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## Meeting OSFI's Strategic Objectives

### • Quality

OSFI's accountability framework includes several key components. Since June 1996, OSFI has operated under a legislated mandate. The mandate helps to clarify that OSFI's primary responsibility is to minimize undue losses for depositors and policyholders by administering a regulatory and supervisory framework that contributes to public confidence in the Canadian financial system. The mandate stresses the importance of taking supervisory actions in a timely and effective manner.

OSFI's success as an organization depends on its ability to meet this mandate.

The concepts underlying the mandate required further elaboration in order to make them more transparent, understandable and achievable. Therefore, in 1995, in anticipation of the enactment of the legislative mandate, OSFI developed a mission statement which provided the framework within which the requirements of the mandate are to be achieved. This mission statement

appears on the inside cover of this report.

Five core strategic objectives relating to the mission statement were developed in 1996. These objectives represent the essential elements of OSFI's mission statement.

In some respects, these strategic objectives are complementary. In other respects, they may conflict with one another, requiring that a balance be struck.

For example, meeting the objective of safeguarding depositors, policyholders and pension plan members from undue loss naturally contributes to public confidence. Accordingly, many of the strategies to meet these two objectives will overlap.

On the other hand, the objectives relating to cost effectiveness and competition both impose constraints on OSFI's activities, and on the supervisory regime. No regulatory authority can have access to unlimited resources. Resource levels are set by

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balancing the need for effective regulation and supervision against the legitimate concern that regulatory and supervisory constraints and levels of costs, both direct and indirect, should not undermine competitiveness in the industry or have an undesirable impact on consumers. Striving for cost effectiveness means setting priorities, focusing on what is necessary to achieve results in a timely way, and finding innovative ways to use resources efficiently and effectively.

A fifth objective, a commitment to quality, acts as the underpinning for the other four strategic objectives.

Performance measures against which OSFI can test its success in meeting these objectives are currently under development. This task is complicated by the fact that virtually no models of performance measurement exist for a financial institutions regulator; therefore, creativity is required. OSFI hopes to have several measures in place, on a provisional basis, for the 1997-98 planning year, with others to follow in subsequent years.

Within this accountability framework, how is OSFI poised to meet the external and internal challenges it faces?

OSFI has developed a number of strategies to help meet the demands created by the five strategic objectives. In general terms, these involve two main elements:

- refining the regulatory and supervisory framework to focus more clearly on major risk areas, including significant emerging risks; and
- continuously testing new and existing initiatives against core objectives and the performance measures developed to support these objectives.

Specific strategies designed to meet each strategic objective are described below:

*“We contribute to public confidence by enhancing the safety and soundness of the Canadian financial system. We evaluate system wide risks and promote the adoption of sound business and financial practices.”*

Contributing to public confidence includes effective rule setting and encouraging the adoption of sound business and financial practices. This can involve the development of legislation, regulations, guidelines or policy statements, and working with industry on professional practices.

### **Identifying and understanding emerging risks on an ongoing basis**

In the 1996-97 planning period, OSFI made additional efforts to identify, understand and prioritize important and emerging risks being faced by federally-regulated financial institutions. The results of this work, developed through a standing internal task force drawn from the Policy and Operations sectors, have been used in the planning process for the current period. Reviews of key risks are ongoing.



In addition, a research paper on the effects of technology on the financial sector was prepared by the Policy Sector. This work resulted in two additional projects:

- first, a policy statement on outsourcing business functions to regulated and unregulated service providers has been released. The statement is intended to address a growing trend for financial institutions to outsource core business functions — a trend facilitated by technology; and
- second, OSFI developed a consumer-friendly statement, for its Internet web site, describing the role of regulation. Implementation is planned for the fall of 1997. A frequently updated list of federally-regulated financial institutions will also be made available on the Internet web site. This responds to concerns that technology, notably the Internet, enhances the scope for consumers to be misled regarding the regulated status of financial services providers.

During 1997, Canada's first electronic financial institutions were incorporated. Because they will be dependent for their survival on non-traditional distribution channels, these institutions created new issues for the supervisory system, such as the need to review steps taken by the institutions to ensure the security of the products to be offered via customers' personal computers.

### **Closing the expectations gap**

A key challenge that OSFI faces with respect to its goal of contributing to confidence in the Canadian financial system is the need to foster a realistic understanding of the role of regulation and supervision. Most Canadians deal with federal financial institutions and place some direct or indirect reliance

on OSFI. It is important that the basis for such reliance be realistic and understood.

In 1995, the federal government clarified, through the release of a discussion paper entitled *Enhancing the Safety and Soundness of the Canadian Financial System*, that regulation cannot and should not attempt to prevent all failures of financial institutions. A regulatory mandate that attempts to prevent all failures could result in a regulatory regime that is overly intrusive and costly. Such a regime could also discourage institutions from taking reasonable risks, and could therefore put Canadian financial institutions at a competitive disadvantage. An alternative regulatory mandate, based on the concept of having mandatory supervisory intervention and legislated levels of key financial variables or "trip wires", is inherently inflexible and could create incentives for inaction or deferred action by an institution's supervisor. Neither option is acceptable. Instead, a more flexible regulatory framework, which allows for early resolution of an institution's problems, has been retained for the Canadian marketplace. OSFI has been mandated to safeguard the interests of depositors and policyholders. However, the mandate recognizes that failures of financial institutions can and will occur. It is important that OSFI continue to work in a variety of ways to make its role and mandate understood. This Annual Report represents one such vehicle.

### **Enhancing disclosure of financial information**

Heightened awareness by consumers of the financial conditions of their financial institutions can have a favourable impact on public confidence. The 1995 discussion paper proposed that more information on the financial condition of federally-regulated financial institutions be

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disclosed and that it be disclosed more frequently. Federal financial institutions legislation has been amended to accommodate these proposals. Both the Canadian Institute of Actuaries (CIA) and the Canadian Institute of Chartered Accountants (CICA) have formed committees to address actuarial and accounting disclosure issues and both have developed additional guidance for disclosure by financial institutions. OSFI has issued specific disclosure requirements for deposit-taking institutions in its Guidelines on Annual Disclosure Requirements. Similar guidelines in respect of insurance companies are in the process of being finalized.

The guidelines describe the additional information to be included with annual reports and address areas such as: investment and lending portfolios; segmented information regarding assets, liabilities, and revenue; interest rate sensitivity position; and actuarial liabilities. Institutions will also have to address their risk management and control practices in areas such as: credit risk; liquidity risk; interest rate risk; foreign exchange rate risk; and reinsurance risk.

In addition, OSFI now makes year-end financial statements of federally-regulated financial institutions available on its Internet web site. Monthly data is also available with respect to assets of individual banks and domestic assets of the banking industry on a consolidated basis.

Under the *OSFI Act*, OSFI is required to report, through its Annual Report, on the disclosure of information by financial institutions and describing the progress being made in enhancing disclosure. Due to the relatively recent implementation of these disclosure initiatives, a more detailed progress report will be included in next year's Annual Report.

### **Co-operating with other domestic and international regulators in order to contribute to a stronger regulatory and supervisory framework**

OSFI continues to maintain substantial involvement in international regulatory groups. This permits OSFI to participate in the development and refinement of regulatory standards and allows OSFI to share its experiences and concerns, in order to influence international developments. Through this process OSFI also obtains valuable information that is used to respond to regulatory issues arising in Canada.

OSFI participates in the work of the Basle Committee on Banking Supervision under the auspices of the Bank for International Settlements (BIS). This work includes efforts to implement and monitor the credit and market risk capital requirements, to encourage sound risk management practices, and to enhance reporting, disclosure and accounting harmonization efforts. In addition, a special task force of the Committee will soon begin to develop co-ordinated supervisory approaches to the possibility of using credit risk modelling techniques for capital purposes. This work is expected to result in further changes to supervisory and examination practices.

OSFI also participates in the Joint Forum of Banking, Securities and Insurance Supervisors, which is developing new approaches to supervision and information sharing for international conglomerates of deposit-taking institutions, investment dealers and insurance companies. An exercise using an existing Canadian conglomerate was completed in 1996-97 to identify the suitability of current supervisory approaches to the particular structure, operations and risk management of the conglomerate. This exercise, and those completed by other



countries, will be used to develop additional proposals regarding the harmonization and co-ordination of supervisory activities over the coming year.

OSFI contributes senior representation to the International Association of Insurance Supervisors (IAIS), the work of which is similar to, but at an earlier stage of development than, that of the Basle Committee.

Finally, OSFI has embarked on a process for updating and enhancing its memoranda of understanding with other regulators, beginning with banking regulators in the United Kingdom and the United States.

On the domestic front, OSFI is involved in a number of harmonization and co-ordination initiatives and is committed to continuing these efforts. OSFI and the Ontario Securities Commission have enhanced communication on regulatory issues and activities. OSFI continues to work with the Canada Deposit Insurance Corporation (CDIC) to reduce non-productive duplication and enhance cost-effectiveness. OSFI has also developed agreements with a number of provincial financial institutions regulators under which OSFI performs certain supervisory activities, such as examinations, on a contract or delegated basis. In 1996, OSFI conducted on-site examinations on a cost recovery basis for provincially-regulated financial institutions in Ontario, Manitoba, Prince Edward Island, New Brunswick, Newfoundland and Labrador. OSFI is currently updating its agreements with the Province of Manitoba to provide examination and monitoring functions for financial institutions incorporated in that province.

### **Contributing to a sound domestic regulatory framework**

OSFI is committed to making a policy contribution in areas which affect the solvency and efficiency of federally-regulated financial institutions and pension plans.

Over the 1996-97 period, OSFI worked closely with the Department of Finance on two legislative initiatives. First, OSFI contributed to Bill C-82 which, for the most part, came into force in mid-1997. This Bill included provisions relating to foreign bank entry, self-dealing, joint ventures and access to capital for mutual life insurance companies. Second, OSFI took the lead in developing a White Paper concerning changes to the *Pension Benefits Standards Act, 1985* (PBSA) which was released in July 1996, followed by the introduction of enabling legislation in March 1997. It is anticipated that this legislation will be reintroduced in the new Parliament.

In consultation with the Department of Finance, OSFI will also play a lead role in developing an appropriate prudential framework to accompany proposed legislation that will enable foreign banks to establish branches in Canada. This framework is slated for public release by the end of 1997.

OSFI recognizes the valuable contribution being made by the Task Force on the Future of the Canadian Financial Services Sector, and will contribute information and advice to the committee, as requested.

### **Working with professional associations to assess the basis for reliance**

The ability to rely on professional groups such as external auditors and appointed and independent actuaries is one of the key factors in maintaining a cost effective supervisory system. For larger institutions, this reliance extends

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to the internal audit function. The sustainability of the reliance levels must be reconfirmed periodically.

In 1996, a review of the internal audit function at the major deposit-taking institutions was carried out. Generally, this review confirmed that OSFI could continue to rely on the internal audit functions of these institutions. The review also resulted in several recommendations to ensure that reliance levels can be sustained. A “best practices” paper has been developed, and will be used to assess internal audit units in other financial institutions supervised by OSFI. In future planning periods, similar reviews will be completed in other areas where OSFI places significant reliance on third parties.

OSFI also works closely with professional associations on standards of professional practice. For example, because OSFI relies on the appointed actuary of an insurance company to opine on the present and future financial condition of a company, OSFI is working with the CIA towards the goal of consolidating actuarial standards of practice. These standards will give actuaries guidance on selecting assumptions, margins and methods for determining appropriate actuarial reserves.

While recognizing the importance of professional actuarial judgement, OSFI strongly encourages that CIA standards of practice facilitate their objective application and sufficiently narrow the range of acceptable practice. The CIA standards must be useful to practitioners, and must also be enforceable by the profession. The alternative is for regulators to define accepted actuarial practice. OSFI would prefer a robust system of standards, supported by a peer review process and disciplinary procedures under the auspices of the CIA. OSFI also believes that the profession must put in place a system of independent peer review —

this gives the strongest message to the public that the profession is meeting its mandate. The CIA is currently studying the early implications of a peer review programme, and OSFI is assisting in and encouraging this process.

### **Developing standards of business practice**

OSFI continues to work with the industry sectors to develop standards and “best practices”. Over 1996-97, OSFI worked with the Canadian Life and Health Insurance Association (CLHIA) on the development of standards of sound business and financial practices and an associated self-assessment process. These standards, which are currently in place on a voluntary basis, will become OSFI guidelines next year. Modifications may be made as a result of experience in the transition period. These guidelines could become formal regulations in the future.

### **Developing performance measures for public confidence**

With respect to public confidence, three possible performance measures are under study:

- a composite financial indicator of risk to reflect the overall financial condition of the Canadian financial sector and its constituent industry groups;
- effectiveness surveys, directed to the measurement of the quality, effectiveness, impact, relevance and utility of OSFI's activities in promoting the adoption of sound business and financial practices; and
- a national opinion survey of public attitude towards, and confidence in, the financial sector and its constituent industry groups.



These measures will be considered in 1997-98. Implementation would begin the following year, with a view to implementation the following year.

*“We identify institution-specific risks and trends and intervene in a timely manner so as to minimize losses to policyholders, depositors and pension plan members.”*

Safeguarding from undue loss includes refining the supervisory framework to strengthen financial institutions and private pension plans, operating an early intervention framework, and enhancing the competencies of staff directly involved in the supervisory process.

### **Strengthening the balance sheets of financial institutions**

In recognition of the important role of capital as a cushion in the event of financial difficulty, several capital-related projects have been initiated. The results of these projects will be taken into consideration as part of the longer term goal to develop institution-specific capital requirements.

- Canadian financial institutions have become more active internationally and have expanded their lines of business. In a liquidation scenario, assets located outside Canada or under the control of other legal entities

may not be free to flow back to the regulated financial institution in Canada. For example, assets located in other jurisdictions may not be available to support Canadian claims because of actions of foreign insolvency officials, legal or taxation issues, foreign exchange controls, or the political intervention of another country. The determination of how much capital is likely to be available can depend on where in a corporate group a problem emerges, what regulatory actions are taken in other jurisdictions, and other variables. OSFI has undertaken a project to better understand the capital available to support obligations to Canadian depositors, policyholders and creditors. The data obtained will be used to determine capital availability in a variety of circumstances.

- The risk-based capital adequacy requirements currently in place for Canadian banks are based on the international standards agreed upon in 1988 by the Basle Committee on Banking Supervision. Under that framework, banks have been required to maintain minimum capital of 8% of risk-weighted assets for credit risk purposes and a specified amount for market risk, as determined by formula or by using a bank's internal models. Ongoing work of the Committee, in which OSFI participates, involves the review of the existing standards and, in particular, the purposes and characteristics of bank capital. Such a review will serve as a yardstick for establishing criteria to evaluate capital instruments. Future considerations include areas of risk which are not currently addressed by capital requirements and new capital measurement techniques.

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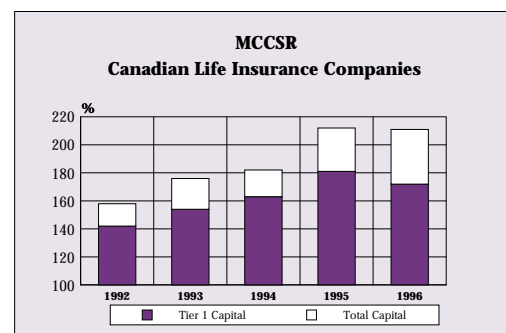
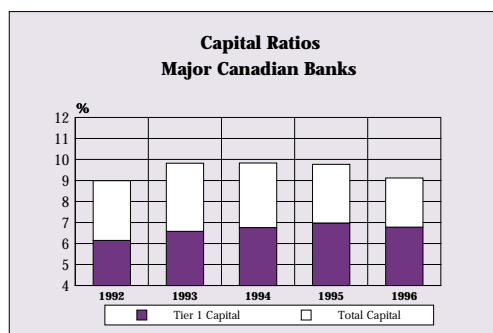


Although the capital ratios of the major Canadian banks exceed the minimum required by the Basle Committee standards, ratios have declined slightly over the past two years. OSFI has expressed a preference that capital return to 1995 risk-weighted levels (approximately 7% tier 1 capital and 10% total capital). OSFI is also encouraging the banks to enhance methodologies for matching capital levels to their individual risk profiles.

- OSFI continues to refine the Minimum Continuing Capital and Surplus Requirements (MCCSR) and Test of Adequacy of Assets Margin requirements (TAAM). These standards establish minimum capital standards for Canadian life insurance companies and for foreign companies transacting business in Canada on a branch basis.
- OSFI continues to evaluate inter-company exposures and to reflect appropriate measures in its capital requirements. The 1997 MCCSR guideline will incorporate new requirements for lapse risk and will impose other requirements for changes in interest rate environment risk. The changes to these standards have been continuous since 1992 and several different transition rules are now in existence. To improve stability, OSFI has

announced a moratorium on substantive changes until the year 2000, by which time a more fundamental review can take place.

- In recognition that credit risk remains one of the more significant risks faced by deposit-taking institutions, OSFI developed a policy statement on general provisions and allowances for credit losses at deposit taking-institutions. This statement addresses risk management and accounting issues and what OSFI expects from federally-regulated deposit-taking institutions with respect to their general provisioning policies. OSFI has also issued a companion accounting paper on recognizing and measuring inherent credit risk. These papers are applicable to deposit-taking institutions with year ends starting on or after November 1, 1998.
- As a result of the significant increase in the trading activities of Canadian banks, OSFI has issued a guideline on the capital adequacy requirements for market risk. This guideline applies to deposit-taking institutions that meet minimum trading requirements and is consistent with the international standards approved in 1996 by the Basle Committee. Market risk encompasses interest rate risk





and equity risk in the portfolio of trading securities and foreign exchange and commodity risk across the entire institution. Institutions will be expected to implement the guideline by January 1998.

- Internationally, work has been spearheaded by the BIS on reducing and controlling foreign exchange clearing and settlement risk. Many of the issues identified are the responsibilities of the banks themselves. Together with the Bank of Canada, OSFI is surveying Canadian banks on practices and proposed future developments (including industry initiatives and initiatives by individual institutions) and is following other market developments. Depending on the extent of the private sector initiatives undertaken, possible future supervisory initiatives may be considered. An important recent development in risk control is the implementation of Multinet, which provides for the netting and clearing of foreign exchange positions and reduces risk to the clearing and settlement system.

### **Reviewing and rechallenging regulatory and supervisory practices**

To use resources effectively, OSFI seeks to apply and enhance a risk-based approach to the examination and monitoring practices which it applies to financial institutions and pension plans. During the course of 1996, increased co-ordination of the examination of conglomerates took place between the deposit-taking and insurance examination groups, in order to deal with risks on a consolidated basis.

Given the accelerating rate of change in the financial services industry, the Regulatory and

Supervisory Practices Group was formed in 1997 to review OSFI's existing regulatory and supervisory approaches. Through a pilot examination project involving two large conglomerates, one a major Canadian-based international bank and the other a major Canadian-based international life insurance company, the Practices Group will develop recommendations for improvements to supervisory and examination methodology. The review will also include consideration of internal processes for carrying out the analysis of information on individual financial institutions and the links between OSFI's Policy and Operations functions. Completion of this complex project is expected in two years. Under the auspices of this group, a team of market risk specialists has been assembled to review and validate internal models that have been developed by the major banks to measure market risk.

### **Refining the early intervention framework**

One of OSFI's ongoing challenges is to identify areas of concern early and to intervene appropriately to minimize problems and losses to policyholders, depositors and pension plan members.

To help meet this challenge, over the past year OSFI has further developed the Guide to Intervention for Deposit-Taking Institutions and the Guide to Intervention for Insurance Companies. A Guide to Intervention for Pension Plans has also been prepared. These documents outline the main criteria used to classify a financial institution or pension plan at a particular stage of supervisory concern, and the actions which may be taken by OSFI at each of these stages. During 1996-97, OSFI further refined the criteria for classifying institutions at particular stages, and it is intended that the Guides will be updated annually.

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The electronic data base systems available to OSFI's analysts and examiners already provide ready access to key financial information concerning financial institutions. In 1996-97, the first phase of a series of early warning tests was developed. These tests will be integrated with the data base for deposit-taking institutions during 1997-98.

### **Ensuring that supervisory staff have appropriate skills**

An important objective for OSFI is to ensure that supervisory staff have the level of skill and knowledge required to meet the challenges of the rapidly evolving financial services marketplace. One key to this objective is recognizing areas where additional technical or "specialist" skills are required. The creation of the market risk team under the auspices of the Regulatory and Supervisory Practices Group is a step in this direction. Over the 1997-98 fiscal year, OSFI will begin to establish specialist teams in other areas, which will ultimately include financial conglomerates, foreign-owned financial institutions, and financial products.

### **Developing performance measures for safeguarding from undue loss**

OSFI is attempting to establish three performance standards to track how effectively it intervenes in the case of troubled financial institutions:

- a quantitative intervention index, to measure the efficiency and effectiveness of OSFI's interventions, and to focus on the number of institutions and value of assets represented on the stages of OSFI's Guides to Intervention;

- a qualitative intervention index, to measure OSFI's effectiveness in carrying out the actions called for in the Guides to Intervention respecting financial institutions of concern to OSFI; and
- a loss recovery index, to measure the cost to the system of dealing with institutions which fail.

It is anticipated that provisional standards will be developed in the 1997-98 planning year, and will be tested throughout the following year.

*"We fulfill our regulatory mandate having due regard for the need to allow institutions to compete effectively."*

This objective helps clarify that it is not necessarily OSFI's role to facilitate competition. However, given the fact that solvency regulation and supervision can impose constraints on the ability of a financial institution to compete, particularly with unregulated institutions, OSFI has an obligation to limit constraints on competition to those which are essential for accomplishing the other elements of its mandate. OSFI must be sensitive to the need to assess the impact of all its policies and procedures on the competitive position of the industries regulated and supervised by OSFI and the members of these industries.



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This objective is also consistent with the development of a more targeted and effective regulatory and supervisory framework, which is also essential to meeting OSFI's other strategic objectives.

### **Continuous monitoring of the regulatory burden imposed on institutions and pension plans**

Competitive barriers can be lowered by taking legislative initiatives to remove artificial or antiquated requirements. For example, Bill C-82 served to remove or rationalize technical rules in a number of areas, such as self-dealing and joint venture arrangements. OSFI worked closely with the industry and the Department of Finance to develop the technical amendments contained in Bill C-82, and will continue to do so for future legislative reviews. Legislation being developed to allow foreign banks to carry on business through branches in Canada represents another example of an initiative to reduce regulatory barriers.

Proposed amendments to the PBSA, to be re-introduced in 1997, also include some steps to reduce the regulatory burden. As a result of these changes, OSFI will no longer be required to review all plan documents and plan amendments. Plan administrators will be required to attest that documents and amendments to documents meet regulatory requirements. In addition, the proposed legislation would enable the development of a simplified pension plan for small employers. A simplified pension plan would utilize standardized documents prepared by professional groups or financial institutions, and would be administered by a financial institution. This would reduce costs and simplify administration for small employers.

Larger issues concerning competition are being investigated by the Task Force on the Future of the Canadian Financial Services Sector. The report of the Task Force in 1998 may suggest additional changes to remove barriers to competition.

### **Further reducing overlap and duplication of regulation in the Canadian financial system**

In addition to the initiatives involving provincial governments mentioned earlier, OSFI has been working closely with the Department of Finance and the Ontario Ministry of Financial Institutions to develop an agreement under which the federal government would assume responsibility for the prudential regulation and supervision of trust and loan companies operating in Ontario. Such an agreement would be consistent with the 1996 announcement of the Government of Ontario that it is interested in pursuing alternative arrangements for trust and loan regulation in the province. This would represent an important step forward in improving the efficiency of the regulatory structure for financial institutions in Canada.

Streamlined information-gathering requirements for insurance companies have also been developed with the Province of Ontario. During 1996, OSFI reached an agreement with the Ontario Insurance Commission (OIC) which provided that OSFI would supply the OIC with annual return data for federally regulated insurance companies (life and property and casualty) and fraternal benefit societies operating in Ontario. As a result, commencing with the 1996 year end, these companies and societies are no longer required to file their annual returns with the OIC. Several other provinces have expressed interest in this type of arrangement, and OSFI is prepared to co-operate with them in a similar fashion.



*OSFI seeks to obtain ongoing feedback on the competitive impact of regulation and supervision.*

### **Developing performance measures for competition**

Through its consultation processes, OSFI seeks to obtain ongoing feedback on the competitive impact of regulation and supervision. Reducing unnecessary regulation has been a consistent theme in legislative and regulatory initiatives over the past few years. As well, OSFI is participating with the Insurance Bureau of Canada in an effective regulation project, and with the Canadian Bankers Association on identifying key regulatory differences between Canada and the United States that may impede the competitive position of Canadian banks.

OSFI is considering various approaches to measure performance in this area. These include:

- enhancing the process of developing regulations, guidelines, and policy statements by conducting more formalized and specific consultation with respect to their competitive impact. This may be done through discussion or a questionnaire;
- developing an intrusiveness index, based on the volume and complexity of regulation imposed;
- developing a regular survey-based approach (either survey or focus group) to elicit industry views;
- commissioning research by third parties, such as that done recently by the Conference Board of Canada on the cost of regulation; and
- developing an ongoing program evaluation methodology.

Each approach has advantages and disadvantages and the development of final measures will require consultations with industry groups and further study. A decision on the basic approach will be made in 1997-98.

*"We maintain a full and open dialogue with our stakeholders on the costs and benefits of our work."*

OSFI recovers the expenses it incurs in the supervision of financial institutions through an assessment process. Expenses associated with the supervision of pension plans are recovered by means of an annual fee charged to pension plans. The details of the expenditures incurred by OSFI during 1996-97 are provided in Annex 1. OSFI has developed various strategies to meet the cost effectiveness objective.

### **Maintaining a dialogue on costs with industry associations**

OSFI meets annually with the Canadian Bankers Association, the Canadian Life and Health Insurance Association and the Insurance Bureau of Canada to discuss costs incurred, projected cost increases, new initiatives, and cost management strategies for the coming year.



## Ensuring effective control of OSFI's costs

As part of its commitment to stakeholders to control its operational costs, OSFI embarked in 1995-96 on a program to review the way in which annual budgets are developed and approved, and has focused on actively challenging budget submissions from all organizational units. This process was furthered in 1996-97 through the addition of a detailed action planning and prioritization exercise in line with OSFI's five strategic objectives and the adoption of a two-year budgeting horizon for its operating budgets.

During 1997-98, OSFI will further refine its planning and budgeting process to ensure better linkages among its main planning framework components and to provide better sequencing between the main planning activities within the OSFI planning cycle. It is anticipated that these enhancements will provide more complete analysis in support of final planning and budgeting decisions and will allow for timely input of final budget amounts. The key elements in this process will be a full review of the 1997-98 planning cycle process, with significant work to be completed on the OSFI Planning Framework and related processes, guidelines and tools in time for implementation during 1998-99.

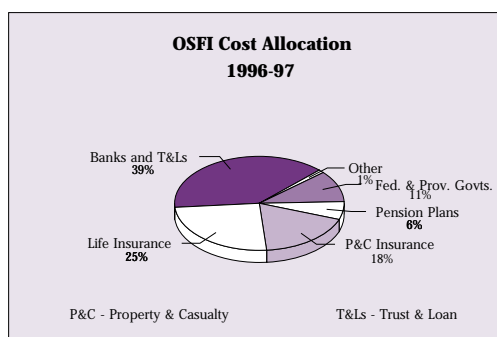
OSFI has achieved its target of reducing overall Corporate Services operating costs by 15%. This has translated into a zero real growth of Corporate Service budgets in 1997-98. This reduction has been realized despite making provision for the resumption of collective bargaining, a sharp increase in Government of Canada Employee Benefits Plan charges and the introduction of several important new corporate initiatives.

## Concentrating on OSFI's core activities

In 1995-96, a study was conducted of OSFI's functions and activities in terms of their contribution to OSFI's strategic objectives. As a result, the Pension Advice Section was transferred to Revenue Canada, Taxation, in 1996, and, in April 1997, the Excise Tax function, which OSFI had performed for a number of years, was also transferred to Revenue Canada. At the same time, OSFI's responsibilities under the *Civil Service Insurance Act* were transferred to Human Resources Development Canada.

## Exploring more equitable cost allocations among the sectors regulated

During 1996-97, an internal task force was mandated to examine the feasibility of adopting a modified user pay system for assessing OSFI's costs to the industry. A primary objective of the task force was to develop a better cost measurement and cost recovery system. The task force has completed a review of OSFI's current methodology for levying assessments and has provided the Canadian Bankers Association, the Canadian Life and Health Insurance Association, and the Insurance Bureau of Canada with a report outlining the results of the review. The report also provides a series of alternatives for industry consideration. OSFI expects to have a decision on this issue by April 1998.



*A cornerstone of OSFI's efforts to maintain a high standard of regulatory and supervisory quality is the recruitment, development and retention of a highly skilled, professional and motivated workforce.*

At present, OSFI also incurs costs that are not directly related to the regulation and supervision of financial institutions or pension plans. For example, OSFI provides advice and information to members of the legal and accounting professions, but does not charge directly for this service. OSFI is currently reviewing this practice as part of its user pay initiative.

To build on previous inter-agency work, OSFI has also been planning a parallel study on the burden to financial institutions of the information requirements of OSFI, the Bank of Canada and the Canada Deposit Insurance Corporation. Owing to its scope and complexity, this study has been deferred, pending completion of other priorities.

#### **Developing performance measures to assess cost-effectiveness**

OSFI is currently examining three indicators to assess its overall cost-effectiveness and to facilitate comparison with other regulators' costs:

- the ratio of supervisory costs (direct and indirect) in dollars and in staff time, for each industry sector, to assets or revenues;
- a comparison of OSFI's internal compliance costs as defined above with similar cost figures from other jurisdictions (e.g. the provinces, the U.S., the U.K. etc.); and
- a derivation of a total compliance cost by industry, including OSFI internal costs and all internal and external costs incurred by institutions to ensure compliance with OSFI requirements, and a comparison between OSFI's internal compliance costs and the total compliance costs for each industry segment.

It is expected that the development of these measures will be completed in concert with discussions with the industry sectors on changes to the allocation of OSFI costs and the possible implementation of a modified user pay scheme. These measures will coincide with any revisions to OSFI's cost allocation framework.

*"We provide a high-quality service by giving employees the tools and professional development to meet the challenges of a rapidly changing environment."*

A cornerstone of OSFI's efforts to maintain a high standard of regulatory and supervisory quality is the recruitment, development and retention of a highly skilled, professional and motivated workforce. This would be a significant challenge under the best of circumstances, but it is a particularly difficult one now in the face of heavy demand for talented individuals on the part of financial institutions, continuing pay constraints in the public sector, and high staff departure levels. To respond to this challenge, OSFI has initiated the development and implementation of a multi-faceted human resources management strategy. This strategy includes such elements as maximizing OSFI's human resource management flexibility and autonomy, the simplification and consolidation of its staff relations and position classification frameworks, the



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identification of core competencies and critical skill sets, and the acquisition and implementation of effective recruitment, training and professional development approaches and tools.

As part of this process, OSFI seeks the input of its employees on issues of importance in the direction and management of the organization. To this end, OSFI has initiated a review of its staff performance appraisal process, has adopted a cyclical upward feedback program, and has completed a comprehensive employee survey to gauge employee perceptions and opinions. It has also taken steps to improve communication between management and staff to ensure that issues are identified and discussed in an open and progressive manner.

#### **Simplifying staff relations and human resource management frameworks by consolidating the employee classification system under a single universal classification scheme**

As a first step towards the simplification of its human resource and staff relations frameworks, OSFI is developing a Universal Classification System (UCS) for all employee groups and levels within the organization. Benchmark job descriptions have been developed by a task force consisting of management, employees and union representatives. Work is currently underway to complete position analysis questionnaires for all positions within OSFI. It is anticipated that the UCS process will be completed before the end of 1997-98.

#### **Identifying core competencies and assessing staff against expected competency levels**

OSFI has launched a process to identify core competencies for all areas of operation in line with its mission and strategic objectives. Once finalized, this list will be used to support or

provide the necessary parameters for OSFI's initiatives in staff recruitment, development and training, performance appraisal and career and succession planning. It is expected that the first phase of the core competencies project will be completed by the end of 1997-98.

#### **Developing a comprehensive learning guide and training plan to address core competencies**

A comprehensive learning guide, listing all OSFI training and development tools and proposed training and development initiatives, has been published to serve as a catalogue of training opportunities sponsored by the organization. In tandem with the identification process for OSFI core competencies, the Professional Development and Training Division will develop a comprehensive training plan, targeting the training and development needed to support the acquisition and retention of core competencies by all management and staff.

#### **Providing an effective vehicle for the recruitment and in-house development of entry level staff**

Since its formation, OSFI has attempted to recruit professional staff who have financial institutions experience. Unlike many other organizations, OSFI has not sought to recruit and train university graduates to fill its vacancies. OSFI's current strategy is no longer as effective as it once was because the market for experienced recruits is competitive. Recruiting qualified replacements has become increasingly difficult and time-consuming.

OSFI recognizes that it must reduce the current rate of staff departure; otherwise, its capacity to discharge its mandate will be seriously impaired. While OSFI must continue to try to attract experienced personnel, it must



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also build from within by developing its staff. As a first step, OSFI is creating a career management program for new university graduates. The objective is to ensure that OSFI will continue to fulfill its mandate by attracting and retaining qualified people through a training and development program linked to a clear career path. A typical candidate will be exposed to all aspects of the regulatory and supervisory framework, as well as major functional and support activities. This exposure will cross organizational boundaries and will provide opportunities to apply and improve analytical, team management, managerial, and leadership skills in a structured and progressive fashion.

Notices have been placed in several universities to assess interest in the program by students graduating in 1997.

### **Obtaining greater flexibility to manage human resources in a highly responsive and adaptive fashion**

As a result of the need to ensure flexible and timely responses to changing labour market conditions, OSFI is exploring options to mitigate current challenges, including the possibility of opting out of the *Public Service Employment Act*. Such a change would require the support of the government.

### **Ensuring that OSFI's information technology (IT) is effective in meeting its evolving needs**

Within the overall framework of OSFI's IT architecture, several key initiatives have been launched to enhance its capabilities in the area of information management and technology. These include:

- improving and expanding OSFI's external (Internet) and internal (Intranet) web sites and completing extensive electronic document management and electronic forms pilot projects. The implementation of such initiatives is expected to significantly reduce the need for paper-based communication, both internally and externally, while enhancing access to all types of information by OSFI stakeholders, including OSFI staff;
- designing and implementing an upgraded dial-in capability in support of remote working situations and teleworking capability; and,
- implementing a server and desktop replacement program to optimize the acquisition of hardware and the management of IT assets in line with a lifecycle approach.

### **Developing performance measures to assess quality**

OSFI is currently completing the initial steps in the development of three performance measures pertaining to the quality of its operations and staff competencies. These measures are the following:

- core competency profile

Core competencies are being developed which will be used to assess training needs through the evaluation of individual and organizational gaps between actual and target competencies.





- level of employee satisfaction

A comprehensive employee survey has been conducted which will provide base year data for periodic assessment of overall employee satisfaction within OSFI, and which will allow for some benchmarking with other organizations engaged in similar activities.

- comprehensive quality index for OSFI processes

Test indices are being examined to assess their relevance and validity in reflecting the overall quality of both internal OSFI processes and outputs and activities driven by external requests for OSFI rulings or approvals.

## Striking the Balance

The financial services industry is in a constant state of evolution. The industry introduces new products and services in rapid response to market and consumer demand. In addition, individual companies are expanding into new markets, and new participants are entering the Canadian marketplace. OSFI is well aware that the evolution in the industry must be accompanied by a comparable evolution in the regulatory and supervisory environment. The appropriate balance must be struck so that depositors, policyholders, and members of pension plans are afforded an acceptable degree of

protection while the industry's ability to compete, both domestically and internationally, is not unduly restricted or impaired. OSFI remains committed to achieving this balance, and will review its policies and approaches continuously to respond to changing conditions and circumstances. OSFI seeks and values the views of all stakeholders in achieving the proper balance.



## Strategic Objectives Mapping

Public Confidence	<ul style="list-style-type: none"> <li>• Identifying and understanding emerging risks on an ongoing basis</li> <li>• Closing the expectations gap</li> <li>• Enhancing the disclosure of financial information</li> <li>• Cooperating with other domestic and international regulators in order to contribute to a stronger regulatory and supervisory framework</li> <li>• Contributing to a sound domestic regulatory framework</li> <li>• Working with professional associations to assess the basis for reliance</li> <li>• Developing standards of business practice</li> <li>• Developing performance measures for public confidence</li> </ul>
Safeguard from Undue Loss	<ul style="list-style-type: none"> <li>• Strengthening financial institutions' balance sheets</li> <li>• Reviewing and rechallenging regulatory and supervisory practices</li> <li>• Refining the early intervention framework</li> <li>• Ensuring that supervisory staff have appropriate skills</li> <li>• Developing performance measures for safeguarding from undue loss</li> </ul>
Competition	<ul style="list-style-type: none"> <li>• Continuous monitoring of the regulatory burden imposed on institutions and pension plans</li> <li>• Further reducing overlap and duplication of regulation in the Canadian financial system</li> <li>• Developing performance measures for competition of regulated institutions and OSFI's impact in this area</li> </ul>
Cost Effectiveness	<ul style="list-style-type: none"> <li>• Maintaining a dialogue on costs with industry associations</li> <li>• Ensuring effective control of OSFI's costs</li> <li>• Concentrating on OSFI's core activities</li> <li>• Exploring more equitable cost allocations among the sectors regulated</li> <li>• Developing performance measures to assess cost-effectiveness</li> </ul>
Quality	<ul style="list-style-type: none"> <li>• Simplifying staff relations and human resource management frameworks by consolidating the classification system under a single universal classification scheme</li> <li>• Identifying core competencies and assessing staff against expected competency levels</li> <li>• Developing a comprehensive learning guide and training plan to address core competencies</li> <li>• Providing an effective vehicle for the recruitment and in-house development of entry level staff</li> <li>• Obtaining greater flexibility to manage human resources in a highly responsive and adaptive fashion</li> <li>• Ensuring that OSFI's information technology (IT) is effective in meeting its evolving needs</li> <li>• Developing performance measures to gauge the quality aspect of OSFI operations</li> </ul>

