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

OSFI
ANNUAL REPORT HIGHLIGHTS

2011-2012

OSFI
BSIF

Canada

OSFI ***Annual Report Highlights 2011–2012*** provide a summary of both performance against annual priorities and achievements related to ongoing program responsibilities. The full report and financial statements are available on the OSFI website.

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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 Parliament through the Minister of Finance.
- OSFI supervises and regulates 422 banks and insurers, and some 1,354 federally registered private pension plans. As at March 31, 2012, these organizations managed total assets of $4,901 billion.
- The Office of the Chief Actuary, which is an independent unit within OSFI, provides actuarial valuation and advisory 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, which in 2011-2012 totalled $124 million. OSFI is funded mainly through assessments on the financial services industry and a user-pay program for selected services. A small portion of OSFI's revenue is received through an appropriation from the Government of Canada for actuarial valuation and advisory services relating to various public sector pension and benefit plans.
- As of March 31, 2012, OSFI employed 622 people in offices located in Ottawa, Montréal, Toronto and Vancouver.

SUPERINTENDENT'S MESSAGE

THE past year has been an interesting and busy one for OSFI. In 2011-2012, we witnessed ongoing global economic turmoil, financial market volatility, historically low interest rates, and relatively slow economic growth in many countries. OSFI continued to monitor closely the impact of these events on the Canadian financial institutions and pension plans that we oversee. We increased our staff complement in specialized skill areas and enhanced our supervision of institutions and pension plans.

We maintained an active role in international forums, including the Financial Stability Board, the Basel Committee on Banking Supervision, the Senior Supervisors Group and the International Association of Insurance Supervisors. Through participation in these groups, OSFI ensures it is well positioned to learn from, and contribute to, discussions on enhancements to global financial regulatory frameworks.

Domestically, OSFI continued to work with the Department of Finance, the Bank of Canada, Canada Deposit Insurance Corporation, and the Financial Consumer Agency of Canada to discuss and coordinate approaches to oversight of the financial sector, and to continue regulatory refinements that reflect best practices.

In 2011-2012, OSFI paid increased attention to the capital planning activities of banks, given the importance of capital to deal with unexpected shocks, and the move to Basel III in 2013. In the insurance industry, we focused on the work plan for introducing more risk-sensitive approaches to regulatory capital and began preparation of a paper outlining future regulatory refinements for the life insurance industry.

Given the record levels of household debt in Canada, and that real estate based lending represents a significant portion of banks' balance sheets, OSFI also focused its attention on the issues of residential mortgages and home equity lines of credit. While real estate based lending has contributed to the profitability of the Canadian banking industry, it has left many households vulnerable to adverse economic shocks. In an effort to prevent these vulnerabilities from evolving into problems for the financial system, OSFI issued a draft Guideline on Residential Mortgage Underwriting Practices and Procedures in March 2012 (final version issued in June 2012). The guidance builds on OSFI's domestic supervisory work, and reflects and expands upon the Financial Stability Board's Principles for Sound Residential Mortgage Underwriting (issued in the fall of 2011).

OSFI has always viewed strong corporate governance as an essential element of effective risk management. Weaknesses in corporate governance contributed to failures at a number of international financial institutions during the global financial turmoil. Accordingly, OSFI is placing even greater emphasis on promoting effective corporate governance at financial institutions in Canada.

OSFI's Corporate Governance unit conducted a comparative review of governance practices at a number of institutions during 2011-2012, and we are using the results as a basis to update our Corporate Governance Guideline.

While the past year has been challenging, I am proud of how well OSFI has performed. Over its 25-year history, OSFI has worked to contribute to public confidence in a strong, stable and competitive financial system. Our people are the most important element of our effectiveness, and will continue to be so for the next 25 years and beyond.

Julie Dickson

Julie Dickson

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Deputy Superintendent,
Supervision Sector

MARK ZELMER
Assistant Superintendent,
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JULIE DICKSON
Superintendent of Financial Institutions

GARY WALKER
Assistant Superintendent,
Corporate Services Sector

PERFORMANCE AGAINST PRIORITIES 2011-2012

OSFI's primary objective is to contribute to the safety and soundness of the Canadian financial system, while taking into account the need of federally regulated financial institutions and private pension plans to take reasonable risks and to remain competitive domestically and internationally. Last year's Annual Report listed four priorities to achieve OSFI's strategic outcomes for 2011-2012. This section reports major accomplishments under each of those priorities. OSFI achieved its goals for the reporting year and continues to work on these multi-year priorities.

PRIORITY A – Responding to Risks Emanating from the Economy

Steps Taken

- Monitored the Canadian and international economic environment for trends and potential shocks through OSFI's Emerging Risk Committee and targeted research
- Conducted significant cross-sector reviews in the areas of:
  - Asset-liability management
  - Corporate governance
  - Structural interest rate risk
  - Stress tests
- Continued to conduct:
  - Risk management seminars
  - Supervisory colleges
  - Crisis management and industry information sessions
- Participated actively on various international committees, including:
  - Financial Stability Board (FSB)
  - Basel Committee on Banking Supervision (BCBS)
  - Senior Supervisors Group (SSG)
  - International Association of Insurance Supervisors (IAIS)

PRIORITY B – Responding to Risks Emanating from Regulatory Reform (including banking, insurance, pensions and accounting [IFRS] reforms)

Steps Taken

- Issued new/revised guidelines, advisories or letters on:
  - Capital Adequacy Requirements (update re securitization and market risk)
  - Non-Viability Contingent Capital
  - Liquidity Principles
  - Submission to United States re draft "Volcker Rule"
  - Residential Mortgage Underwriting Practices and Principles (draft guideline)

  - Internal Target Capital Ratio for Insurance Companies
  - Participating Account Management and Disclosure to Par and Adjustable Policyholders
  - Appointed Actuary: Legal Requirements, Qualifications and Peer Review (draft guideline)
  - Minimum Continuing Capital and Surplus Requirements (MCCSR) update
  - Minimum Capital Test (MCT) update
  - Mean Reversion in Models of Equity Returns

- Continued to conduct Qualitative Impact Studies (QIS) and capital monitoring to assess impacts of rules to be implemented or still under development

- Carried out reviews of trading book and operational risk approaches

- Continued development of the liquidity framework and liquidity requirements

- IFRS / Disclosures
  - Issued a letter on OSFI's position regarding early adoption of IFRS
  - Performed a targeted review of public disclosures to identify best practices and areas for improvement in financial reporting
  - Posted letters to the industry to operationalize Pillar 3 disclosures in several areas, such as remuneration disclosures, Basel 2.5 enhancements and revisions disclosures
  - Presented at the FSB roundtable on disclosures and at the Canadian Public Accountability Board symposium on audit quality
  - Continued to work through the BCBS and IAIS to influence the International Accounting Standards Board (IASB) on accounting decisions
  - Provided positions on changes in accounting for IFRS 9 Financial Instruments and IFRS 4 Insurance Contracts (Phase II)
  - Continued to monitor IASB and Financial Accounting Standards Board decisions as they impact the Canadian capital regime

PRIORITY C – A High-Performing and Effective Workforce

Steps Taken

- Built on existing strength and deep specialization by increasing the staff complement in critical areas such as Capital, Supervision Deposit-Taking Group, and Actuarial divisions

- Reviewed and prioritized employee learning needs and provided specialized training (e.g., International Financial Reporting Standards, liquidity) to enhance OSFI staff knowledge base, expertise and leadership

- Conducted a compensation market survey to ensure we continue to meet our stated compensation philosophy

- Strengthened Human Resource frameworks (in areas such as compensation, performance management and HR planning) and internal controls

PRIORITY D – An Enhanced Corporate Infrastructure

Steps Taken

- Initiated renewal of the Tri-Agency Database System, which is shared with the Bank of Canada and Canada Deposit Insurance Corporation, to modernize the processing system supporting all three organizations to collect, validate, manage and maintain financial returns
- Initiated major technology renewal projects for:
  - Document/records management
  - Website and intranet site
  - Business Intelligence
  - Risk Assessment System for Pensions

The four priorities described above will also guide the achievement of strategic outcomes for 2012-2013. Details can be found on OSFI's website in the *Plan and Priorities 2012-2015*.

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OSFI has the following ongoing areas of responsibility:

Federally Regulated Financial Institutions

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

Federally Regulated Private Pension Plans

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

Provision of expert actuarial valuation and advice to contribute to a financially sound Canadian public retirement system, including the Canada Pension Plan, various public sector pension and benefit plans, and other programs

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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 loss. OSFI does this while recognizing that management and boards of directors are ultimately responsible and that financial institutions can fail.

Throughout 2011-2012, OSFI continued to exercise a heightened level of monitoring of financial institutions and markets, and took action to achieve strategic priorities by: developing supporting guidance for the updated Supervisory Framework; strengthening the design and application of supervisory processes; conducting significant cross-sector reviews in several areas, including capital adequacy and corporate governance; and communicating our expectations for risk management to FRFIs.

OSFI worked with various domestic partners – including the Bank of Canada, the Department of Finance, the Canada Deposit Insurance Corporation, and the Financial Consumer Agency of Canada – to review developments in the financial system and lessons learned, and to discuss and coordinate approaches to oversight of the financial sector. We continued to enhance collaboration with the Bank of Canada and the Department of Finance on analysis of macroeconomic and systemic risk issues.

OSFI also continued to participate actively in international forums to develop and implement best practices. These include the Financial Stability Board, the Basel Committee on Banking Supervision, the Senior Supervisors Group and the International Association of Insurance Supervisors.

Deposit-taking institutions

The Canadian banking industry performed satisfactorily in 2011, despite the challenging global environment. Record profits were reported in 2011 as the Canadian economy remained relatively strong while credit conditions and capital markets improved. Average return on equity for the banking sector improved from 14.5% in 2010 to 15.5% in 2011.

Under current Basel Committee international standards (Basel II), the Canadian banking industry was adequately capitalized in 2011. The banks' Tier 1 capital levels remained above the Basel Committee's 4% minimum and OSFI's target expectation of 7%.

In addition to macroeconomic challenges, adoption of International Financial Reporting Standards (IFRS) for accounting, and revision of international capital and liquidity standards, are major issues for the Canadian banking industry. OSFI has liaised closely with the conglomerate banks on potential impacts of the 2012 IFRS transition, and will continue to work with the industry to evaluate their capital and liquidity management strategies in light of new standards under Basel III.

OSFI, in conjunction with the Bank of Canada, conducted another macroeconomic stress-testing exercise by prescribing a common scenario to participating banks, in order to better understand, and to increase awareness in financial institutions about, potential system-wide risks and vulnerabilities.

Insurance companies

In 2011, the Canadian life insurance industry again produced financial results below its historical standard. Total net income of federally regulated life insurance companies and branches for the year was $4.3 billion (50% from the three large conglomerates) for a return on equity of 5.8%. This compares with a 2010 performance of $4.5 billion in net income (61% from the three large conglomerates) and a return on equity of 6.1%. With a sound capital base and strong reserve levels, the life insurance industry was healthy going into 2012.

OSFI continues to monitor and provide guidance to the industry on risk mitigation strategies. In 2011, OSFI asked a selected number of life insurers and life reinsurers, representing over 98% of the federally regulated Canadian life insurance industry, to complete stress tests based on standardized scenarios. OSFI reviewed the results of the exercise, shared the

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aggregate results with industry, and is using them to determine if there are any significant changes in the risk profile of each life insurer.

The property and casualty (P&C) industry continued to show resiliency in 2011, despite a challenging economic and operating environment both internationally and domestically. Net income for the P&C industry in Canada during 2011 improved to \$3.5 billion (included in this number is \$573 million of other revenues representing mergers and acquisitions activity). Industry return on equity was 9.8%, up from the 6.8% reported in 2010.

The Canadian P&C industry continues to be adequately capitalized as 2011 showed solid Minimum Capital Test (MCT) results for Canadian companies, and Branch Adequacy of Assets Test (BAAT) results for foreign companies. The industry combined MCT/BAAT ratio of 242% was well above OSFI's minimum supervisory target of 150%.

Repeal of OSFI's reinsurance regulations as of July 2011 and implementation of guideline B-3, Sound Reinsurance Practices and Procedures, will introduce significant changes into Canada's reinsurance framework (e.g., changes to collateral requirements, introduction of new Reinsurance Security Agreements). OSFI will be monitoring developments within the marketplace as a result of the changes.

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Supervisory tools

In 2011-2012, OSFI began updating internal guidance to support its risk-based Supervisory Framework (introduced in 1999 and updated in 2011). The framework considers an institution's inherent business risks, risk management practices (including corporate governance) and financial condition. It supports our ability to identify and assess material risk to an institution that could result in potential loss to depositors or policyholders. The framework also facilitates early intervention should issues arise from an institution or its external environment, so there is a greater likelihood of satisfactory resolution.

In 2011-2012, OSFI again held annual risk management seminars for the industries it regulates (DTIs, Life insurance, and P&C insurance) to reinforce the need for strong risk management and to share lessons learned.

Continuing the practice of organizing Colleges of Supervisors, in 2011-2012, OSFI hosted a college for two of Canada's largest banks, in line with Financial Stability Board recommendations, which brought together executives from each bank with supervisors from several jurisdictions where they do business. For the second consecutive year, OSFI also hosted a college for a large life insurance company. In addition, OSFI again conducted crisis management and industry information sessions.

Composite risk and intervention ratings

The Composite Risk Rating (CRR) represents OSFI's overall assessment of an institution's safety and soundness for its depositors and policyholders. As at the end of March 2012, OSFI had assigned a low or moderate CRR to 92% of all rated institutions and had rated 8% as either above average or high risk (compared to 90% and 10% as at March 31, 2011).

Financial institutions are also assigned an intervention rating, 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, 2012, there were 38 staged institutions. With a few exceptions, the majority of the staged institutions were in the early warning (stage 1) category.

REGULATION AND GUIDANCE

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 the development of federal legislation and regulations affecting federally regulated financial institutions (FRFIs), and comments on accounting, auditing and actuarial standards development, and determines how to incorporate them into our regulatory framework. OSFI also participates in a number of international and domestic rule-making activities.

During 2011-2012, OSFI continued to promote sound risk management practices through its rule-making activities. OSFI's emphasis on robust risk management systems at financial institutions is reflected in the fact that the World Economic Forum continues to rank Canada's banking system as the world's soundest.

Domestic rule making

The governing statutes applicable to FRFIs are reviewed every five years to ensure they remain current and promote an efficient, competitive and prudent financial services sector. Following the Government of Canada's September 2010 launch of the legislative review, OSFI submitted a number of proposals regarding amendments to the statutes and associated regulations. During 2011-2012, OSFI continued to work closely with the Department of Finance in the development of amendments to the legislation and supporting regulations. Bill S-5, *An Act to amend the law governing financial institutions and to provide for related and consequential matters*, received Royal Assent on March 29, 2012.

During 2011-2012, OSFI released one guideline and three advisories related to the measurement of capital and capital adequacy of banks and trust and loan companies. In February 2012, OSFI issued

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Prudential Limits and Restrictions Guideline B-6 on liquidity risk management applicable to banks, bank holding companies, and trust and loan companies. The guideline reflects international standards that emphasize the principles by which an institution's liquidity risk management framework will be assessed by OSFI supervisors.

OSFI undertook its annual update of the Minimum Continuing Capital and Surplus Requirements (MCCSR) guideline during 2011, with the revised version coming into effect for the 2012 fiscal year. With stakeholder input considered, the guideline was updated to clarify certain elements or make the guidance more risk-based.

In June 2011, OSFI issued Guideline A-4, Internal Target Capital Ratio for Insurance Companies. The guideline sets out OSFI's expectations for federally regulated life insurance, and property and casualty insurance, companies with respect to the setting of an internal target capital ratio. It also addresses how capital adequacy assessment fits within the context of OSFI's supervisory framework.

In cooperation with the Autorité des marchés financiers (AMF) and Assuris, OSFI continued with renewal of the standardized MCCSR approach for life insurance. This significant undertaking was initiated mainly to respond to potential issues around upcoming changes in accounting and actuarial standards, and emerging concerns related to the Canadian Asset Liability Method (CALM).

OSFI released in September 2011 an updated version of the Minimum Capital Test (MCT) Guideline, after an extensive consultation process with different stakeholders of the property and casualty (P&C)

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insurance industry. The revised version came into effect as of January 1, 2012. The guideline reflected OSFI's ongoing intention to make the P&C insurance capital test more risk-based and to bring greater consistency with the capital requirements of other financial sectors. It also consolidates the MCT and Branch Adequacy of Assets Test (BAAT) into one document – the MCT Guideline.

In October 2011, OSFI issued a letter to the industry in response to the new or amended IFRS issued in May and June of 2011 – Consolidation suite of standards, IFRS 13 Fair Value Measurement, amendments to IAS 19 Employee Benefits and amendments to IAS 1 Presentation of Items in Other Comprehensive Income.

In March 2012, OSFI issued for comment a draft guideline on Residential Mortgage Underwriting Practices and Procedures, which reflects and expands upon the Financial Stability Board's Principles for Sound Residential Mortgage Underwriting issued in the fall of 2011. The guidance sets out OSFI's expectations for FRFIs in addressing the risk inherent in mortgage underwriting activities, such as high household indebtedness and other vulnerabilities.

During 2011-2012, OSFI continued its Anti-Money Laundering (AML) and Anti-Terrorism Financing (ATF) supervisory assessment program and regular follow-up work at a wide variety of large and small financial institutions. OSFI further intensified its processes relating to the review of AML/ATF risk assessments undertaken by those applying to establish new FRFIs.

International activities

While the Canadian financial system continues to benefit from approaches taken in Canada, the global marketplace experienced a period of severe stress from which it continues to recover. As a result, international regulatory reform remains at the top of the agenda for the G-20. In 2011-2012, OSFI continued its participation in the development of international rules.

OSFI strengthened relationships with foreign supervisors by participating in international rule-making discussions, participating in and hosting several international supervisory colleges (for both banking and insurance companies), and developing information-sharing agreements with a number of host-country supervisory authorities that regulate significant foreign operations of Canadian banks and insurers.

The Financial Stability Board (FSB) coordinates, at the international level, the work of national financial authorities and international standard setting bodies. During 2011-2012, OSFI continued its close involvement with the FSB through its membership on the FSB Plenary, Steering Committee, and Standing Committee on Supervisory and Regulatory Cooperation. OSFI Superintendent Julie Dickson chairs the Supervisory Intensity and Effectiveness Group, which is conducting significant work in relation to the supervision of systemically important financial institutions.

The Basel Committee on Banking Supervision (BCBS) provides a forum for international rule making and cooperation on banking supervisory matters. OSFI is an active member and is providing leadership and resources to analyzing and reviewing the consistency of member countries' calculation of the risk weighted assets portion of minimum capital ratio standards. In 2011-2012, OSFI participated in quantitative impact studies and multiple work streams on: capital standards for exposures to central counterparties for derivatives contracts; a fundamental review of capital rules for trading book activities; and, the risks of financial institutions that have globally significant operations. OSFI also worked actively with other BCBS members to develop and issue draft rules for capitalizing bank exposure to central counterparties clearing

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derivative transactions and a methodology for assessing global systemically important banks.

Since all FRFIs in Canada are required to follow IFRS and International Standards on Auditing (ISA), OSFI interprets and assesses international rules that may apply to Canadian financial institutions. OSFI works with the International Accounting Standards Board (IASB) and International Auditing and Assurance Standards Board (IAASB) through active participation and leadership in the Accounting Task Force of the BCBS and the Accounting and Auditing Issues Subcommittee of the International Association of Insurance Supervisors (IAIS). In 2011-2012, OSFI provided its positions on changes in accounting for IFRS 9 Financial Instruments and IFRS 4 Insurance Contracts (Phase II).

OSFI actively participates in the work of the International Association of Insurance Supervisors (IAIS), which represents insurance regulators and supervisors of approximately 140 countries. OSFI is a member of the IAIS Executive, Technical, Budget and Implementation Committees, the Supervisory Forum and several subcommittees. In 2011-2012, OSFI contributed to the Survey of Effectiveness of Supervisory Colleges conducted by the IAIS. This included participation in roundtables in Europe and North America, at which results were shared publicly and issues identified were discussed with industry players.

Disclosure of information

Under the OSFI 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 website and through Beyond 20/20 Inc. (see their website for more information); providing guidance to FRFIs on their disclosures; and, participating in international supervisory groups with similar objectives.

During 2011-2012, OSFI performed a targeted review of public disclosures made by large banks to identify best practices and any areas for improvement. Findings were communicated to selected institutions and OSFI saw substantial improvement in the targeted areas in subsequent reporting periods. Throughout 2011-2012, OSFI monitored the FSB and BCBS disclosure requirements for Canadian banks, and found the banks continue to comply in all material respects with such disclosure requirements as they come into effect.

APPROVALS AND PRECEDENTS

The *Bank Act*, *Trust and Loan Companies Act*, *Insurance Companies Act*, and *Cooperative Credit Associations Act* all require federally regulated financial institutions (FRFIs) to seek regulatory approval from the Superintendent of Financial Institutions or the Minister of Finance (acting on the advice of OSFI), prior to engaging in certain transactions or business undertakings. Such regulatory approvals are also required by persons wishing to incorporate a FRFI, and by foreign banks or foreign insurance companies wishing to establish a presence or to make certain investments in Canada. OSFI administers a regulatory approval process that is prudentially effective, responsive and transparent. OSFI's Approvals team strives to ensure that recommendations made to the Superintendent and to the Minister are in the best interest of depositors and policyholders as well as the Canadian financial sector.

In 2011-2012, OSFI processed 222 applications involving 347 approvals (individual applications often contain multiple approval requests), of which 23% were granted by the Minister. Of the 222 applications, 188 were approved and 34 were withdrawn. This represents a small increase in completed applications over the previous year, when 209 applications involving 284 approvals were processed. The majority of applications related to property and casualty insurers (43%) and banks (36%).

Most applications received from deposit-taking institutions related to changes in ownership, substantial investments and redemption of shares/debentures. Applications received from insurance companies related mainly to changes in ownership and reinsurance with related unregistered reinsurers.

Upon request, OSFI provides advance capital confirmations on the eligibility of proposed capital instruments. A total of 26 such opinions and validations were provided in 2011-2012, compared to 28 the previous year.

OSFI develops and publishes legislative guidance including advisories, rulings, and transaction instructions. In 2011-2012, OSFI published two rulings: Business in Canada – Credit card activities and "Near" Foreign Banks – Securities dealer undertakings. In November 2011, OSFI published one revised transaction instruction regarding "Asset transactions greater than 10% of assets".

OSFI has performance standards establishing time frames for processing applications for regulatory approval and for other services. During 2011-2012, OSFI surpassed all of these standards. More information on service performance standards can be found on OSFI's website.

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FEDERALLY REGULATED PRIVATE PENSION PLANS

OSFI supervises federally regulated pension plans and intervenes in a timely manner to protect members and beneficiaries of pension plans from loss, while recognizing that plan administrators are ultimately responsible and that funding difficulties can result in loss of benefits.

Approximately 7% of pension plans in Canada are federally regulated (Statistics Canada data as at January 2010). As at March 31, 2012, 1,354 private pension plans were registered under the *Pension Benefits Standards Act*, 1985 (PBSA), covering over 646,000 employees in federally regulated areas of employment, such as banking, inter-provincial transportation and telecommunications. Between April 1, 2011 and March 31, 2012, federally regulated pension plan assets increased by 7%, to a value of approximately $142 billion and recorded a 4% return on their investments in 2011, compared to 11% in 2010 and 13% in 2009. Pension plans under provincial regulation represent 18 million employees and total assets of $1.08 trillion.

Risk assessment, supervision and intervention

In 2011-2012, OSFI continued to monitor the condition of private pension plans and, to the extent possible, that of their sponsors. On-site examinations of selected pension plans allow OSFI to enhance its assessment of both the plan's financial situation and the quality of administration and oversight. During 2011-2012, OSFI performed 13 examinations. 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 set a target of less than 27 working days after an examination wrap-up meeting to issue its findings, which it met or exceeded 92% of the time in 2011-2012.

OSFI considers both the size of a 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. During the course of 2011-2012, 82 new plans were added to the watch list and 16 were removed, in part due to OSFI's intervention.

OSFI intervened with respect to high-risk pension plans, including taking measures to enforce minimum funding requirements and ensure timely remittance of contributions. OSFI required some plans to restrict portability of benefits in order to stop the impairment of the pension fund. In addition, OSFI used its authority to replace plan administrators and, in three instances, to terminate a pension plan whose future was uncertain, with the objective of providing equitable treatment of all members and beneficiaries.

As part of an ongoing emphasis on the effectiveness and efficiency of its operations, OSFI has initiated an important upgrade to the pension supervisory system supporting its risk assessment framework. The main pillars of that framework for pension plans are: tiered risk indicators, solvency testing, on-site examinations, the watch list, use of intervention powers and ad hoc reviews.

Rules and guidance

The Government of Canada announced reforms in October 2009 aimed at enhancing the security of pension benefits and helping pension plans cope with market volatility. The majority of the reforms were put into effect in 2010 and 2011. OSFI worked closely with the Department of Finance to support the implementation of those changes, and continued to communicate with pension plan stakeholders on the status and timing of legislative reforms.

In 2011, Pooled Retirement Pension Plans (PRPP) became a key element of the Government of Canada's policy agenda, with the PRPP Act being tabled in November 2011. OSFI is providing technical support to this initiative.

OSFI issued new and updated guidance to promote prudent practices and integrate legislative reforms. New guidance included the Stress Testing Guideline for Plans with Defined Benefit Provisions, published in August 2011. Updated guidance included the Draft Guideline for Preparation of Actuarial Reports for Defined Benefit Pension Plans issued in May 2011, the Draft Instruction Guide for Authorization of Amendments Reducing Benefits in Defined Benefit Pension Plans and the Draft Policy Advisory for Buy-in Annuity Products, both issued in January 2012. Federally regulated private pension plans are required to seek approval from OSFI for several different types of transactions affecting pension plans, including plan registrations and terminations, asset transfers between registered defined benefit (DB) pension plans, refunds of surplus, or reduction of benefits.

OSFI held its third annual pension industry forum in Toronto, in February 2012, to communicate recent legislative and regulatory reforms, and discuss guidance issued during the year and other OSFI initiatives. In addition, OSFI conducted a survey of pension plan stakeholders in late 2011 and will be addressing the input received.

Approvals

During 2011-2012, OSFI continued to focus on timeliness for pension approvals while ensuring complex transactions were carefully considered. OSFI processed 60 applications for approval and received 54 new requests, compared to 88 processed applications and 72 new requests in 2010-2011. The number of transactions requiring approval decreased compared to the previous year. The number of outstanding requests for the Superintendent's approval at year end was 20% lower than a year earlier. In the past two years, requests for registration of new plans have declined substantially.

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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. Starting in 2012, the OCA also provides actuarial services to the Canada Employment Insurance Financing Board with respect to the Employment Insurance premium rate setting.

The OCA provides statutory actuarial valuation and advisory services for the CPP, Old Age Security program, the Canada Student Loans Program, 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.

MICHEL MONTAMBEAULT
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Canada Pension Plan/Old Age Security,
Office of the Chief Actuary

The OCA is required by law to produce an actuarial report on the Old Age Security (OAS) Program every three years or whenever a bill is introduced before Parliament that has a significant impact on the financial status of the OAS program. The *9th Actuarial Report on the Old Age Security Program as at 31 December 2009* was tabled on July 20, 2011. Prepared by the Chief Actuary, this triennial actuarial report on the OAS program provides information on the program's future expenditures for the next 50 years.

Part 3 of Bill C-3, the *Supporting Vulnerable Seniors and Strengthening Canada's Economy Act*, received Royal Assent on June 26, 2011. It amended the *Old Age Security Act* to provide a top-up benefit for lower-income Guaranteed Income Supplement (GIS) recipients. As required by the legislation, the Chief Actuary has prepared the *10th Actuarial Report Supplementing the Actuarial Report on the Old Age Security Program as at 31 December 2009* in order to show the effect of this bill on the long-term financial status of the OAS. This report was tabled before the Parliament on November 4, 2011.

In 2011, about five million Canadians received OAS benefits, with a total value of approximately $38 billion or approximately 2.4% of the gross domestic product (GDP). The key findings show that over the long term – as larger numbers of Canadians reach age 65 and life expectancy continues to increase – total OAS expenditures are projected to increase to $108 billion or 3.2% of GDP in 2030.

The statutory *Actuarial Report on the Canada Student Loans Program as at 31 July 2010* was tabled before Parliament on October 7, 2011, in accordance with the *Canada Student Financial Assistance Act*. The report presents the results of an actuarial review of the Canada Student Loans Program (CSLP) as at July 31, 2010 and includes projections of future costs of the Program through loan year 2034-2035.

The OCA completed and provided to the President of the Treasury Board for tabling before Parliament five actuarial reports in 2011-2012 with respect to the public sector insurance and pension plans, including actuarial reports as at March 31, 2010 on the pension plans for the Regular and Reserve Canadian Forces and the Members of Parliament, as well as on the Regular Force Death Benefit Account and on the Benefit Plan financed through the Royal Canadian Mounted Police (Dependants) Pension Plan.

The OCA is continually 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 2011-2012, the OCA was extensively involved in developing the International Actuarial Association's International Standards of Actuarial Practice, in particular the Standard for Valuation of Social Security Programs. In addition, the OCA in collaboration with the International Social Security Association conducted an international survey on Actuarial and Financial Reporting for Social Security Schemes and its Legal Implications, covering 56 social security schemes from 32 countries.

In 2011-2012, the OCA also provided other services, presentations and special studies.

JEAN-CLAUDE MÉNARD
Chief Actuary

FINANCIAL HIGHLIGHTS

OSFI fully recovered all its expenses for the fiscal year 2011-2012. Total expenses were $124.0 million, a $15.6 million, or 14.4%, increase from the previous year. Human resources costs, the main driver of OSFI's expenses, rose by $12.6 million, or 15.4%. This was a result of: staffing vacant positions across all sectors; the full year impact of the previous year's incremental new hires; curtailment of OSFI's severance benefit plan for executive employees and planned growth in employee compensation in accordance with collective agreements; and the impact of these changes on performance-related pay, which is available to employees at all levels within the organization.

The amount charged to individual federally regulated financial institutions (FRFIs) for OSFI's main activities of risk assessment and intervention (supervision), approvals and precedents, and regulation and guidance 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. Total revenues from FRFIs were $110.5 million, an increase of $16.1 million, or 17.0%, from the previous year. Total expenses were $110.7 million, an increase of $15.7 million, or 16.5%, from the previous year.

OSFI's costs for regulating and supervising private pension plans are recovered from an annual assessment charged to plans, based on the number of plan beneficiaries. Total fees assessed during the fiscal year were $7.9 million, unchanged from $7.9 million in 2010-2011. The cost of administering the PBSA for 2011-2012 was $6.7 million, an increase of $0.1 million or 2.2% from the previous year. The increase occurred as a result of planned growth in employee compensation.

The Office of the Chief Actuary (OCA) is funded by fees charged for actuarial valuation and advisory services and by an annual parliamentary appropriation. Total expenses were $6.6 million, an increase of $0.2 million or 2.3% from the previous year.

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