPSA also released the "Proposed Agreement Respecting Multi-Jurisdictional Pension Plans."

In keeping with the objectives of promoting transparency and improving stakeholders' understanding of OSFI's expectations, OSFI issued an instruction guide and standardized approval request form setting out its expectations for filing and reporting requirements where a defined benefit pension plan has terminated.

The newsletter *InfoPensions* was published twice during the fiscal year. *InfoPensions* provides announcements and reminders on issues relevant to federally regulated private pension plans as well as

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descriptions of how OSFI applies selected provisions of the pension legislation and OSFI guidance.

OSFI continued to review and update previously published policy advisories, and post them to a new area of the pensions page of the OSFI Web site under Pensions Plans / Pension Policy Advisories.

APPROVALS

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

OSFI implemented new automated systems to support the pension approvals function and published additional approval instruction guides to the pension industry.

During 2009–2010, OSFI continued to refine processes to improve timeliness while ensuring complex transactions are carefully considered. In addition, OSFI implemented new automated systems to support the pension approvals function and published additional approval instruction guides to the pension industry. As a result, OSFI has cut the number of outstanding requests for approval by 34% and eliminated the backlog.

The number of transactions requiring the Superintendent's approval increased slightly. During the year, OSFI processed 153 applications for approval and received 130 new requests, compared to 149 processed applications and 124 new requests in 2008. In 2009–2010, 75 new plans were registered with OSFI. Of these, 34 were defined benefit plans. A further 18 registered plans, affecting about 600 members, informed OSFI that they were terminating.

ADJUSTMENTS TO PENSIONS

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

INFLATION PROTECTION

In 2009–2010, 21% of the plans that offer defined benefits reported increases in pensions being paid out, i.e., retirees' pensions (compared to 23% the previous year). Of these plans, 60% also increased deferred pensions.

Increases were based on the full Consumer Price Index (CPI) in 45% of cases, 18% on partial CPI and 37% using other formulae, such as excess interest, a flat dollar amount, or a percentage of pension payment. In 68% of cases (74% in 2008–2009), 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 2009–2010, 18% of the plans that made adjustments to pensions did so using surplus funds or gains (compared to 24% the previous year). The remainder used sources outside the pension fund, created unfunded liabilities or used some combination of options to improve pensions.

In 23% of cases, where plans had surplus/gains, they improved benefits, while in 68% of cases the employer used surplus/gains to reduce contributions. The remaining 9% used their surplus/gains for both. This is a small change from 2008–2009, when 22% used surplus/gains to improve benefits, 63% reduced contributions and15% did both.

Asset Breakdown[1] of Pension Plans Regulated by OSFI

FIGURE 16

($ Millions)		2009		2010[2]
Cash	447	0.4%	339	0.3%
Debt Securities				
Short Term Notes, Other Term Deposits	3,400	3.1%	3,391	2.8%
Government Bonds	25,571	23.5%	26,576	21.7%
Corporate Bonds	8,608	7.9%	9,277	7.6%
Mutual Funds -Bonds, Cash Equivalent & Mortgage	8,997	8.3%	9,332	7.6%
Mortgage Loans	1,027	1.0%	801	0.7%
General Fund of an Insurer	115	0.1%	126	0.1%
Total Debt Securities	47,718	43.9%	49,503	40.5%
Equity				
Shares in Investment, Real Estate or Resource Corporation	4,761	4.4%	5,186	4.3%
Common and Preferred Shares	33,325	30.7%	42,776	34.9%
Stock Mutual Funds	9,432	8.7%	12,243	10.0%
Real Estate Mutual Funds	803	0.7%	958	0.8%
Real Estate	2,150	2.0%	2,162	1.8%
Total Equity	50,471	46.5%	63,325	51.8%
Diversified and Other Investments				
Balanced Mutual Funds	5,409	5.0%	3,995	3.2%
Segregated Funds	2,958	2.7%	2,752	2.3%
Miscellaneous Investments	2,229	2.1%	2,804	2.3%
Total Diversified and Other Investments	10,596	9.8%	9,511	7.8%
Other Accounts Receivables (net of liabilities)	(628)	(0.6%)	(178)	(0.1%)
TOTAL NET ASSETS	108,604	100.0%	122,560	100.0%

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

[2] As at March 31, 2010, with comparative figures for the year ended March 31, 2009.

INTERNATIONAL ASSISTANCE

The International Advisory Group (IAG) of the Office of the Superintendent of Financial Institutions was created in 2001 to assist selected emerging market and developing economies in enhancing their regulatory and supervisory system, in line with international banking and insurance supervisory standards. The costs for this program are recovered via Memoranda of Understanding between OSFI and the Canadian International Development Agency. In 2009–2010, the group included four technical staff (including the group head) and one program coordinator.

During 2009–2010, IAG delivered bilateral or multilateral programs, sometimes in partnership with other technical assistance providers, in 30 different jurisdictions. In some cases the training was provided directly to qualifying regulatory agencies. In other instances, IAG delivered regional training programs in partnership with other organizations, such as: the Financial Stability Institute; the International Association of Insurance Supervisors; the Caribbean Regional Technical Assistance Centre; the South East Asian Central Banks Research and Training Centre; the Toronto Leadership Centre for Financial Sector Supervision and the Association of Supervisors of Banks of the Americas.

In total, IAG delivered or participated in 47 programs that provided technical assistance to over 1,500 participants in 2009–2010. The following 19 jurisdictions benefited from IAG technical assistance by hosting programs in 2009–2010: Antigua, Barbados, Dominican Republic, Ecuador, El Salvador, Ghana, India, Indonesia, Kazakhstan, Malaysia, Mexico, Nicaragua, Nigeria, Nepal, Peru, South Africa, Thailand, Uruguay and Vietnam.

OSFI supported the Toronto International Leadership Centre for Financial Sector Supervision by participating on the Board of Directors and providing resources, most notably Program Leaders and Presenters, to assist with the delivery of programs. Through the Centre, individuals with substantial experience in financial supervision from Canada and abroad help supervisors acquire the knowledge and leadership skills to build effective supervisory regimes in their countries.

Insurance Supervision Workshop

OSFI's Arvind Baghel and Jean Sarazin are pictured during the February 2010 Insurance Supervision Workshop held in Hyderabad, India.

OFFICE OF THE CHIEF ACTUARY

The Office of the Chief Actuary (OCA) contributes to a financially sound and sustainable Canadian public retirement income system through the provision of expert actuarial valuation and advice to the Government of Canada and to provincial governments that are Canada Pension Plan (CPP) stakeholders.

The OCA conducts statutory actuarial valuations of the CPP, Old Age Security (OAS) program, the Canada Student Loans Program (CSLP), and pension and benefits plans covering the federal Public Service, the Canadian Forces, the Royal Canadian Mounted Police (RCMP), federally appointed judges, and Members of Parliament.

The OCA was established within OSFI as an independent unit. The Chief Actuary reports to the Superintendent, however the accountability framework of the OCA makes it clear that the Chief Actuary is solely responsible for the content and actuarial opinions in reports prepared by the OCA.

24TH ACTUARIAL REPORT ON THE CANADA PENSION PLAN

The OCA supported the federal-provincial CPP committee's triennial financial review, which was completed in May 2009. Bill C-51 — Economic Recovery Act was introduced before the House of Commons in the fall of 2009 following the completion of the review. Part 2 of this bill contained changes to the CPP recommended by the federal and provincial ministers of finance.

As required by the legislation, the Chief Actuary prepared the 24th Actuarial Report on the CPP, as a supplement to the 23rd Actuarial Report on the CPP as at 31 December 2006, to show the effects of Part 2 of Bill C-51 on the long-term financial status of the CPP.

Bill C-51 received Royal Assent in December 2009 and is expected to become law in January 2011. The proposed changes comprise removing the work cessation test in 2012 (which requires individuals who apply to take their CPP retirement benefit prior to age 65 either to stop working or materially reduce their earnings); increasing the general drop-out

Jean-Claude Ménard was appointed **Chief Actuary** in August 1999. Prior to joining OSFI, Mr. Ménard held progressively senior roles with the Quebec Pension Board, culminating in his appointment as Chief Actuary and Director of Valuation in 1995. From 2002 to 2007, he was Vice-Chairman of the Technical Commission on Statistical, Actuarial and Financial Studies of the International Social Security Association (ISSA). In 2008, he became Chairman of that Commission. In this capacity, he is the official representative of the ISSA and the Canadian Institute of Actuaries on the Social Security Committee of the International Actuarial Association. In February 2008, he was appointed as a member of the National Academy of Social Insurance (NASI), a non-profit organization made up of the leading experts on social insurance.

provision from 15% to 16% in 2012 and to 17% in 2014; requiring working beneficiaries aged less than 65 to contribute with their pensions recalculated and making contributing optional for working beneficiaries aged 65 and older; restoring the actuarial adjustment factors to their approximate fair levels, and other technical changes. The ministers of finance indicated that the proposed changes are intended to provide greater flexibility for older workers to combine pension and work income if they so wish, modestly expand pension coverage, and improve fairness in the Plan's flexible retirement provisions.

The 24th CPP Actuarial Report reflects the financial and economic turmoil countries were exposed to at the time of its preparation, thereby providing Canadians with a more objective picture. The report finds that the legislated 9.9% combined employer-employee contribution rate is expected to be sufficient to sustain the CPP over the next 25 years.

CANADA STUDENT LOANS PROGRAM ACTUARIAL REVIEW

The first statutory *Actuarial Report on the Canada Student Loans Program as at 31 July 2008* was tabled before Parliament on June 8, 2009 in accordance with the *Budget Implementation Act*, 2009, which deems the annual CSLP reports as statutory. The previous CSLP reports were provided to ministers and released to the public.

The report presents the results of an actuarial review of the CSLP as at July 31, 2008 and includes projections of future costs of the program through to the loan year 2032–2033. An actuarial review of the CSLP is prepared in order to provide an evaluation of the program's overall financial costs and increase the level of information available to Parliament and the public.

Jean-Claude Ménard
Chief Actuary

To better monitor and understand emerging risks with respect to Public Sector Pension Plans, the OCA is integrating Asset Liability Modelling into various actuarial projects.

PUBLIC SECTOR INSURANCE AND PENSION PLANS

The OCA completed and provided to the President of the Treasury Board for tabling before Parliament six actuarial reports in 2009–2010 with respect to the public sector insurance and pension plans, including actuarial reports as at March 31, 2008 on the pension plans for the Public Service, the RCMP and the Regular and Reserve Canadian Forces, as well as the Public Service Death Benefit Account and the Regular Force Death Benefit Account. For the first time, the actuarial report on the Canadian Forces included provisions introduced March 1, 2007 regarding the Reserve Force pension plan. These reports provide actuarial information to decision makers, Parliamentarians and the public, thereby increasing transparency and confidence in the retirement income system. The results of these reports were presented by the Chief Actuary and his staff to the Joint Meeting of the Public Service, RCMP and Canadian Forces Pension Advisory committees, as well as at the 2009 Federal-Provincial Pensions Conference.

To better monitor and understand emerging risks with respect to Public Sector Pension Plans, the OCA is integrating Asset Liability Modelling (ALM) into various actuarial projects. The ALM is a financial management tool that allows the projection of assets and liabilities under a range of different possible economic scenarios. The use of ALM provides the OCA with the ability to analyze one of the major risks that Public Sector Pension Plans are exposed to — that the assets will not match the liabilities. If funding deficiencies or surpluses were to continue for an extended period of time, the risk of contribution or benefit adjustments would increase.

SERVICES, PRESENTATIONS AND SPECIAL STUDIES

Other services provided by the OCA during the year included:

- Appearance as expert witness for the CPP Pension Appeals Board
- Ongoing advice and support to the federal-provincial CPP committee of officials
- Public Accounts actuarial reports on the major public sector pension plans sponsored by the Government, including information used in the financial statements of the Public Service, Canadian Forces and RCMP pension plans
- Public Accounts actuarial reports for the Public Service Health Care Plan and pensioners' Dental Service Plan, and assessment of the workers' compensation actuarial liability for the accounting of retirement and post-employment benefits under the government accrual accounting policies
- Public Accounts actuarial report on Pension Act-related post-employment benefits for the Canadian Forces, including war veterans
- Ongoing advice to a range of federal departments and agencies including the Treasury Board Secretariat, Department of Justice, Judicial Compensation and Benefits Commission, Veterans Affairs Canada, Department of National Defence, members of the RCMP and Crown Corporations

- Annual meetings, ongoing advice or support given to the CPP Investment Board, the Public Sector Pension Investment Board, and the Joint Meeting of the Public Service, RCMP and Canadian Forces Pension Advisory committees
- Work as Chair of the International Social Security Association (ISSA) Technical Commission on Statistical, Actuarial and Financial Studies

The 2009–2010 year was marked in Canada by increasing interest in the country's retirement system — its ability to provide Canadians with proper retirement income, as well as to withstand economic and financial shocks. Within this framework, the Chief Actuary was invited to speak to the House of Commons Standing Committee on Finance on the topic of "Measures to Enhance Credit Availability and the Stability of the Canadian Financial System", and to the House of Commons Standing Committee on the Status of Women on the topic of "Women and Pension Security". In addition, the Chief Actuary spoke on the topic of the post-turmoil sustainability of the CPP at the joint Technical Seminar of the ISSA and International Labour Office, and at the Human Resources and Skills Development Canada "Knowledge Talks" series.

In 2009–2010, the OCA maintained the tradition of continual improvements to actuarial methods by applying more extensive research and sophisticated methods toward developing actuarial assumptions, as recommended by the CPP Peer Review Panel. These improvements will be reflected in the upcoming 25th CPP Actuarial Report.

The OCA is continuously involved in performing research and preparing various experience studies covering a wide range of social security, demographic and economic issues that may affect the financial status of pension and benefits plans.

In 2009–2010, the Office of the Chief Actuary published two actuarial studies: Actuarial Study No.7 – CPP Mortality Study, and Actuarial Study No.8 – Technical Aspects of the Financing of the CPP.

Both studies support policy makers in developing and analyzing various policy options in the context of Plan reforms. The information presented in these studies could also benefit private sector organizations that evaluate social security or private pension plan schemes. Actuarial Study No. 8 provides another way to measure financial sustainability. Given the long-term nature of the Plan, it is reasonable to include future contributions and benefits from both current and future contributors in the assessment of the Plan's funded status. This approach shows that the Plan is able to meet its financial obligations and be sustainable for the 75-year projection period.

John Kmetic
Actuary, Office of the Chief Actuary

THE 16TH INTERNATIONAL CONFERENCE OF SOCIAL SECURITY ACTUARIES AND STATISTICIANS

The OCA continues to broaden its sources of information before setting assumptions that will be used in the preparation of the next triennial CPP actuarial report. Through the work performed by the Chief Actuary as Chairman of the ISSA Technical Commission on Statistical, Actuarial and Financial Studies, the OCA hosted the 16th International Conference of the Social Security Actuaries and Statisticians in Ottawa in September 2009. (The first conference was held in Brussels in 1956.)

The 16th Conference in Ottawa united about 160 delegates from more than 50 countries around the world and provided speaking opportunities to leading international experts in the social security field. The OCA presented findings of its Survey on Self-Adjustment Mechanisms for Social Security Schemes and Employer Sponsored Plans. The findings were also presented at the ISSA Technical Seminar in Paris, in October 2009.

For a complete list of meetings, presentations and speeches, see OSFI's Web site under Office of the Chief Actuary.

The OCA hosted the 16th International Conference of Social Security Actuaries and Statisticians in Ottawa in September 2009.

CORPORATE SERVICES

STRENGTHENING INTERNAL COMMUNICATION

In 2009–2010, OSFI's internal communication strategy continued to focus on engaging its employees. Regular town hall meetings and Superintendent Memos to all staff kept employees up-to-date on current issues. Employee orientation sessions, together with planning and budget presentations, informed new and existing staff about OSFI processes and procedures. Focus groups and a new survey tool were also used throughout the year to gain employee input on new initiatives and topics of strong interest.

Regular town hall meetings and Superintendent Memos to all staff kept employees up-to-date on current issues.

ENHANCING INFRASTRUCTURE

The Information Management/Information Technology (IM/IT) Division continued to support the achievement of OSFI's long-term priorities in 2009–2010 through implementation of a new IM/IT Strategy and IM/IT Renewal program. Given the increasing trend to global information sharing and ongoing enhancements to financial reporting and risk assessment, the IM/IT division recognized a need for increased flexibility in its technology systems. The IM/IT Strategy and associated multi-year implementation plan will ensure that strategic and selective investments are made to modernize OSFI's information technology and to renew 'end of life' technologies and applications.

The new IM/IT Strategy established a governance process to provide oversight and accountability for IM/IT investments, using a portfolio management approach to budgeting and planning. This will ensure that IM/IT investments are balanced and made with a view to total cost, expected benefits, and the obligation to maintain existing assets through their lifecycle.

The new IM/IT Strategy established a governance process to provide oversight and accountability for IM/IT investments.

The Tri-Agency Database System, built in 1998 in partnership with the Bank of Canada and the Canada Deposit Insurance Corporation, is the core system OSFI uses to collect, validate, manage and maintain financial returns. As this system has reached 'end of life', OSFI and the partners commissioned a review of its current state, to be undertaken in 2010–2011, and to recommend a replacement strategy.

In 2009–2010, IM/IT implemented a pension plan approval case management system for the Private Pension Plans Division and the development of enabling technology to support Pension Plan Supervisory processes is underway. Preparatory systems work was also completed in anticipation of the 2011 implementation of International Financial Reporting Standards (IFRS).

MANAGING RISKS TO THE WORKING ENVIRONMENT

In response to the H1N1 global virus alert in 2009 and its potential impact on operations, OSFI reviewed and refined its existing pandemic plan, including how to address staff shortages, and revisited divisional business continuity plans. A formal reporting procedure was instituted to inform the Executive Committee on a regular basis of the impact of the virus world-wide, the potential impact on OSFI, and steps being taken to address it.

OSFI also conducted a half-day table-top exercise at its Toronto location to test the robustness of its business continuity plan. An action plan was drawn up to address identified gaps, and Business Continuity Planning Team Leaders are building on lessons learned to enhance OSFI's overall response capabilities.

MANAGING HR CHALLENGES

OSFI has an HR Strategy to place highly motivated people with the right skills in the right place to achieve our business goals. In 2009–2010, the three-year strategy was revised to address specific challenges, including targeting recruitment based on needs identified; ensuring our compensation structure remained competitive; reviewing and revising the HR program framework as required; continuing to apply our HR planning process across sectors to address capacity, skills and succession planning, as well as key learning, training and development plans; refining our performance management process; and reintroducing a 360-degree program for all managers with direct reports.

In 2009–2010, OSFI's annual HR planning process identified several HR challenges as needing particular attention over the planned period and actions were taken to address them as follows:

- *Challenge*: Maintaining our ability to recruit in critical skill areas and to maintain our targeted executive compensation strategy in light of the Government of Canada's *Expenditure Restraint Act*
  Action: Supplementing staffing in such areas as such as capital, credit, and IM/IT; and continuing to balance the use of market premium salaries while reviewing our executive compensation strategy

[L] **Luc Morin**
Access to Information and Privacy Coordinator, Security Services, Corporate Services Sector

[R] **Janet Harris-Campbell**
Chief Information Officer, IM/IT, Corporate Services Sector

- *Challenge*: Ensure employees are adequately trained and developed to meet the changing landscape
  Action: Continuing the targeted development and training of employees in such areas as liquidity and capital adequacy

- *Challenge*: Continuing to ensure that succession plans and knowledge transfer mechanisms are in place to deal with aging demographics
  Action: Developing individual learning plans and organizational changes that facilitate succession needs and key person risk

- *Challenge*: Establishing a plan to address our headcount in light of evolving economic conditions in the financial services industry during the plan period
  Action: Developing a plan to assess changing skill requirements and implement staffing, training and organizational changes necessary to ensure appropriate capacity

FINANCIAL REVIEW AND HIGHLIGHTS

OSFI recovers its costs from several revenue sources. OSFI is funded mainly through asset-based, premium-based or membership-based assessments on the financial institutions and private pension plans that it regulates and supervises, and a user-pay program for legislative approvals and other selected services.

The amount charged to individual institutions for OSFI's main activities of risk assessment and intervention (supervision), approvals and rule making is determined in several ways, according to formulas set out in regulations. In general, the system is designed to allocate costs based on the approximate amount of time spent supervising and regulating each industry. Costs are then assessed to individual institutions within an industry based on the applicable formula, with a minimum assessment for smaller institutions.

Staged institutions are assessed a surcharge on their base assessment, approximating the extra supervision resources required. As a result, well-managed, lower-risk institutions bear a smaller share of OSFI's costs.

OSFI also receives revenues for cost-recovered services. These include revenues from the Canadian International Development Agency (CIDA) for international assistance, revenues from provinces for which OSFI provides supervision of their institutions on contract, and revenues from other federal organizations to which OSFI provides administrative support, and other services.

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

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

Overall, OSFI fully recovered all its expenses for the fiscal year 2009–2010.

OSFI's total expenses were $103.3 million, a $10.1 million, or 10.8%, increase from the previous year. Human resources costs, the main driver of OSFI's expenses, rose by $7.9 million, or 11.5%. This was a result of: staffing supervisory positions in the deposit-taking institutions group, and the market, credit and operational risk areas; adding positions to enhance the Corporate Services Sector; planned growth in employee compensation in accordance with collective agreements, and performance-related pay, which is available to employees at all levels within the organization; and, a 15 basis point increase in the employee benefit plan rate as prescribed by Treasury Board Secretariat.

OSFI's average number of full-time equivalent employees during the year was 530, a 10.4% increase from the previous year. OSFI ended the year with an actual head count of 551, a 10.0% increase from its head count of 501 as at March 31, 2009.

FEDERALLY REGULATED FINANCIAL INSTITUTIONS

REVENUES

Total revenues from federally regulated financial institutions were $88.8 million, an increase of $8.5 million, or 10.6%, from the previous year. Base assessments on financial institutions, which are recorded at an amount necessary to balance revenue and expenses after all other sources of revenue are taken into account, increased by $7.3 million, or 9.7%, from the previous year.

Revenues for cost-recovered services decreased by $0.4 million, or 30.0% from the previous year due to a reduction in the amount of work performed under Memoranda of Understanding with provinces and certain regulated financial institutions.

Revenues from user fees and charges increased by $1.6 million, or 42.9%, from the previous year due to an increase in the average number of staged institutions throughout the year.

EXPENSES

Total expenses were $88.5 million, an increase of $8.7 million, or 10.9%, from the previous year. Human resources costs rose as a result of the hiring of additional supervisory staff and staff to enhance the Corporate Services Sector, particularly in Information Management/Information Technology (IM/IT) and Finance. Facilities costs also increased due to the full year impact of the lease extension for OSFI's Toronto's office and IM/IT costs rose as work progressed on updating the regulatory financial returns to meet the upcoming requirements of International Financial Reporting Standards (IFRS).

BASE ASSESSMENTS BY INDUSTRY

Base assessments are differentiated to reflect the share of OSFI's costs allocated to each industry group (base assessments are the costs allocated to an industry, less user fees and charges and cost-recovered services revenues). The chart on page 57 compares the growth of base assessments by industry group over the past five years.

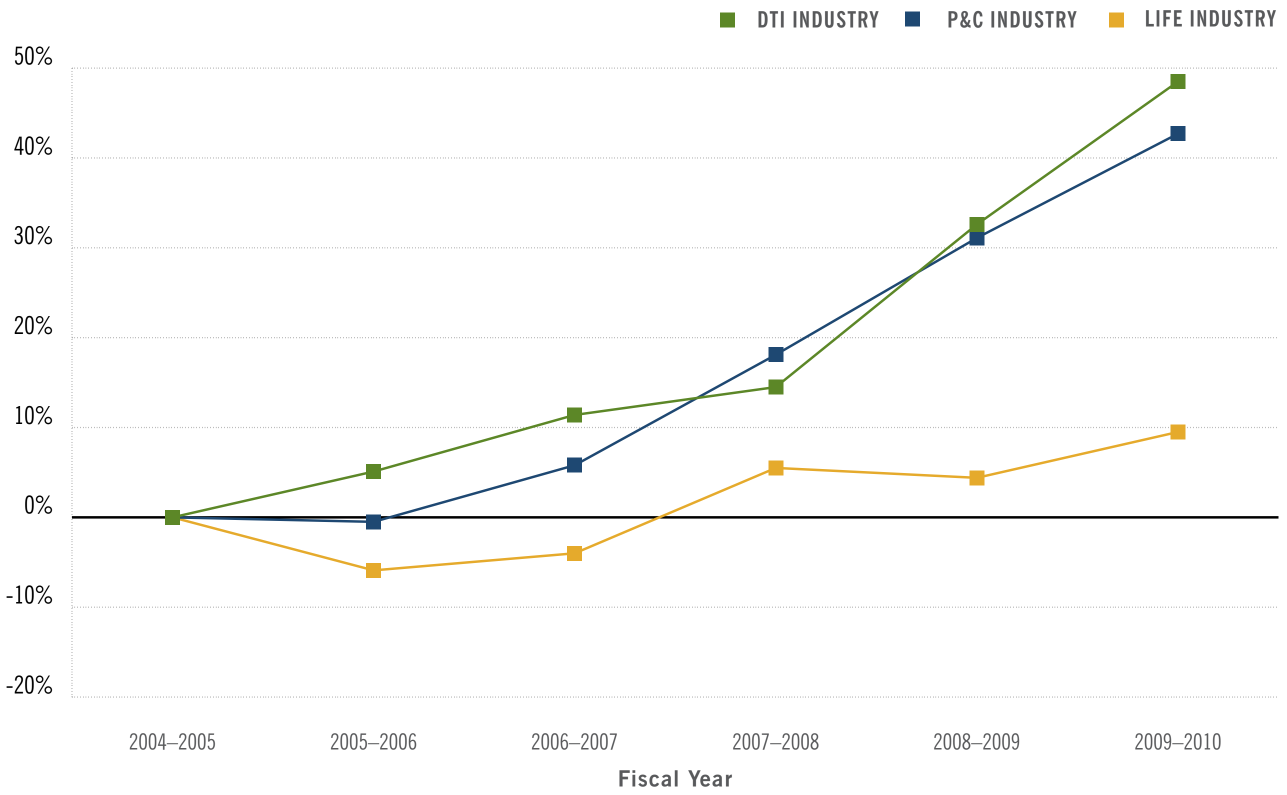
The increase in base assessments on the deposit-taking (DTI) institutions industry during the period from 2004–2005 to 2007–2008 reflects OSFI's efforts on the New Capital Adequacy Framework (Basel II) implementation, Anti-Money Laundering/Anti-Terrorism Financing (AML/ATF) activities, and international work on conceptual changes to accounting standards. The expiry in late 2007 of the agreement with major banks related to the implementation of the internal ratings-based approach of the New Basel Capital Accord was a further contributing factor to the increase in 2007–2008 and 2008–2009. In 2009–2010, growth in supervisory staff and the hiring of employees with current industry experience in credit, market and operational risks in order to focus more effort on higher risk institutions and products, the early detection of problem loan portfolios, and meeting the increasing number, frequency and intensity of international commitments were factors contributing to the growth in expenses.

The increase in assessments on the property and casualty (P&C) insurance industry over the past five years reflects the increase in OSFI's resources during 2004–2005 in response to this sector's difficult economic conditions at the time, OSFI's heightened efforts on actuarial and capital adequacy matters effective 2006–2007, and the addition of resources to strengthen OSFI's actuarial expertise in this industry. The increase in 2009–2010 reflects OSFI's greater focus on this sector due to weakening industry and market conditions, identification of emerging risks, focus on the IFRS implications for this industry, and its efforts on the Minimum Capital Test (MCT).

The decrease in assessments on the life insurance industry from 2004–2005 to 2005–2006 reflects the impact of consolidation among the major companies in this industry. The increase in 2006–2007 and 2007–2008 was the result of OSFI's heightened efforts on more frequent reporting on the conglomerate institutions in this sector, AML/ATF activities, and capital modeling. The decrease in 2008–2009 reflects OSFI's reallocation of resources to higher risk institutions and products within the DTI and P&C industries. The 2009–2010 increase can be attributed to the industry share of incremental OSFI resources to address economic and market conditions and emerging risks.

Over the past five years, additional factors caused increases in base assessments on all industries: OSFI's investments during 2006–2007 and 2007–2008 in large IM/IT projects such as business intelligence for monitoring and analytics; significant shifts in revenue types as a result of the rationalization of the user-pay regime in 2006–2007 and a reduction in surcharge assessments due to the favourable economic conditions at that time; effective 2006–2007, OSFI's work on International Financial Reporting Standards (IFRS), which affects all regulated financial institutions; and, during 2008–2009 and 2009–2010 increases in systems and services to support growth in supervisory and regulatory sectors within the office. Starting in 2008–2009 and continuing through 2009–2010, prevailing economic and market conditions resulted in a significant increase in the number of staged institutions across all industries, and hence in surcharge assessments.

BASE ASSESSMENTS BY INDUSTRY
Cumulative Growth Rates from Fiscal Year 2005



FEDERALLY REGULATED PRIVATE PENSION PLANS

FEES ASSESSED

OSFI's costs for regulating and supervising private pension plans are recovered from an annual fee charged to plans, based on the number of plan members. Plans are assessed a fee upon applying for registration under the *Pension Benefits Standards Act, 1985* (PBSA) and upon filing their annual information return. Total fees assessed during the fiscal year were $8.6 million, up from $7.9 million a year earlier.

The fee rate is established based on OSFI's estimate of current year costs to supervise pension plans, adjusted for any excess or shortfall of fees in the preceding years. The estimate is then divided by the anticipated assessable membership to arrive at a per member fee. The rate established for 2009–2010 was $24.00 per assessable member, unchanged from the previous year.

The excess or shortfall of fees in any particular year is amortized over five years in accordance with the fee formula set out in regulations. Prior to 2003–2004, accumulated surpluses had kept fee rates down; in 2003–2004 and 2004–2005, however, OSFI incurred unplanned expenses related to problem pension plans that depleted the surplus position. Subsequent fee rates have been set by regulation to recover the accumulated shortfall and the annual cost of administering the PBSA. The rate established and published in the *Canada Gazette* for 2010–2011 has been set at $22.00 per assessable member.

EXPENSES

The cost of administering the PBSA for 2009–2010 was $6.5 million, an increase of 10.2% from $5.9 million in the previous year. The increase occurred as a result of planned growth in employee compensation and an increased usage of corporate services costs related to the second phase of the pensions processes and systems renewal project. This phase of project, which commenced in 2009–2010, is expected to be completed in 2011–2012.

INTERNATIONAL ASSISTANCE

Total expenses were $2.2 million, unchanged from the previous year. This program is funded primarily by the Canadian International Development Agency (CIDA), from which approximately three-quarters of the program costs are recovered. The balance of costs is funded by base assessments on federally regulated financial institutions.

OFFICE OF THE CHIEF ACTUARY

The Office of the Chief Actuary is funded by fees charged for actuarial services and by an annual parliamentary appropriation. Total expenses were $6.1 million, an increase of $0.7 million, or 13.8%, from the previous year due to an increase in staff complement, planned growth in employee compensation and costs incurred to host the 2009 International Social Security Association (ISSA) conference in September 2009.

Fees Assessed and Expenses for Fiscal Years 2004–2005 to 2009–2010
($000, except Basic Fee Rate)

FY	2004–2005	2005–2006	2006–2007	2007–2008	2008–2009	2009–2010
Fees Assessed	3,444	3,846	5,402	7,703	7,927	8,578
Expenses	4,919	5,442	5,875	5,876	5,931	6,529
Basic Fee Rate* per member	11.00	12.00	16.50	24.00	24.00	24.00

* The minimum and maximum annual assessment per plan is derived by multiplying the annual assessment by 20 and 10,000 respectively. With an annual assessment of $24.00 per member, the minimum annual assessment is $480 and the maximum is $240,000.

FUTURE ACCOUNTING CHANGES

TRANSITION TO INTERNATIONAL FINANCIAL REPORTING STANDARDS (IFRS)

In February 2008, the Canadian Accounting Standards Board (AcSB) confirmed that publicly accountable entities will be required to adopt International Financial Reporting Standards (IFRS) in place of Canadian Generally Accepted Accounting Principles (GAAP) for fiscal years beginning on or after January 1, 2011. The Public Sector Accounting Board (PSAB) continues to allow other government organizations (OGOs), such as OSFI, to determine their most appropriate basis of accounting (between IFRS and the *Public Sector Accounting Handbook*). OGOs that determine IFRS to be the most appropriate basis of accounting for their organization would follow the same transitional timeframe as publicly accountable entities.

The primary users of OSFI's annual report and the general purpose financial statements contained therein are regulated financial institutions and private pension plan sponsors – that is, the paying stakeholders to whom OSFI is accountable – and their respective industry associations who, on the whole, operate financially based on GAAP. These primary users will be adopting IFRS effective 2011. OSFI has therefore decided to adopt IFRS so that it may continue to provide relevant, reliable, comparable and understandable financial information to its paying stakeholders.

As part of its transition to IFRS, OSFI has established a formal project governance structure with oversight by a Steering Committee, consisting of management from accounting and finance, information technology, and business operations. Regular updates of the status and progress of the IFRS conversion plan are also presented to OSFI's Executive Committee and Audit Committee.

OSFI has chosen to approach the conversion in five phases: (1) diagnostic assessment; (2) design and planning; (3) assessment, design and development; (4) implementation; and, (5) post implementation review. During fiscal year 2009–2010, OSFI completed phases two and three.

OSFI continues to monitor standards development as issued by the International Accounting Standards Board and the Canadian Institute of Chartered Accountants' AcSB, as well as the PSAB. Such developments could affect the timing, nature or disclosure of the adoption of IFRS.

IMPACT OF ADOPTION OF INTERNATIONAL FINANCIAL REPORTING STANDARDS (IFRS)

OSFI has not completed the full quantification of the impacts the future adoption of IFRS will have on its financial statements; however, the following areas have been identified for potential significant differences:

- employee benefits (including severance benefits);
- capital and intangible assets;
- impairment of assets; and
- provisions and contingent liabilities.

EMPLOYEE BENEFITS (SEVERANCE LIABILITY)

Actuarial gains and losses arise as a result of changes in the value of the accrued benefit obligation and plan assets due to experience being different from that assumed and changes in actuarial assumptions. International Accounting Standard (IAS) 19 "Employee Benefits" ("IAS 19") allows an entity to immediately recognize actuarial gains and losses in full as they arise in income or in other comprehensive income, or to recognize them over a longer period through a systematic amortization through income. The latter approach is consistent with OSFI's current policy. Under IFRS, OSFI expects to implement a policy recognizing actuarial gains and losses as they occur in other comprehensive income. The impact of this proposed policy change is twofold:

- Recognition, as a part of opening equity, of all unrecognized actuarial gains and losses as at April 1, 2010. It is expected that this change

- will reduce the accrued severance liability by approximately $550 thousand.
- Thereafter, actuarial gains and losses will be recognized into other comprehensive income as they occur.

OSFI believes that recognition of actuarial gains and losses into other comprehensive income as they occur will result in greater transparency with respect to the financial position of the employee severance plan. This approach is also consistent with the proposed direction of the IASB with respect to immediate recognition of actuarial gains and losses.

CAPITAL AND INTANGIBLE ASSETS

Adoption of IFRS may require OSFI to segregate its assets into various components. IFRS requires that some assets that were capitalized as one item may have to be broken down into their individual components and amortized separately if they have materially different useful lives. OSFI is currently evaluating its assets under IFRS. Based on the work done to date, OSFI does not expect significant financial impacts. Most of the changes will be procedural in nature.

IMPAIRMENT OF ASSETS

Adoption of IFRS will affect the timing and nature of impairment testing. Impairment testing will now be required at each reporting period even if no indications of impairment are present. It is not expected at this time that this additional testing will result in material financial adjustments.

PROVISIONS AND CONTINGENT LIABILITIES

IAS 37 "Provisions, Contingent Liabilities and Contingent Assets" ("IAS 37") provides guidance on liability recognition for a number of non-financial liabilities for which the outcome and/or related costs are subject to uncertainty. This will require some change in current policy for such matters, since the measurement and recognition criteria differ in some respects under Canadian GAAP. Specifically, IAS 37 establishes a lower recognition threshold for liabilities and requires both contractual and constructive liability recognition. The full impact of IAS 37 has not yet been determined, but OSFI does not expect to see a material adjustment based upon the analysis completed to date. OSFI may need to modify its analysis depending on the outcome of the current IASB project on IAS 37.

FUTURE CHANGES TO IFRS

International Financial Reporting Standard 1 requires that the accounting policies used by OSFI in the opening IFRS balance sheet be based upon IFRS, effective at March 31, 2012. OSFI monitors IASB developments to ensure that the impacts of any potential or actual changes to IFRS are appropriately considered in its changeover plan.

IDENTIFICATION AND RESOLUTION OF KEY INFORMATION TECHNOLOGY REQUIREMENTS

OSFI has performed an analysis of its data system infrastructure and has concluded that transition to IFRS will not result in a material modification to any of its financial systems.

INTERNAL CONTROL OVER FINANCIAL REPORTING

IFRS will also have an impact on internal controls over financial reporting. Management is currently evaluating these process change requirements.

TRAINING AND COMMUNICATION REQUIREMENTS

OSFI has undertaken the development of a communications plan to inform external stakeholders and key internal staff of the relevant modifications to the accounting and reporting of financial results ensuing from the transition to IFRS. Training seminars on relevant IFRS standards and their potential impact have been provided and will continue for key OSFI personnel.

The transition to IFRS is a significant undertaking. As the implementation phase has just started, OSFI is unable, at this time, to quantify the full impact of IFRS on its financial statements. The following table outlines the elements of OSFI's IFRS conversion plan along with an assessment of progress towards achieving these objectives. As the project progresses or further changes in regulation conditions occur, changes to the transition plan may be required.

OSFI IFRS Changeover Plan
Assessment as at March 31, 2010

Project Phase	Milestone	Status
1. Diagnostic Assessment		
• Identify differences in Canadian GAAP/ IFRS accounting policies	External advisor's report presented to OSFI's Executive and Audit Committees	Completed
2. Design and Planning		
• Launch project, establish project governance • Develop training and communications plan	Project structures in place	Completed
3. Assessment, Design and Development		
• Identify solutions to IFRS and evaluate • Develop final solutions to IFRS	Solutions approved by OSFI's Executive and Audit Committees	Completed
4. Implementation		
• Rollout IFRS solutions • Test and remediate	Financial systems and processes are able to captureand report IFRS information	In progress, completion in 2010–2011
5. Post Implementation Review		
• Debrief management and assess implementation • Ongoing IFRS update and related changes management	Ongoing process post implementation	To be started in 2011–2012

FINANCIAL STATEMENTS

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OSFI
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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 the Office of the Superintendent of Financial Institutions' (OSFI's) management.

These financial statements, which include amounts based on management's best estimates as determined through experience and judgment, have been prepared in accordance with Canadian generally accepted accounting principles for publicly accountable Canadian reporting entities. 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, that resources are managed economically and efficiently in the attainment of corporate objectives, and that transactions are in accordance with the *Financial Administration Act* and regulations and with OSFI's policies and statutory requirements.

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

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

Julie Dickson

Julie Dickson
Superintendent of Financial Institutions

Gary Walker
Assistant Superintendent
Corporate Services

Ottawa, Canada
May 28, 2010

Auditor General of Canada
Vérificatrice générale du Canada

AUDITOR'S REPORT

To the Minister of Finance

I have audited the balance sheet of the Office of the Superintendent of Financial Institutions as at 31 March 2010 and the statements of operations and comprehensive income, accumulated deficit 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 31 March 2010 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

Nancy Y. Cheng, FCA
Assistant Auditor General
for the Auditor General of Canada

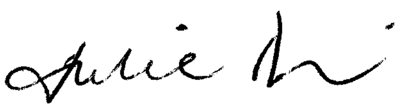
Ottawa, Canada
28 May 2010

OFFICE OF THE SUPERINTENDENT OF FINANCIAL INSTITUTIONS

BALANCE SHEET

AS AT MARCH 31 (IN THOUSANDS OF DOLLARS)

	Note	2010	2009
ASSETS			
Cash Entitlement		$ 49,661	$ 43,850
Accounts Receivable, net	5, 6	5,448	5,448
Accrued Base Assessments		114	605
Prepaid Expenses		852	763
Capital Assets	9	5,624	5,782
Intangible Assets	10	4,109	5,848
TOTAL ASSETS		**$ 65,808**	**$ 62,296**
LIABILITIES AND EQUITY OF CANADA			
Liabilities			
Accrued Salaries and Benefits		$ 13,419	$ 13,592
Accounts Payable and Accrued Liabilities	6	9,166	4,656
Unearned Base Assessments		3,749	6,383
Unearned Pension Plan Fees		2,647	598
Other Unearned Revenue		420	992
Employee Future Benefits	11	8,869	8,537
		38,270	**34,758**
Equity of Canada			
Contributed Surplus	19	28,327	28,327
Accumulated Deficit	19	(789)	(789)
		27,538	**27,538**
TOTAL LIABILITIES AND EQUITY OF CANADA		**$ 65,808**	**$ 62,296**
Contractual Obligations and Contingencies	12		



JULIE DICKSON
Superintendent of Financial Institutions

The accompanying notes form an integral part of these financial statements.

OFFICE OF THE SUPERINTENDENT OF FINANCIAL INSTITUTIONS

STATEMENT OF OPERATIONS AND COMPREHENSIVE INCOME

FOR THE YEAR ENDED MARCH 31 (IN THOUSANDS OF DOLLARS)

	Note	2010	2009
Regulation and Supervision of Federally Regulated Financial Institutions			
Revenue	17	$ 88,753	$ 80,252
Expenses	17, 18	88,471	79,769
Net Results before Filing Penalties Revenue		282	483
Filing Penalties Revenue	15	39	486
Filing Penalties Earned on Behalf of the Government		(39)	(486)
Net Results		**282**	**483**
Regulation and Supervision of Federally Regulated Private Pension Plans			
Revenue	17	6,529	5,931
Expenses	17, 18	6,529	5,931
Net Results		**-**	**-**
International Assistance			
Revenue	17	1,717	1,689
Expenses	17, 18	2,183	2,172
Net Results		**(466)**	**(483)**
Office of the Chief Actuary of Canada			
Revenue	17	5,201	4,512
Expenses	17, 18	6,126	5,381
Net Results		**(925)**	**(869)**
NET RESULTS OF OPERATIONS BEFORE GOVERNMENT FUNDING		**(1,109)**	**(869)**
Government Funding	13	1,109	869
NET RESULTS OF OPERATIONS AND COMPREHENSIVE INCOME		**$ -**	**$ -**

The accompanying notes form an integral part of these financial statements.

OFFICE OF THE SUPERINTENDENT OF FINANCIAL INSTITUTIONS
STATEMENT OF ACCUMULATED DEFICIT

FOR THE YEAR ENDED MARCH 31 (IN THOUSANDS OF DOLLARS)

		2010		2009
ACCUMULATED DEFICIT, BEGINNING OF YEAR	**$**	**(789)**	**$**	**(789)**
Net Results of Operations and Comprehensive Income		**-**		**-**
ACCUMULATED DEFICIT, END OF YEAR	**$**	**(789)**	**$**	**(789)**

The accompanying notes form an integral part of these financial statements.

OFFICE OF THE SUPERINTENDENT OF FINANCIAL INSTITUTIONS
STATEMENT OF CASH FLOWS

FOR THE YEAR ENDED MARCH 31 (IN THOUSANDS OF DOLLARS)

	Note	2010	2009
CASH FLOWS FROM OPERATING ACTIVITIES			
Cash Receipts from Financial Institutions, Pension Plans and Other Government Departments		$ 108,703	$ 104,631
Cash Paid to Suppliers and Employees		(106,450)	(96,032)
Insurance Company Liquidations, net	16	5,680	1,028
Filing Penalties Revenue Remitted to the Consolidated Revenue Fund	15	(39)	(486)
Net Cash Provided by Operating Activities		**7,894**	**9,141**
CASH FLOWS FROM INVESTING ACTIVITIES			
Acquisition of Capital Assets	9	(1,715)	(928)
Acquisition of Intangible Assets	10	(368)	(696)
Net Cash Used in Investing Activities		**(2,083)**	**(1,624)**
NET INCREASE IN CASH ENTITLEMENT		**5,811**	**7,517**
CASH ENTITLEMENT AT BEGINNING OF YEAR		**43,850**	**36,333**
CASH ENTITLEMENT AT END OF YEAR		**$ 49,661**	**$ 43,850**

The accompanying notes form an integral part of these financial statements.

OFFICE OF THE SUPERINTENDENT OF FINANCIAL INSTITUTIONS
NOTES TO THE FINANCIAL STATEMENTS

MARCH 31, 2010 (IN THOUSANDS OF DOLLARS)

1. Authority and objectives

Mandate

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

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

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

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

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

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

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

2. Revenue and spending authority

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

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

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

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

Pursuant to Section 16 of the OSFI Act, Parliament has provided annual appropriations to support the operations of the Office of the Chief Actuary.

3. Accounting changes

a) Adoption of new accounting standards

Goodwill, Intangible Assets* and *Financial Statement Concepts

Effective April 1, 2009, OSFI adopted CICA Handbook Section 3064, *Goodwill and Intangible Assets*, which clarifies that costs can be deferred only when they relate to an item that meets the definition of an asset, and as a result start-up costs must be expensed as incurred. CICA Handbook Section 3064 – *Goodwill and Intangible Assets* replaces CICA Handbook Section 3062 – *Goodwill and Other Intangible Assets* and CICA Handbook Section 3450 - *Research and Development Costs.* CICA Handbook Section 1000, *Financial Statement Concepts,* was also amended to provide consistency with the new *Goodwill and Intangible Assets* standard.

3. Accounting changes (continued)

a) Adoption of new accounting standards (continued)

The adoption of these standards did not have a material impact on the cash flows or operations of OSFI since all intangible assets recognized prior to the adoption of the standard met the definition of an asset. The adoption of these standards required certain software costs totalling $4,109 as at March 31, 2010 (2009: $5,848) to be re-classified and separately presented on the Balance Sheet and disclosed as intangible assets (Note 10).

Financial Instruments – Disclosures

In March 2009, the AcSB amended CICA Handbook Section 3862, *Financial Instruments – Disclosures*, to enhance the disclosure requirements regarding fair value measurements including the relative reliability of the inputs used in those measurements and the liquidity risk of financial instruments. The amendments are effective for OSFI's financial statements for the year ended March 31, 2010, however the adoption of this standard did not have an impact on the financial position, cash flows, or operations of OSFI, as CICA Handbook Section 3862 relates to disclosures only. Note 8 includes additional information about OSFI's policy for the settlement of its payables.

Financial Instruments – Recognition and Measurement

Effective April 1, 2009, OSFI adopted a number of amendments to CICA Handbook Section 3855 *Financial Instruments – Recognition and Measurement*. The amendments relate to revised definitions of certain financial assets, methods of assessing impairments for certain financial assets, reclassifications of financial assets, assessments of embedded derivatives on reclassification of a financial asset out of the held for trading category, and subsequent accounting of impaired financial assets. The amendments did not have an impact on the financial position, cash flows, or operations of OSFI, since OSFI does not have any financial instruments affected by the new standard.

b) Future accounting changes

International Financial Reporting Standards (IFRS)

On February 13, 2008, the Accounting Standards Board (AcSB) of the CICA confirmed that the use of International Financial Reporting Standards (IFRS) will be required in 2011 for all publicly accountable Canadian reporting entities. IFRS will replace Canada's current generally accepted accounting principles for these entities that are responsible to large or diverse groups of stakeholders. OSFI will adopt IFRS commencing on April 1, 2011, with comparatives for the year commencing April 1, 2010. In 2008-2009, OSFI completed its initial assessment of the impact to its financial statements of adopting IFRS, and in 2009-2010, completed the 'Solutions Development' phase of the project, which included a

3. Accounting changes (continued)

b) Future accounting changes (continued)

detailed study of all applicable standards identified in the initial assessment, the identification of all options available to OSFI, and recommendations for changes to policies, procedures, systems and business processes. The most significant policy change will result in the realization into income, on an annual basis, of all actuarial gains and losses, arising from changes in interest rate and/or actuarial assumptions. OSFI will be assessing and testing these solutions during fiscal year 2010-2011.

4. Significant accounting policies

a) Basis of presentation

The financial statements of OSFI have been prepared in accordance with Canadian generally accepted accounting principles for publicly accountable Canadian reporting entities.

b) 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.

c) Financial instruments

The classification of financial instruments is determined by OSFI at initial recognition and depends on the purpose for which the financial assets were acquired or liabilities were incurred. All financial instruments are recognized initially at fair value. The fair value of financial instruments on initial recognition is based on the transaction price, which represents the fair value of the consideration given or received. Subsequent to initial recognition, financial instruments are measured based on the accounting treatment corresponding to their classification.

4. Significant accounting policies (continued)

c) Financial instruments (continued)

Classification	Accounting Treatment
Held for Trading (HFT)	Cash Entitlement is classified as “Held for Trading”. Cash Entitlement is measured at fair value. Gains and losses arising from changes in the fair value are recorded in Net Results of Operations before Government Funding in the period in which they arise.
Loans and Receivables	Accounts Receivable and Accrued Base Assessments are classified as “Loans and Receivables”. Loans and Receivables are non-derivative financial assets with fixed or determinable payments that are not debt securities. Subsequent to initial recognition, Loans and Receivables are measured at amortized cost using the effective interest method. Any gain, loss or interest income is recorded in revenues or expenses depending on the nature of the loan and receivable that gave rise to the gain, loss or income.
Other Financial Liabilities	Accrued Salaries and Benefits, Accounts Payable and Accrued Liabilities, Unearned Base Assessments, and Unearned Pension Plan Fees are classified as “Other Financial Liabilities”. Other Financial Liabilities are non-derivative financial liabilities that have not been designated at fair value. Subsequent to initial recognition, Other Financial Liabilities are measured at amortized cost using the effective interest method. Any gain, loss or interest expense is recorded in revenues or expenses depending on the nature of the financial liability that gave rise to the gain, loss or expense.

OSFI assesses at each balance sheet date whether there is objective evidence that a financial asset is impaired. For the classification of Loans and Receivables, any write-down or impairment is recognized in the period incurred and collected in the following year through base assessments to the industry to which the balance pertains.

4. Significant accounting policies (continued)

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	Lesser of useful life or remaining term of the lease
Furniture and Fixtures	7 years
Office Equipment	4 years
Informatics Hardware	3 or 5 years
Informatics Infrastructure (Networks)	4 or 5 years
Informatics Software	5 years

During fiscal year 2009-2010, OSFI revised the estimated useful lives for certain Informatics Hardware assets, such as printers and scanners, from three to five years, and certain Informatics Infrastructure assets, such as servers and data storage devices, from three years to either four or five years. The changes to these estimates were implemented effective April 1, 2009 and have been accounted for prospectively. The revised useful lives resulted in $124 less amortization being recorded in 2009-2010 than would otherwise have been recorded using the former estimated useful lives.

e) Intangible assets

Intangible assets consist of internally developed and externally purchased software that is not an integral part of the related hardware.

Intangible assets acquired independently are measured on initial recognition at historical cost. At initial recognition, internally developed intangible assets comprise all directly attributable costs necessary to create, produce, and prepare the software to be capable of operating it in the manner intended by OSFI. Following initial recognition, intangible assets are carried at cost less any accumulated amortization and any accumulated impairment losses.

Intangible assets are amortized over their estimated useful life and assessed for impairment whenever there is an indication that the intangible asset may be impaired. An asset is considered impaired when its carrying value exceeds its recoverable value or it is no longer in use. The amortization expense on intangible assets is recognised in the Statement of Operations and Comprehensive Income in the expense category consistent with the function of the intangible asset.

4. Significant accounting policies (continued)

e) Intangible assets (continued)

Amortization is calculated using the straight-line method over the assets' estimated useful lives of five years. OSFI re-assesses annually the estimated useful life and amortization method of this asset category.

Amortization of intangible assets under development commences in the month in which the asset is available and ready to use, however OSFI tests annually at the Balance Sheet date for any evidence of impairment during the development phase.

Gains or losses arising from disposal of an intangible asset are measured as the difference between the net disposal proceeds and the carrying amount of the asset at the time of disposal, and are recognised in the Statement of Operations and Comprehensive Income when the asset is disposed of or otherwise written off.

f) Leases

OSFI does not have borrowing authority and therefore cannot enter into lease agreements that are classified as capital leases. OSFI has established procedures to review all lease agreements and identify if the proposed terms and conditions would result in a transfer to OSFI of substantially all the benefits and risks incidental to ownership.

OSFI records the costs associated with operating leases in the Statement of Operations and Comprehensive Income in the period in which they are incurred.

g) Employee future benefits

(i) Pension benefits

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

Both the employees and OSFI contribute to the cost of the Plan. OSFI's responsibility with regard to the Plan is limited to its contributions, which are recorded in the Statement of Operations and Comprehensive Income. Actuarial liabilities are recognized in the financial statements of the Government of Canada, as the Plan's sponsor. Current legislation does not require OSFI to make contributions for any actuarial deficiencies of the Plan.

4. Significant accounting policies (continued)

g) Employee future benefits (continued)

(ii) Severance benefits

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

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

(iii) Other future benefits

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

h) Specified purpose account for insurance company liquidations

OSFI has an interest-bearing, specified purpose account (note 16) within the Consolidated Revenue Fund for insurance company liquidations. Prior to amendments to the *Winding-up and Restructuring Act*, OSFI acted as liquidator of failed insurance companies when appointed by Court Order. Under these circumstances, the Superintendent hired agents to carry out the liquidation work in each case. Section 23.3 of the *Winding-Up and Restructuring Act,* which came into force in 1996, established that the Superintendent can no longer be appointed as liquidator of a failed institution.

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

4. Significant accounting policies (continued)

i) Use of estimates

These financial statements are prepared in accordance with Canadian generally accepted accounting principles, which require that OSFI's management make estimates and assumptions that affect the amounts reported in these financial statements. At the time of preparation of these statements, management believes the estimates and assumptions to be reasonable. Liabilities related to human resources, employee future benefits and the useful lives of capital assets are the most significant items for which estimates are used. Actual results could differ significantly from those estimates.

j) Contingencies

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

k) Revenue recognition

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

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

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

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

MARCH 31, 2010 (IN THOUSANDS OF DOLLARS)

4. Significant accounting policies (continued)

k) Revenue recognition (continued)

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

Filing penalties are penalties 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 are not available to reduce the net costs that OSFI assesses the industry (i.e., they are non-respendable) and are remitted to the Consolidated Revenue Fund. Filing penalties are charged in accordance with the *Administrative Monetary Penalties (OSFI) Regulations*.

5. Accounts receivable

As at March 31, the aging of non-related party accounts receivable was as follows (for terms and conditions relating to related party receivables, refer to note 6):

Days Outstanding	Current	31-60	61-90	91-120	> 120	Total
2010	$ 381	$ 46	$ 2	$ 13	$ 193	$ 635
2009	$ 746	$ 3	$ 5	$ 56	$ 1,198	$ 2,008

OSFI records an allowance for doubtful accounts considering the age of an outstanding receivable and the likelihood of its collection. Provisions are also made where collection of the receivable is doubtful based on information gathered through collection efforts. An allowance is reversed once collection of the debt is successful or the amount is written off.

An account receivable will be considered to be impaired and will be written off when OSFI is certain that collection will not occur and all requirements of the Debt Write-Off Regulations 1994 have been met. During the year, no interest was earned on impaired assets and none of the past due amounts has been renegotiated. Those that are neither past due or impaired are considered to be fully collectible.

MARCH 31, 2010 (IN THOUSANDS OF DOLLARS)

5. Accounts receivable (continued)

As at March 31, 2010, accounts receivable at an initial value of $147 (2009: $249) were impaired and fully provided for. The following table provides a reconciliation of the movement in this allowance during the year:

	2010	2009
Allowance for Doubtful Accounts, beginning of year	**$ 249**	**$ 153**
Additions	60	210
Unused amounts reversed	(162)	(114)
Allowance for Doubtful Accounts, end of year	**$ 147**	**$ 249**

Excluded from the analysis above are Accrued Base Assessments and Other Fees of $114 and $4,960, respectively, that have not been billed as at March 31, 2010. There is no provision for these amounts as they are considered to be fully collectible.

The concentration of all amounts owing to OSFI as at March 31, 2010 is as follows:

	Trade Accounts Receivable	Accrued Base Assessments	User Fees and Charges	Cost Recovered Services & Other	Total	% of Total Exposure
Federally Regulated Financial Institutions	$ 178	$ 114	$ 4,384	$ -	$ 4,676	82%
Private Pension Plans	431	-	-	-	431	7%
Other	26	-	-	576	602	11%
Total	**$ 635**	**$ 114**	**$ 4,384**	**$ 576**	**$ 5,709**	**100%**

6. 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. These transactions are measured at the exchanged amount, which is the amount of consideration established and agreed to by the related parties.

OSFI recorded expenses of $23,609 (2009: $19,820) and revenue of $8,270 (2009: $7,707) from transactions with other government departments during the year.

For the year ended March 31, 2010, the amounts of accounts receivable and accounts payable and accrued liabilities from these related parties are $171 (2009: $241) and $1,820 (2009: $1,414), respectively.

6. Related party transactions (continued)

During the year, OSFI received services without charge from the Office of the Auditor General and Public Works and Government Services Canada for audit services and pay system administrative services, respectively. Accordingly, an amount of $170 has been recorded as both an expense and government assistance.

7. Fair value

Due to their short-term nature, the carrying values of OSFI's financial instruments are presumed to approximate their fair values.

8. Financial risk management

OSFI's financial liabilities include Accrued Salaries and Benefits, Accounts Payable and Accrued Liabilities, Unearned Base Assessments and Unearned Pension Plan Fees. The main purpose of these liabilities is to provide short-term financing for OSFI's operations. Financial assets include Cash Entitlement, Accounts Receivable and Accrued Base Assessments.

OSFI is exposed to market risk, credit risk and liquidity risk in connection with its financial instruments.

a) Market risk

Market risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices. Market risk comprises three types of risk: interest rate risk, currency risk and other price risk, such as equity risk. OSFI is exposed to currency risk on any amounts payable that are to be settled in a currency other than the Canadian dollar but is not exposed to interest rate risk or to other price risk.

Currency risk – Currency risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates. OSFI's exposure to the risk of changes in foreign exchange rates relates primarily to OSFI's operating activities (when revenues or expenses are denominated in a currency other than the Canadian dollar).

OSFI manages its exposure to currency risk by structuring its contracts in Canadian dollars wherever possible. The majority of OSFI's transactions are denominated in Canadian dollars; as such, OSFI's exposure to currency risk is insignificant.

There is no impact to revenue since all billings are done in Canadian dollars.

8. Financial risk management (continued)

b) Credit risk

Credit risk is the risk that the counterparty will not meet its obligations under a financial instrument, resulting in a financial loss for OSFI. The maximum exposure OSFI has to credit risk as at March 31, 2010 is $5,562 (2009: $6,053) which is equal to the carrying value of its Accounts Receivable and Accrued Base Assessments.

All federally regulated financial institutions and federally regulated private pension plans are required to register with OSFI and pay the base assessments and fees as established by OSFI. Any loss incurred by OSFI as a result of a counterparty not meeting its obligations is recorded in the year incurred and collected in the following year through assessments to the industry to which the balance pertains, as outlined in the OSFI Act. All remaining receivables are with other Canadian federal and provincial government organizations, where there is minimal potential risk of loss. OSFI does not hold collateral as security.

c) Liquidity risk

Liquidity risk is the risk that OSFI will encounter difficulty in meeting its obligations associated with financial liabilities. OSFI's objective is to maintain sufficient Cash Entitlement through its collection of base assessments, fees, cost recovered services and other charges in order to meet its operating requirements. OSFI manages liquidity risk through detailed annual planning and billing processes that are structured to allow for sufficient liquidity from one billing period to the next. OSFI's objective is to accurately estimate its operating costs and cash requirements for the current year and to recover these through its interim base assessments, fees and other sources of revenue.

OSFI's policy is to settle its liabilities by the following means (in decreasing order of priority):

- Disbursing payments from its Cash Entitlement account
- Drawing on its revolving expenditure authority, pursuant to paragraph 17.4 of the OSFI Act.

Pursuant to paragraph 17.4 of the OSFI Act, OSFI secures a revolving expenditure authority through the Annual Reference Level Update (ARLU) estimates process. On an annual basis, OSFI obtains authority from the Treasury Board Secretariat to draw up to $25 million from the Consolidated Revenue Fund to ensure availability of funds prior to receipt of revenue. No interest is charged when this expenditure authority is used. Drawings on this facility were $Nil as at March 31, 2010 (2009: $Nil).

Refer to Note 2 for further information on OSFI's authority.

MARCH 31, 2010 (IN THOUSANDS OF DOLLARS)

8. Financial risk management (continued)

c) Liquidity risk (continued)

The table below summarizes the maturity profile of OSFI's financial liabilities as at March 31, 2010 based on contractual undiscounted payments. When the counterparty has a choice of when the amount is paid, the liability is allocated to the earliest period in which OSFI can be required to pay. When amounts are due in instalments, each instalment is allocated to the earliest period in which OSFI can be required to pay.

	On demand	Less than 3 months	3 to 12 months	1 to 5 years	Greater than 5 years	Total
Accrued Salaries & Benefits	$ 3,847	$ 1,545	$ 8,027	$ -	$ -	$ 13,419
Accounts Payable & Accrued Liabilities	-	3,486	5,680	-	-	9,166
Unearned Base Assessments	-	-	3,749	-	-	3,749
Unearned Pension Plan Fees	-	-	(137)	2,476	308	2,647
Total	**$ 3,847**	**$ 5,031**	**$ 17,319**	**$ 2,476**	**$ 308**	**$ 28,981**

The liquidity of OSFI's financial assets is outlined in Note 5 Accounts Receivable.

Unearned Pension Plan Fees represent the accumulation of in-year surplus or deficit against fees collected. These are in turn paid or collected over a period of five years commencing one year from the year in which they were established. OSFI does not charge nor pay interest to the various pension plans over the five years and records these amounts at historic cost.

9. Capital assets

	Cost				Accumulated Amortization				Net Book Values	
Categories	Opening Balance	Additions	Disposals	Closing Balance	Opening Balance	Amortization Expense	Disposals	Closing Balance	2010	2009
Leasehold Improvements	$ 5,694	$ 596	$ -	$ 6,290	$ 2,584	$ 726	$ -	$ 3,310	$ 2,980	$ 3,110
Furniture and Fixtures	4,188	391	(204)	4,375	2,704	469	(204)	2,969	1,406	1,484
Office Equipment	384	-	(147)	237	347	19	(147)	219	18	37
Informatics Hardware	3,066	447	(1,955)	1,558	2,315	409	(1,836)	888	670	751
Informatics Infrastructure	2,522	281	(992)	1,811	2,269	152	(1,111)	1,310	501	253
Informatics Software	666	-	-	666	519	98	-	617	49	147
Total	**$ 16,520**	**$ 1,715**	**$ (3,298)**	**$ 14,937**	**$ 10,738**	**$ 1,873**	**$ (3,298)**	**$ 9,313**	**$ 5,624**	**$ 5,782**

MARCH 31, 2010 (IN THOUSANDS OF DOLLARS)

10. Intangible assets

	Externally Purchased Software	Internally Developed Software	Internally Developed Software under Development	Total
Cost:				
At April 1, 2009	$ 9,792	$ 2,931	$ 582	**$ 13,305**
Additions	91	-	277	**368**
Transfer to 'In Use'	-	339	(339)	**-**
At March 31, 2010	$ 9,883	$ 3,270	$ 520	**$ 13,673**
Accumulated Amortization and impairment:				
At April 1, 2009	$ 4,963	$ 2,494	$ -	**$ 7,457**
Impairment write-down	-	-	268	**268**
Amortization	1,691	148	-	**1,839**
At March 31, 2010	$ 6,654	$ 2,642	$ 268	**$ 9,564**
Net book value:				
At March 31, 2010	**$ 3,229**	**$ 628**	**$ 252**	**$ 4,109**
At March 31, 2009	**$ 4,829**	**$ 437**	**$ 582**	**$ 5,848**

The internally developed software under development was assessed for impairment at March 31, 2010. One project was discontinued for technical reasons, resulting in an impairment write-down of $268 included in expense on the statement of Operation and Comprehensive Income.

11. Employee future benefits

a) Pension benefits

OSFI and all eligible employees contribute to the Public Service Pension Plan. This pension plan provides benefits based on years of service and average earnings at retirement. The benefits are fully indexed to the increase in the Consumer Price Index. The estimated employer contributions to the Public Service Pension Plan during the year were $7,406 (2009: $6,299).

As required under present legislation, the contributions made by OSFI to the Plan are 1.94 times (2009: 1.91 times) the employees’ contribution on amounts of salaries of $139.5 or less (2009: $136.7 or less) and 8.9 times (2009: 7.55 times) the employees’ contribution on amounts of salaries in excess of $139.5 (2009: $136.7).

MARCH 31, 2010 (IN THOUSANDS OF DOLLARS)

11. Employee future benefits (continued)

b) Severance benefits

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

	2010	2009
Accrued Benefit Obligation, beginning of year	**$ 9,064**	**$ 8,629**
Current service cost	801	741
Interest cost	362	371
Benefits paid	(831)	(539)
Actuarial gain	(1,077)	(138)
Accrued Benefit Obligation, end of year*	**8,319**	**9,064**
Unamortized net actuarial gain (loss)	550	(527)
Accrued Benefit Liability	**$ 8,869**	**$ 8,537**
Net Benefit Plan Expense		
Current service cost	$ 801	$ 741
Interest cost	362	371
Benefit Expense	**$ 1,163**	**$ 1,112**

* The cost corresponding to annual changes in the accrued benefit liability is recovered from OSFI's various sources of revenue outlined in note 4(k) to the financial statements. Amounts collected in excess of benefits paid are presented on the balance sheet under the heading of Cash Entitlement.

The significant actuarial assumption adopted in measuring OSFI's accrued benefit obligation is a discount rate of 5.5% (2009: 4.0%). This rate represents a change in estimate from the previous year in order to better reflect the effective rate at which the liability could be settled currently. For measurement purposes, management's best estimate for the general salary increases to estimate the current service cost and the accrued benefit obligation as at March 31, 2010 is an annual economic increase of 1.5% for the plan years 2011 and 2012 inclusively (2009: 1.5% for the plan years 2010 to 2012 inclusively). Thereafter, an annual economic increase of 2.0% is assumed (2009: 2.0%). The average remaining service period of active employees covered by the benefit plan is 12 years (2009: 12 years).

This change in estimate has no impact on the March 31, 2010 accrued benefit liability and minimal impact on the future year since the net actuarial gain (loss) is within the 10% range of the benefit obligation as outlined in note 4(g)(ii).

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12. Contractual obligations and contingencies

a) Contractual obligations

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

2010-2011	$	6,048
2011-2012		5,614
2012-2013		2,100
2013-2014		32
2014-2015		31
	$	13,825

b) Contingencies

In its normal course of operations, OSFI is involved in claims and litigation for which provisions are made to the extent determinable, in accordance with accounting policy note 4(j).

13. 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 $939 (2009: $869). OSFI also receives administrative support from other departments in the form of services without charge. In the current year OSFI recorded government funding revenue and administrative expenses in the amount $170 for these services provided without charge by related parties.

MARCH 31, 2010 (IN THOUSANDS OF DOLLARS)

14. Capital management

OSFI includes Contributed Surplus and Accumulated Deficit, collectively entitled "Equity of Canada", in its definition of capital.

	2010	2009
Contributed Surplus	$ 28,327	$ 28,327
Accumulated Deficit	(789)	(789)
Equity of Canada	$ 27,538	$ 27,538

OSFI operates on a cost recovery basis. Its objective when managing capital is to closely manage actual costs to those estimated and communicated to its paying stakeholders. Any operating shortfall or excess is factored into the assessments and fees charged to regulated entities in the following year. OSFI fully recovered all of its costs incurred in the year.

OSFI is not subject to any externally imposed capital requirement.

OSFI did not change its capital management objectives, policies or processes during the year ended March 31, 2010.

15. Filing penalties

Filing penalties levied by OSFI are remitted to the Consolidated Revenue Fund. The funds are not available for use by OSFI and are not included in the balance of the Cash Entitlement. As a result, the penalties do not reduce the amount that OSFI assesses the industry in respect of its operating costs.

In the year ended March 31, 2010, OSFI levied $39 (2009: $486) in late and erroneous filing penalties.

MARCH 31, 2010 (IN THOUSANDS OF DOLLARS)

16. Specified purpose account for insurance company liquidations

The following activity occurred in this account:

	2010	2009
Opening Balance	$ 1,028	$ -
Recoveries deposited	5,680	1,028
Interest earned	-	-
Distribution of assets from liquidated estates	(1,028)	-
Closing Balance	**$ 5,680**	**$ 1,028**
Remaining insurance company liquidations under control of the Superintendent	**3**	**5**

17. Revenue and Expenses by Business Activity

Revenue by Business Activity

	2010					2009				
	Base Assess-ments	Cost-Recovered Services	Pension Plan Fees	User Fees and Charges	TOTAL	Base Assess-ments	Cost-Recovered Services	Pension Plan Fees	User Fees and Charges	TOTAL
Regulation and Supervision of Federally Regulated Financial Institutions	$ 82,393	$ 951	$ -	$ 5,409	**$ 88,753**	$ 75,107	$ 1,359	$ -	$ 3,786	**$ 80,252**
Regulation and Supervision of Federally Regulated Private Pension Plans	-	-	6,529	-	**6,529**	-	-	5,931	-	**5,931**
International Assistance	-	1,717	-	-	**1,717**	-	1,689	-	-	**1,689**
Office of the Chief Actuary	-	5,155	-	46	**5,201**	-	4,445	-	67	**4,512**
TOTAL REVENUE	**$ 82,393**	**$ 7,823**	**$ 6,529**	**$ 5,455**	**$ 102,200**	**$ 75,107**	**$ 7,493**	**$ 5,931**	**$ 3,853**	**$ 92,384**

MARCH 31, 2010 (IN THOUSANDS OF DOLLARS)

17. Revenue and Expenses by Business Activity (continued)

Expenses by Business Activity

	2010	2009
Regulation and Supervision of Federally Regulated Financial Institutions		
Risk Assessment and Intervention	$ 60,521	$ 55,131
Rule Making	18,965	17,671
Approvals	8,985	6,967
Total	**88,471**	**79,769**
Regulation and Supervision of Federally Regulated Private Pension Plans	**6,529**	**5,931**
International Assistance	**2,183**	**2,172**
Office of the Chief Actuary		
Canada Pension Plan and Old Age Security	2,158	1,886
Public Pension Plans	3,258	2,841
Canada Student Loans Program	710	654
Total	**6,126**	**5,381**
TOTAL EXPENSES	**$ 103,309**	**$ 93,253**

MARCH 31, 2010 (IN THOUSANDS OF DOLLARS)

18. Revenue and expenses by major classification

	For the year ended March 31				
	2010	**2009**	**2008**	**2007**	**2006**
Revenue					
Base Assessments	$ 82,393	$ 75,107	$ 67,807	$ 63,890	$ 60,878
Cost-Recovered Services	7,823	7,493	9,156	9,568	8,624
Pension Plan Fees	6,529	5,931	5,876	5,875	5,442
User Fees and Charges	5,455	3,853	2,801	3,192	5,222
Total Revenue Earned from Respendable Sources	**102,200**	**92,384**	**85,640**	**82,525**	**80,166**
Expenses					
Human Resources	76,533	68,642	63,010	58,632	55,254
Information Management/Technology	8,820	8,209	7,605	9,546	10,418
Facilities	7,806	6,631	6,470	6,615	6,247
Travel	4,077	3,995	3,487	3,311	3,333
Administration	3,566	2,727	3,098	2,750	2,623
Professional Services	1,165	1,851	1,419	978	1,495
Professional Development	1,342	1,198	1,424	1,461	1,551
Total Expenses	**103,309**	**93,253**	**86,513**	**83,293**	**80,921**
Net Results of Operations before Non-Respendable Filing Penalties Revenue and Government Funding	**(1,109)**	**(869)**	**(873)**	**(768)**	**(755)**
Government Funding	1,109	869	873	768	755
Filing Penalties Revenue	39	486	374	227	805
Filing Penalties Earned on Behalf of Government	(39)	(486)	(374)	(227)	(805)
Net Results of Operations and Comprehensive Income	**$ -**	**$ -**	**$ -**	**$ -**	**$ -**
Average Number of Employees	**530**	**480**	**459**	**446**	**434**

19. Equity of Canada

Contributed Surplus – OSFI was established on July 2, 1987 by the OSFI Act. OSFI was created through the merger of its two predecessor agencies – the Department of Insurance and the Office of the Inspector General of Banks. To help fund OSFI's first year of operations and establish a pool of working capital necessary to support its annual assessment and expenditure cycle, OSFI was credited with the assessments that recovered the costs of its predecessors for the previous fiscal year. This amount is reflected as contributed surplus.

Accumulated Deficit – The accumulated deficit was created as part of OSFI's transition to accrual accounting under Canadian generally accepted accounting principles in fiscal 2000-2001. As part of the transition, additional transactions were required to be recorded that created the deficit. This amount has not changed since the transition.

20. Comparative figures

Certain 2009 comparative figures have been reclassified to conform to the presentation adopted in 2010.